IRC 965, BEAT, GILTI and FDII – Through the Lens of a SALT Professional + Recent Developments

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Agenda

– Federal Tax Reform
  • Cheat Sheet

– Decisions, Decisions
  • Understanding Conformity

– Through the SALT Lens
  • Transition Tax
  • Global Intangible Low Taxed Income (GILTI) & Foreign Derived Intangible Income (FDII)
  • Base Erosion and Anti-abuse Tax (BEAT)

– Special Apportionment Issues

– Recent Developments
Federal Tax Reform
Cheat Sheet
# Federal Tax Reform
## Cheat Sheet

<table>
<thead>
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<th>Provision</th>
<th>Description</th>
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| **Transition Tax**<br>(IRC § 965) | - One-time transition tax on untaxed foreign earnings of certain foreign subsidiaries of US companies by deeming those earnings to be repatriated.  
- Amounts are included in a taxpayer’s gross income as Subpart F income.  
- The amount taxed is determined based on foreign subsidiaries’ E&P, the greater amount measured on one of two testing dates.  
- The tax rate on amounts attributable to cash and cash equivalents is 15.5%, and any remaining E&P is taxed at an 8% rate. Effective rates are achieved through a partial deemed DRD.  
- Tax may be paid in installments over an 8-year period. |
| **BEAT**<br>(IRC §§ 14401, 59A) | - The Base Erosion Anti-Abuse Tax (BEAT) generally imposes a 10% minimum tax (5% in 2018) on a taxpayer’s income determined without regard to tax deductions arising from base erosion payments (including the portion of a taxpayer’s net operating loss (NOL) deduction treated as related to base erosion payments), which generally cannot be reduced by credits other than, through 2025, the research credit under IRC § 41(a) (R&D credit) and 80% of certain other credits. |
## Federal Tax Reform

**Cheat Sheet**

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<td><strong>GILTI</strong>  (IRC §§ 951A, 250)</td>
<td>- Imposes tax on a US taxpayer’s Global Intangible Low Taxed Income (GILTI), which approximates the taxpayer’s allocable share of amounts earned by CFCs outside the US in excess of routine returns on tangible property.&lt;br&gt;- Included in federal taxable income in a manner similar to Subpart F income.&lt;br&gt;- A 50% deduction for such income is provided, generally resulting in a US tax rate of 10.5% for GILTI income, reduced by 80% of related foreign tax credits, subject to ordinary limitations.</td>
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<tr>
<td><strong>FDII</strong>   (IRC § 250)</td>
<td>- Permits domestic corporations to deduct 37.5% of their Foreign Derived Intangible Income (FDII), which calculates an amount similar to GILTI and multiplies that amount by the fraction of the income earned in the US that is attributable to property sold or licensed to a non-US person for foreign use or to services provided outside the US.</td>
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# Federal Tax Reform

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<td><strong>Foreign DRD</strong> (IRC § 245A)</td>
<td>100% DRD or “participation exemption” equal to the “foreign-source portion” of dividends a US taxpayer receives from a 10%-owned foreign corporation.</td>
</tr>
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<td><strong>Interest Limitation</strong> (IRC § 163(j))</td>
<td>Limits the deduction for net business interest expense to 30% of adjusted taxable income. Generally, disallowed business interest may be carried forward indefinitely.</td>
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<td><strong>Bonus Depreciation</strong> (IRC § 168(k))</td>
<td>Expands bonus depreciation to allow full expensing of the cost of both new and used “qualified property” acquired and placed in service after September 27, 2017, and before January 1, 2023. Phase out of depreciation rate for property placed in service between 2023 and 2026; zero rate in 2027 and thereafter.</td>
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Decisions, Decisions
Understanding Conformity
State I.R.C. Conformity Decision Tree

Old I.R.C. | New I.R.C.
---|---
IRC § 168(k) | IRC § 250
IRC § 965 | IRC § 951A
IRC § 163(j) | IRC § 59A
Hawaii does not adopt bonus depreciation IRC § 168(k).

Maine does not include IRC § 965 into its state income base because it has static conformity (Dec. 31, 2016).

New York has rolling conformity, but excludes the FDII IRC § 250 deduction.

New York conforms to the IRC § 163(j) interest limitation because it has rolling conformity.

Although New Jersey has rolling conformity, due to the fact that its starting point for calculating taxable income is Form 1120 line 28, in combination with historic decoupling from IRC special deductions (where IRC § 250 lies), it is likely that New Jersey will not permit the FDII IRC § 250 deduction.
Through the SALT Lens
Transition Tax
Transition Tax – IRC § 965
Hypothetical

Accumulated Post-1986 Deferred Foreign Income (Deferred Foreign Income)

US Parent

US Shareholder

Deferred Foreign Income Corporation (DFIC)
Transition Tax – IRC § 965
Hypothetical – Considerations and Implications

- Is the associated deduction for amounts of the transition tax considered “special deductions” for federal income tax purposes?

