STATE TAXES AFTER REFORM
PARTNERSHIP

Senate Select Committee on Federal Tax Code Implementation
Testimony on State Conformity to the Tax Cuts and Jobs Act
Presented by Morgan Scarboro, STAR Partnership

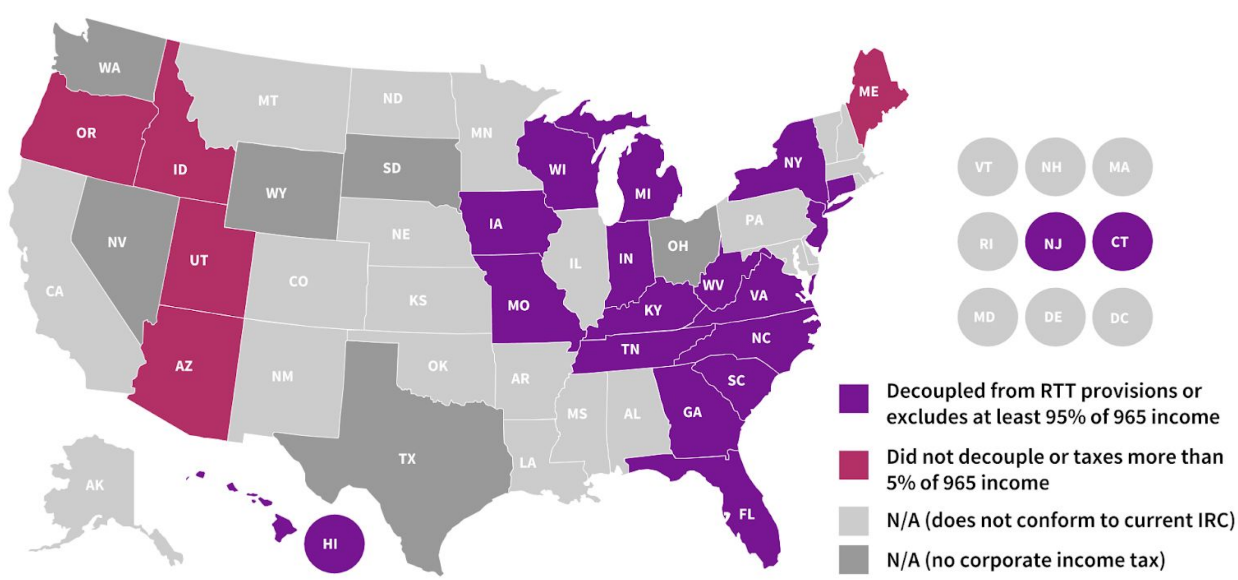
Wednesday, January 30th, 2019

Madam Chair and Members of the Committee, my name is Morgan Scarboro, Senior Policy Analyst & Economist with MultiState Associates. I appreciate the opportunity to testify on the way states have responded in the wake of the Tax Cuts and Jobs Act (TCJA). The TCJA represents the biggest change in business taxes since the corporate income tax was initially created. It is fundamentally different than any corporate income tax system that has ever been imposed in the United States; and therefore, states must carefully weigh which provisions they choose to conform to.

The single most important fact to understand is that blind conformity to the corporate income tax changes imposed under the TCJA will always result in a state tax increase absent a proactive response. The reason is simple: the federal government significantly reduced the corporate income tax rate, from 35% to 21% (a 40% reduction in the top rate), but at the same time broadened the tax base. States which "conform" to the new, broader federal corporate income tax base without any offsetting changes will automatically and significantly increase business taxes – by 12% on average.

