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Federal Tax Changes & Implications to States

2018 SEATA Conference

Nashville, Tennessee

July 16, 2018

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Presenters

- Frank M. O'Connell, Dir. of Legal Affairs & Tax Policy
  - Georgia Department of Revenue, Atlanta, GA
- Alysse McLoughlin, Partner
  - McDermott Will & Emery, New York, NY
- Steve Wlodychak, Principal
  - Ernst & Young LLP, Washington, DC

Agenda

- Overview of the Tax Cuts and Jobs Act (P.L. 115-97) (TCJA)
- General state conformity
- State conformity problems to TCJA
  - International provisions
  - Pass-through Entity provisions
  - Interest Deduction Limitations
- State workarounds the $10K federal limitation on state and local tax deductions

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What's in the new law? Three key drivers of FEDERAL tax reform

Lower rates

- Significantly reduced the headline corporate tax rate (35% to 21% (40% rate reduction))!
- Eliminated corporate alternative minimum tax (AMT)
- Reduced individual tax rates too (but also provided rate relief for some owners of pass-through entities (PTEs) (not accountants or lawyers!!!)

Broader tax base

- To pay for the lower rates, the TCJA broadened the tax base (e.g., limited deductions)
- Affects corporate and individual taxation alike.

New international tax system

- Moved the US from a "worldwide" to a "territorial" tax system
  - Quasi-territorial? New provisions (e.g., Global Intangible Low-Taxed Income (GILTI), Foreign Derived Intangible Income (FDII), Base Erosion Anti-Abuse Tax (BEAT)) maintain key elements of a worldwide system)
- Transition tax to get there (but also raises a LOT of revenue)
  - One time inclusion in gross income of US shareholders of previously untaxed accumulated foreign earnings of foreign corporate subsidiaries
    - Effective rate determined by deduction with the rate determined by whether the earnings are in cash (15.5%) or non-cash assets (8%)

Will states conform to the new law?

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- Now that federal tax reform is enacted, attention will turn to the states
- ***EVERY*** state with a corporate income tax ties to the federal Internal Revenue Code (IRC) in some way, shape or form as the starting point for determining state taxable income:
  - If the IRC changes (e.g., base expansion, elimination of deductions, modifications of credits), the state income tax base changes as well.
- States differ how they conform – IRC conformity dates are key:

Fixed	Rolling	Selective
• Conformity **generally** not automatic • Legislature can consider whether and when to conform to IRC changes	• Conformity **generally** automatic • Legislature must affirmatively consider whether to decouple from IRC changes	• Conformity **generally** depends on specific provisions • Legislature can consider whether and when to conform to IRC changes

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Will states conform to the new law?

- Now that federal tax reform is enacted, attention will turn to the states
- ***EVERY*** state with a **Personal** income tax ties to the federal Internal Revenue Code (IRC) in some way, shape or form as the starting point for determining state taxable income:
  - If the IRC changes (e.g., base expansion, elimination of deductions, modifications of credits), the state income tax base **"sometimes" changes as well.**
- States differ how they conform – IRC conformity dates are key:

Fixed	Rolling	Selective
• Conformity **generally** not automatic • Legislature can consider whether and when to conform to IRC changes	• Conformity **generally** automatic • Legislature must affirmatively consider whether to decouple from IRC changes	• Conformity **generally** depends on specific provisions • Legislature can consider whether and when to conform to IRC changes

Conformity to IRC (corporate)