- How will states revise their income tax forms?
  - IRC 965 Transition Tax Statement v. state tax forms

- How does the state treat Subpart F income? The Deferred Foreign Income is designated as Subpart F income for federal tax purposes.
  - E.g., California does not conform to the federal treatment of Subpart F income. Rather, California requires water’s-edge filers to include a portion of their CFC’s income in the water’s-edge return. Cal. Rev. & Tax. Cd. § 25110(a)(2)(A)(ii)
Transition Tax – IRC § 965
Hypothetical – Considerations and Implications

— Is the Deferred Foreign Income constitutionally includable in US Shareholder’s tax base?
  * Is DFIC engaged in a unitary business with US Shareholder?
  * What if DFIC is engaged in a unitary business with US Shareholder for some, but not all, of the post-1986 years that the Deferred Foreign Income was accumulated?
  * Compliance burdens in separate return states

— If the Deferred Foreign Income is included in US Shareholder’s tax base as Subpart F income, is the inclusion of the Deferred Foreign Income, but not the inclusion of DFIC’s corresponding apportionment factors, unconstitutionally discriminatory?

— Timing: States generally do not afford a similar payment deferral mechanism as allowed for federal income tax purposes, thus taxpayers will have to currently recognize and take into income the net inclusion of the transition tax.
Transition Tax – IRC § 965
Hypothetical – Considerations and Implications

Is there potential discrimination against foreign commerce?

- Because the transition tax requires an inclusion with respect to foreign subsidiaries while there is not a similar income inclusion with respect to domestic subsidiaries, a state’s conformity to the transition tax will likely face constitutional scrutiny under Kraft.
  - In Kraft General Foods, Inc. v. Iowa Dep’t of Revenue & Finance, 505 U.S. 71 (1992), the US Supreme Court found that Iowa’s inclusion of dividends from foreign subsidiaries, but not from domestic subsidiaries, in a taxpayer’s apportionable income tax base unconstitutionally discriminated against foreign commerce. Iowa’s discrimination was based on the state’s conformity to the federal corporate income tax scheme.
  - Compare taxing US Shareholder in a combined report during the year the Deferred Foreign Income was earned versus taxing the Deferred Foreign Income through IRC § 965 conformity.
    - E.g., differing apportionment factors, NOLs, etc.
Transition Tax – IRC § 965
State Responses

– Included in Income After Deduction (IRC § 965(a) inclusion and IRC § 965(c) deduction)
  • Alabama (Notice: IRC Section 965 (April 27, 2018))
    • State’s DRD applies
  • Illinois (Illinois Department of Revenue FY 2018-23 March 2018)
    • Subtraction modification for foreign dividends will apply
  • Georgia (H.B. 918)
    • Allows Subpart F subtraction modification
    • Allows Subpart F subtraction modification
Transition Tax – IRC § 965
State Responses (cont’d)

— Included in Income Without Deduction (IRC § 965(a) inclusion without IRC § 965(c) deduction)
  • Idaho (H.B. 355)
    • Requires add back of amounts deducted under IRC § 965(c)
  • Oregon (S.B. 1529)
    • Requires add back of amounts deducted under IRC § 965(c)
  • Indiana (H.B. 1316)(ss))
    • Foreign DRD applies based on ownership thresholds
  • Connecticut (OCG-4 (May 11, 2018) / S.B. 11)
    • DRD applies, but requires an expense disallowance equal to 5% of dividends
  • Massachusetts (Estimated Tax Penalty Relief for Corporations Affected by the Transition Tax on Deferred Foreign Earnings (May 15, 2018)
    • Will 95% DRD apply?
Transition Tax – IRC § 965
State Responses (cont’d)

— Excluded from Income
  • New York (2018-2019 Fiscal Year Budget)
  • Tennessee (Notice #18-05 (Apr. 2018))
    • Excluded because IRC § 965 income is not reported on federal Form 1120 – instead included in IRC 965 Transition Tax Statement.
  • Florida (Tax Info. Publication No. 18C01-0)
    • Excluded based on IRC § 965 income being reported on IRC 965 Transition Tax Statement or Florida’s Subpart F income subtraction modification.
  • California (California Guidance — Taxable Year 2017 IRC Section 965 Reporting (May 16, 2018))
  • Michigan (May 2018 Tax Policy Newsletter)
  • New Jersey (Notice: New Jersey’s Treatment of Deemed Repatriation Dividends Reported Pursuant to IRC Section 965 (March 16, 2018)) (depending on ownership thresholds)
    • Excluded because the state’s DRD applies.
    • State decoupled from IRC § 965
Transition Tax – IRC § 965
State Responses (cont’d)

— Installment Payments Allowed
  • Utah (S.B. 244)
  • Oklahoma (H.B. 3715)

— Installment Payments Not Allowed
  • Connecticut (OCG-4 (May 11, 2018))
  • Illinois (2017 Illinois Tax Guidance)
Through the SALT Lens

Global Intangible Low Taxed Income (GILTI) & Foreign Derived Intangible Income (FDII)
GILTI & FDII
Considerations and Implications

- What’s the state’s starting point for calculating the tax base?
  - The GILTI and FDII deductions are in IRC § 250, which is included in the line 29b "special deductions."