Repatriation Transition Tax (RTT)

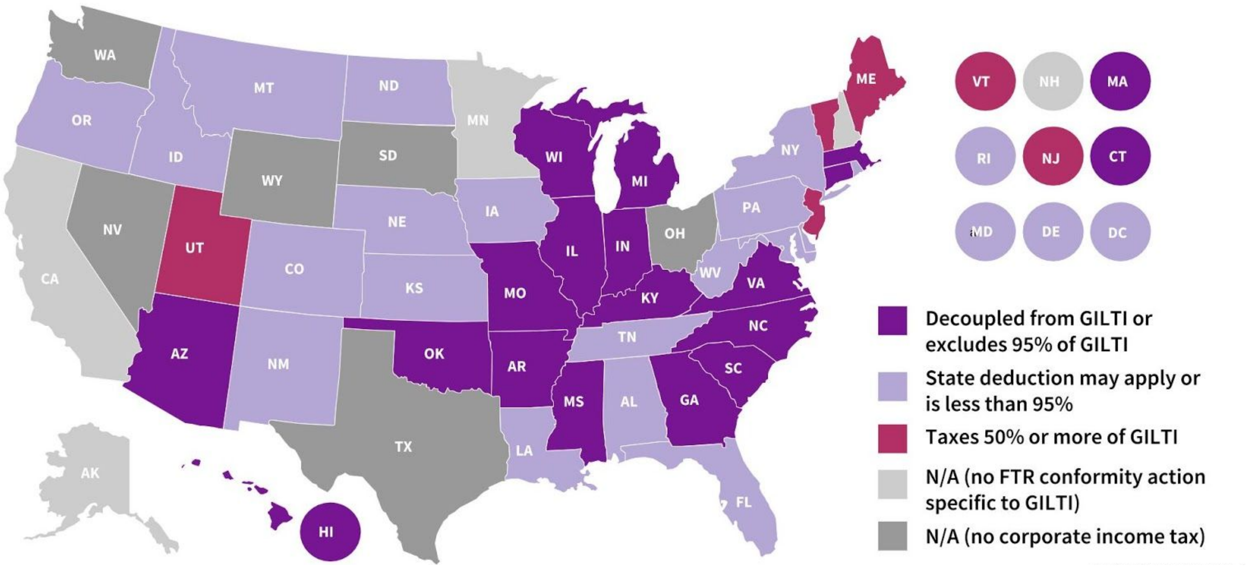
A significant majority of states which acted in 2018 decoupled from the one-time tax on repatriated earnings and profits. The State Taxes After Reform ("STAR") Partnership recommends that states decouple from federal provisions addressing repatriated foreign earnings in order to remain consistent with policies to avoid taxation of foreign income, and a significant majority of states followed this recommendation. Seventeen of the 21 states which have acted in the wake of the TCJA decoupled from the RTT (purple states in the map below). Only five states failed to decouple (or provide significant relief) and thus include one-time repatriated foreign earnings and profits in their state tax bases (red states on the map below).



About Us: The STAR (State Taxes After Reform) Partnership was formed to help the business community navigate the state legislative, executive, and regulatory reaction to federal tax reform. Please visit our website for more information about the STAR Partnership and our work (www.star-partners.org).