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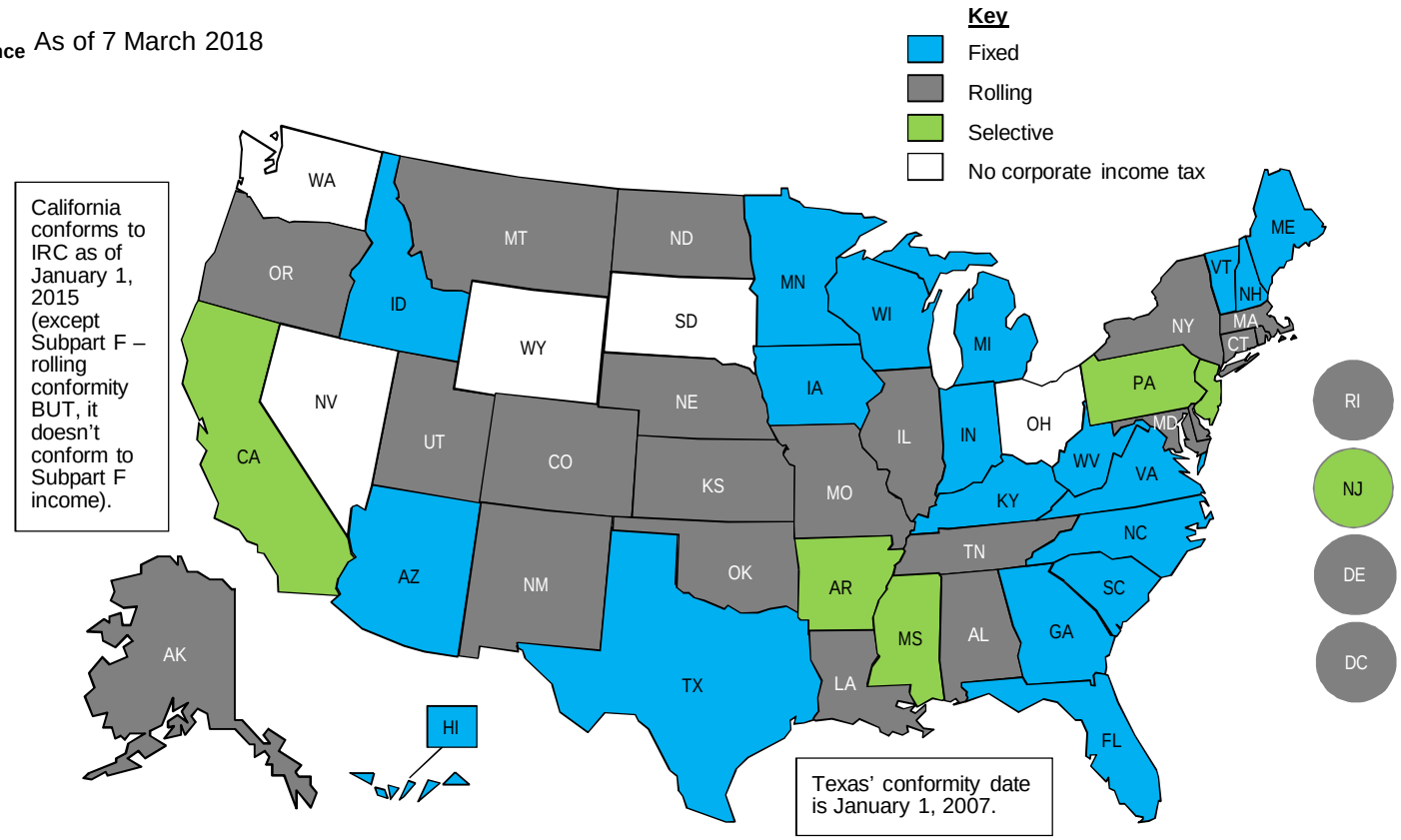
As of 7 March 2018



Watch it change!