- Many statutory state Subpart F subtractions do not apply to IRC § 951A.

- States may also not conform to the IRC § 250 deductions or may require to addback amounts deducted under IRC § 250.
GILTI & FDII
Considerations and Implications

— How does the state treat Subpart F income?
— Is the GILTI constitutionally includable in the US taxpayer’s tax base?
  • Is the CFC engaged in a unitary business with the US taxpayer?
— If the GILTI is included in the tax base as Subpart F income, is the inclusion of the GILTI, but not the inclusion of the CFC’s corresponding apportionment factors, unconstitutionally discriminatory?
— Is there potential discrimination against foreign commerce?
  • Because the GILTI provisions require an inclusion with respect to foreign subsidiaries while there is not a similar income inclusion with respect to domestic subsidiaries, a state’s conformity to GILTI will likely face constitutional scrutiny under Kraft.
GILTI & FDII
State Responses

- GILTI Income Excluded
  - Georgia (S.B. 328)
  - Wisconsin (A.B. 259)
  - Michigan (May 2018 Tax Policy Newsletter)

- GILTI Income Included
  - Illinois (March 2018 Illinois Tax Guidance)
    - Subject to state’s foreign dividend subtraction modification

- GILTI Income Included (after 50% GILTI deduction), But FDII Deduction Excluded
  - New York (2018-2019 Fiscal Year Budget)

- GILTI Income Included, But Disallowed IRC § 250 Deduction for 50% of the GILTI
  - Oregon (S.B. 1529)

- GILTI Income Included, But Disallowed IRC § 250 Deduction for 50% of the GILTI and the Deduction for IRC § 78 Gross-up Amounts Related to GILTI and FDII
  - Idaho (H.B. 463)
Through the SALT Lens

Base Erosion and Anti-abuse Tax (BEAT)
BEAT – IRC § 59A
SALT Implications

– The federal impact of the BEAT is the payment of additional tax for those taxpayers subject to it.
– Because the BEAT is a separate tax that does not go into the calculation of federal taxable income, the BEAT currently does not have an impact on state taxable income.
– Taxpayers should stay on the lookout for what states will do with the BEAT.
  • Constitutional scrutiny under Kraft?
    • Because the BEAT is directed at payments made to “foreign related parties” and no similar alternative tax is directed at payments made to domestic related parties, a state’s incorporation to the BEAT will likely face constitutional scrutiny under Kraft.
BEAT – IRC § 59A

State Responses

– Not Adopted / Not Applicable
  • California (Summary of Federal Income Tax Changes 2017 (Dec. 22, 2017))
  • Maine (Preliminary Report on the Effects on Maine of the Federal Tax Cuts and Jobs Act (Feb. 1, 2018))

– Vermont (H. 719) is the first state to offer US insurance companies looking to avoid BEAT levied on reinsurance ceded to offshore affiliates by forming a new kind of captive insurance company called an “affiliate reinsurance company” in Vermont.
Special Apportionment Issues
Special Apportionment Issues
Taking a Position

— What’s generally included in the sales factor?
  • Broadly includes gross receipts not allocated as nonbusiness income.
  • Includes receipts from tangible personal property, services, rentals, royalties, sales of stock, and business operations generally, at least in the absence of some specific limitation.

— If IRC § 965 income or GILTI is included in a state’s tax base, should the corresponding apportionment factors attributable to such income be included?
  • Are they receipts?
  • How much should be included?
    • E.g., if a state conforms to GILTI inclusion (IRC § 951A) and deduction (IRC § 250) should only 50% of the corresponding factors be reflected in the apportionment factor?
  • Does substantial distortion exist if the corresponding apportionment factors are excluded?
  • Does inclusion reflect a reasonable sense of how income is generated?
  • Does exclusion discriminate against foreign commerce?
Recent Developments
New Mexico – Inclusion of Foreign Affiliate Income  
*In the Matter of General Electric Co. & Subsidiaries*, No. 18-12 (N.M. Admin. Hearings Office Apr. 6, 2018)

— The New Mexico Administrative Hearings Office held that New Mexico’s inclusion of dividends and Subpart F income received from foreign affiliates, while excluding dividends received from domestic affiliates, did not violate the Foreign Commerce Clause.

— The Hearings Office reasoned that inclusion of the dividends and Subpart F income from foreign affiliates is permissible when the taxpayer files a consolidated New Mexico return because “there is a tax symmetry” under the consolidated group method.

— Factor representation was not an issue in this case because the Department had computed the taxpayer’s tax liability by including the foreign affiliates’ factors in the taxpayer’s New Mexico apportionment factor.
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