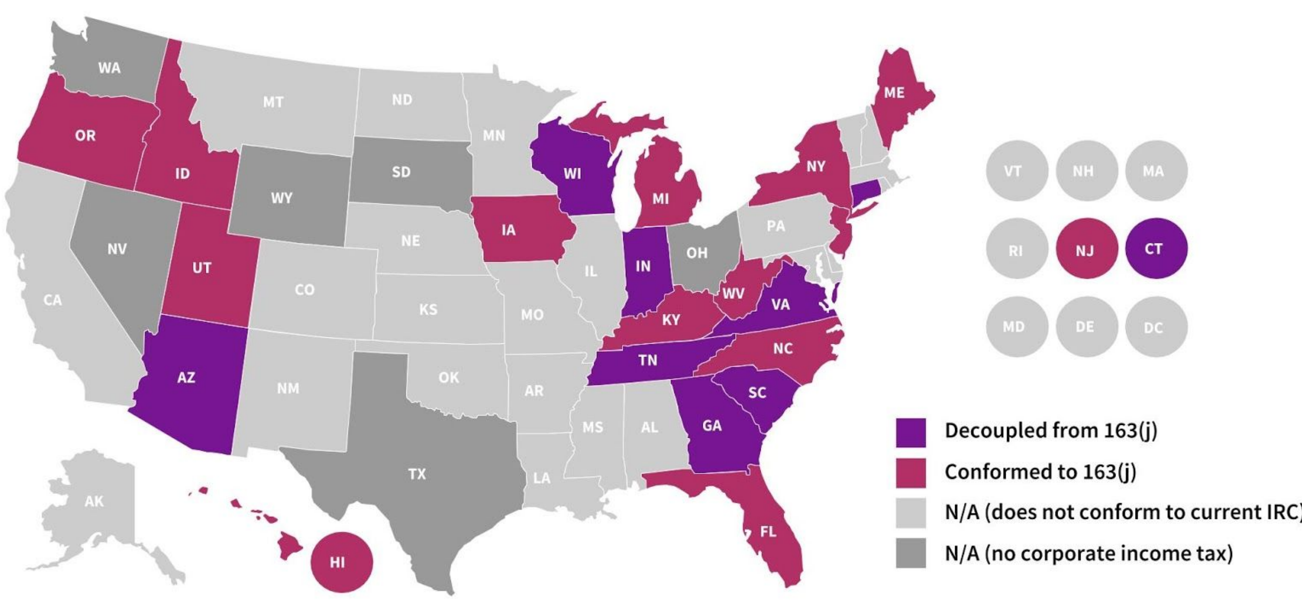
Global Intangible Low-Taxed Income (GILTI)

Seventeen states have either decoupled from GILTI or exclude 95 percent of GILTI from the state tax base (dark purple on the map below). In another 20 states, the state has a deduction that may apply to GILTI, or the deduction for GILTI is less than 95 percent (light purple on the map below). Only four states tax 50 percent or more of GILTI (Maine, New Jersey, Vermont, and Utah—red on the map below). Under the prior federal tax system, states generally did not include foreign income in their own tax bases, for both policy reasons and Constitutional limitations, and states should continue to respect these policy and Constitutional rationales, including in their treatment of GILTI.