Conformity to IRC **(Personal)**

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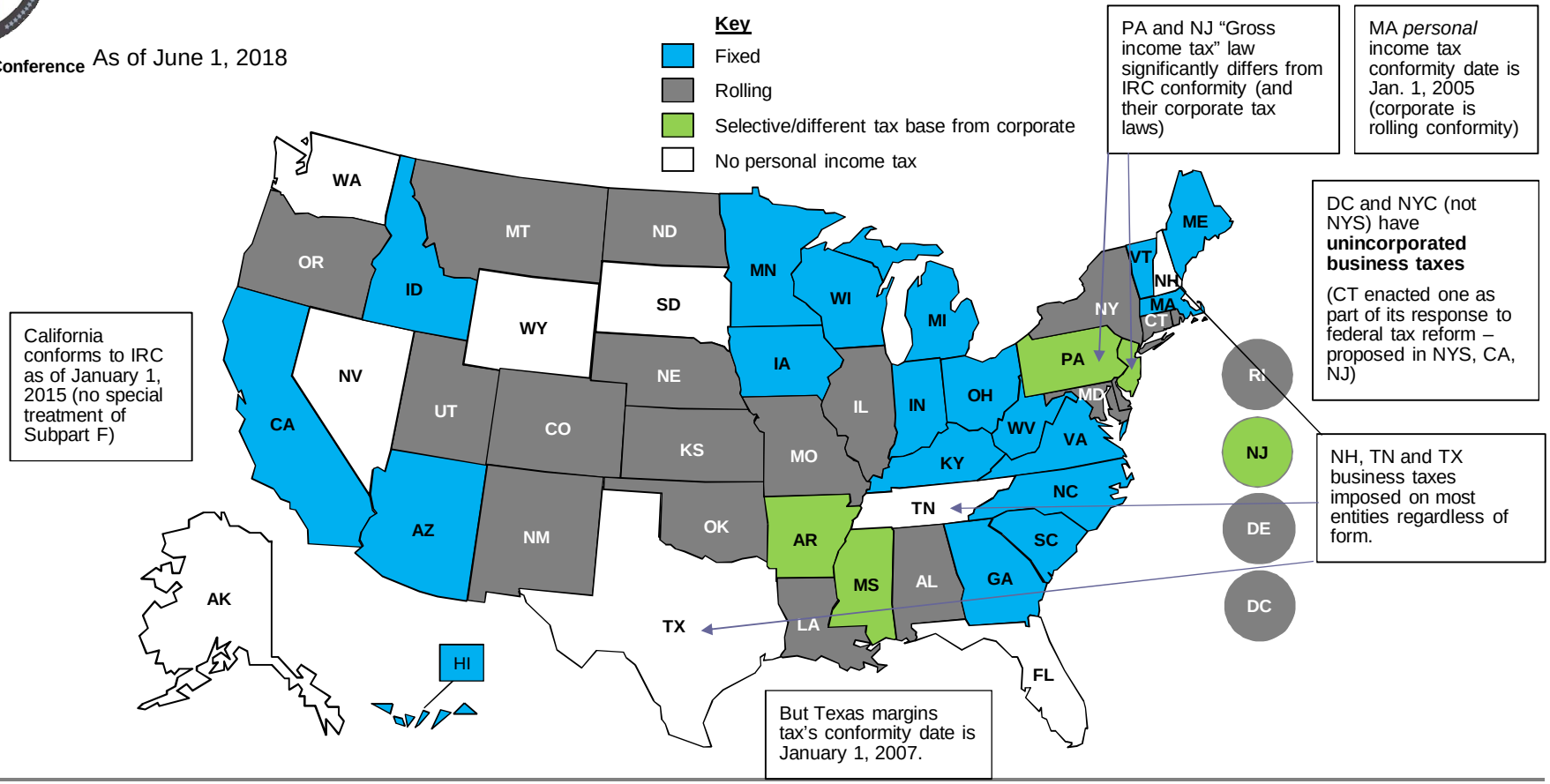
As of June 1, 2018



State personal income taxes differ from corporate taxes

- Some states that have a corporate income tax don't have a personal income tax
- On the other hand, some states impose their business taxes on PTEs just like they do on corporations
- The personal income tax law of some states differs remarkably and significantly from its corporate income tax law
  - Sometimes not even codified in the same code!
- The IRC conformity date for some states' personal income tax law differs from that used for its corporate income tax law
- Although a state "might" use federal taxable income as a starting point for determining state personal taxable income for convenience, the administrative convenience may not match the law (especially PA and NJ (and maybe not after July 1 tax bill!))

New international provisions: Transition Tax, GILTI

- TCJA enacts significant reforms to US taxation of international transactions
  - Transition tax (IRC §965)
    - Special Subpart F inclusion of post-1986 earnings and profits of foreign corporations with corresponding deduction to achieve 15.5% (cash) or 8% (other) effective federal tax rate; payable over eight years
  - 100% deduction for future distribution of earnings from foreign subsidiaries (IRC §245A) – Foreign DRD
  - Global Intangible Low Taxed Income (GILTI) (IRC §§951A/250)
    - Inclusion in gross income of foreign corporate subsidiaries income in excess of 10% return on tangible asset value; subject to 50% deduction (decreasing to 37.5%) resulting in federal effective rate of 10.5% (13.125% effective rate after decrease)

GILTI/FDII – The Carrot and the Stick (or the Stick and the Carrot)

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- GILTI in a nutshell
  - Determine the value of the tangible assets on the tax balance sheet of a controlled foreign corporation (CFC) if it were filing a US federal income tax return; Multiply that amount by 10%, set aside.
  - Determine the CFC's Subpart F income, set that aside
  - Determine the CFC's taxable income as if it filed a US federal income tax return
  - Add the CFC's 10% rate of return on tangible assets plus its Subpart F income (from Steps 1 and 2) and then SUBTRACT that sum from its deemed taxable income in Step 3 – that's the GILTI amount that the
    United States shareholder (US Shareholder) (which does NOT have to be a corporation) must include in its US GROSS INCOME
  - That's essentially the calculation (a little bit more complicated to reflect some interest expense, deferral items, credits, divisions among owners,)
- Finally, the United States shareholder can deduct the applicable GILTI percentage under IRC §250(a)(1)(B):
  - 50% (until 2025)
  - 37.5% (2026 thereafter)
  - Results in effective federal GILTI tax rates of 10.5% and 13.125%

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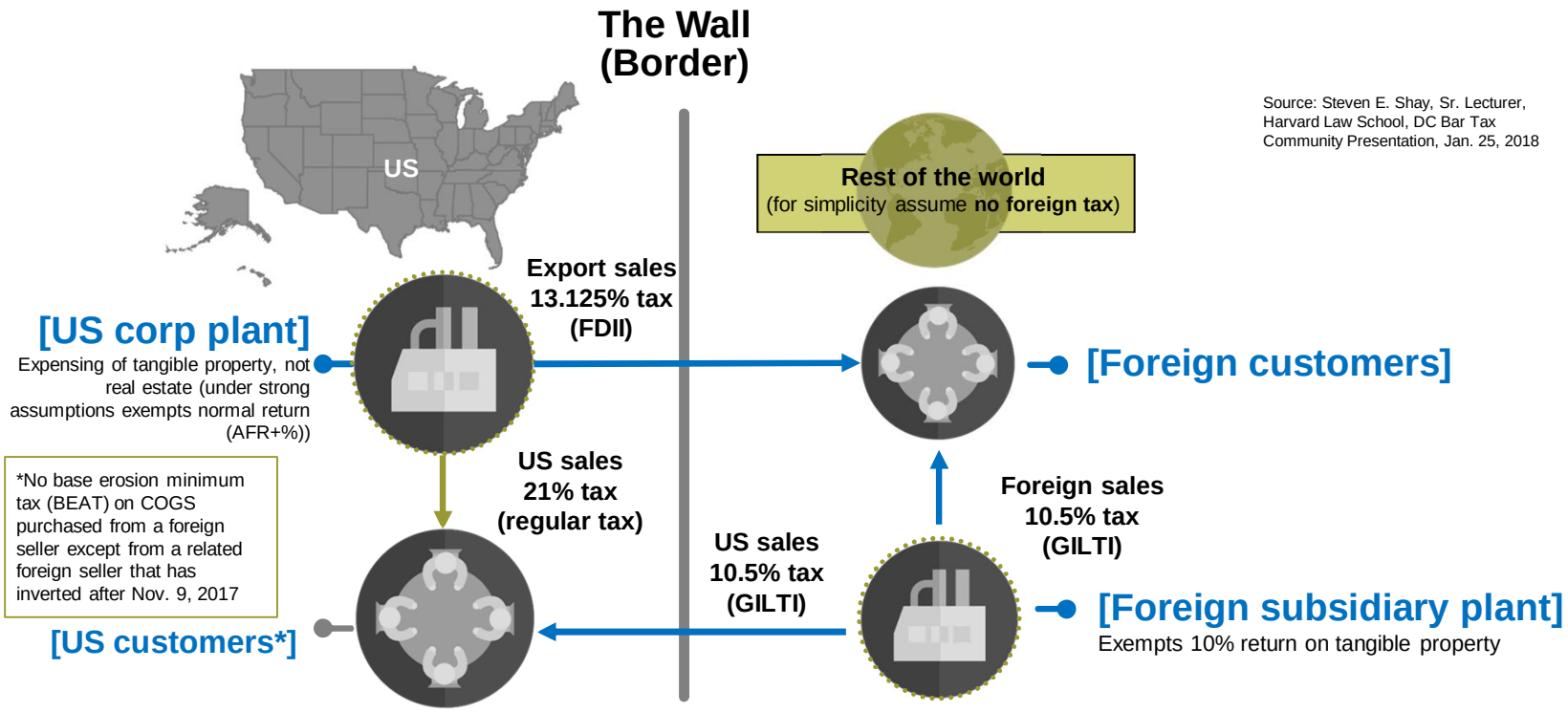
Tax reform provisions impacting trade for US based MNCs