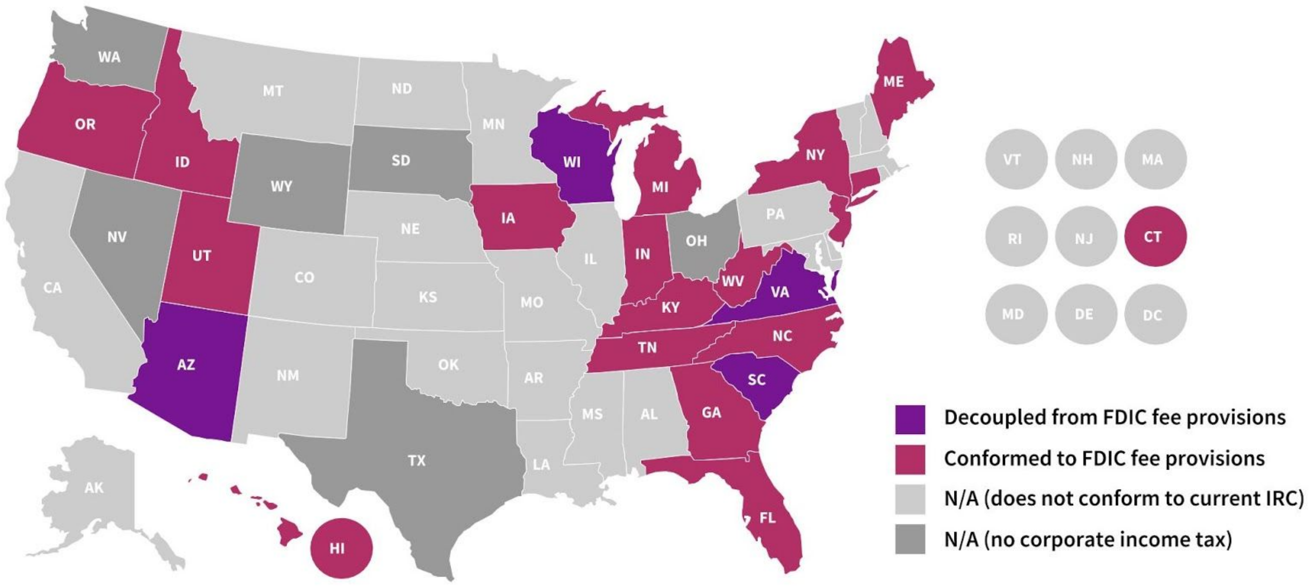
Interest Expense Limitation

Eight of the 21 states that took federal tax reform implementation action decoupled from the federal interest expense limitation, as recommended by the STAR Partnership. Adopting the federal limitation on interest expense increases the cost of capital and of doing business in Kansas and could encourage businesses to move to states with more favorable tax laws. Moreover, this federal provision would be extremely complex to impose, administer, and comply with at the state level.



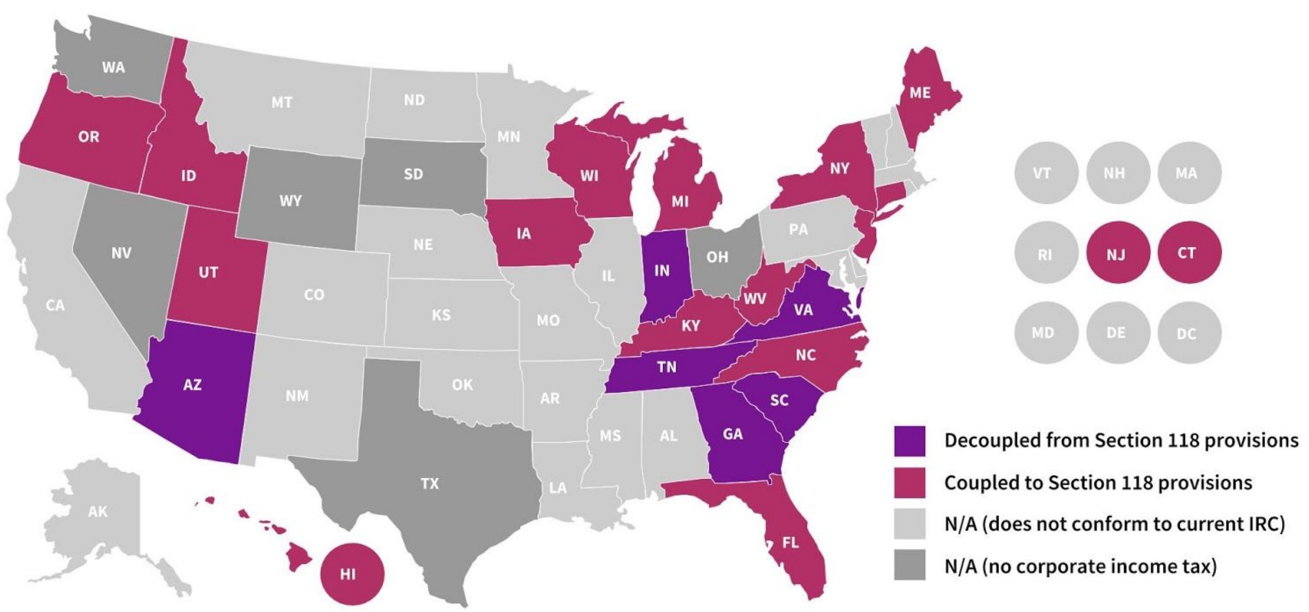
Federal Deposit Insurance Corporate (FDIC) Fees

Four states have decoupled from the tax on FDIC fees. This federal provision disallowing the deduction for FDIC fees was included purely as a means of raising revenue to offset the 40% cut in federal corporate rates. Because taxpayers are not benefitting from such a reduction in Kansas, there is no rationale for limiting the deductibility of FDIC fees.



Section 118 Contributions to Capital

Six states have followed the STAR Partnership's recommendation to decouple from section 118 provisions on contributions to capital (Arizona, Georgia, Indiana, South Carolina, Tennessee, and Virginia). This federal provision would specifically contravene state policy goals by imposing taxes on states' own economic development incentives.



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