Source: Steven E. Shay, Sr. Lecturer, Harvard Law School, DC Bar Tax Community Presentation, Jan. 25, 2018

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Can states tax it? Transition Tax, GILTI – Constitutional issues

- States can't simply conform to the federal income treatment of foreign-source income (e.g., transition tax, GILTI, FDII, BEAT):
- US Constitutional limitations:
  - **Foreign Commerce Clause** limits state taxation of foreign dividends:
  - ***Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance***, 505 U.S. 71 (1992)
    - Does that rule apply to Subpart F income? Does it apply to all the new international provisions (e.g., transition tax, GILTI, FDII and the BEAT?
    - Complicated by contradictory state rulings in unitary combined reporting states (neither of which was ever appealed to the U.S. Supreme Court) (***Kraft*** fn. 23):
      - ***E.I. du Pont de Nemours & Co. v. State Tax Assessor***, 675 A.2d 82 (Maine 1996)
      - ***Appeal of Morton Thiokol, Inc.***, 864 P.2d 1175 (Kansas 1993)
  - Are they unconstitutional "state" tariffs under the **Import-Export Clause**?
    - *Woodruff v. Parham* (1868); *Camps Newfound/Owatonna, Inc. v. Town of Harrison* (1996 (J.Thomas dissent)); *Loudon County v. Dulles Duty Free LLC* (Va. S.Ct. 2017 (cert. den. U.S. S.Ct. April 2, 2018))

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Can states tax it? Transition Tax, GILTI – Their own statutes

STATE OF NEW JERSEY
DEPARTMENT OF THE TREASURY

Division of Taxation

March 16, 2018

Notice: New Jersey's Treatment of Deemed Repatriation Dividends Reported Pursuant to Internal Revenue Code (IRC) Section 965

The federal Tax Cuts and Jobs Act, which was signed into law on December 22, 2017, includes a one-time repatriation transition tax on earnings and profits accumulate abroad.

The law requires a specified foreign corporation (as defined in the Internal Revenue Code (IRC)) that has accumulated post-1986 deferred foreign income to report such income as a deemed repatriation dividend, which will be taxed to the recipient at a reduced effective federal tax rate. Regardless of whether the earnings and profits are brought back, the repatriation transition tax is imposed on the deemed repatriation dividends for the last tax year beginning before January 1, 2018.

For New Jersey Corporation Business Tax purposes, the deemed repatriation dividends will be excluded from entire net income, as provided in the Corporation Business Tax Act (N.J.S.A. 54:10A-4(k)(5)). If a corporation does not meet the ownership thresholds, the deemed repatriation dividends will be included in entire net income to the extent provided in the Act.

For New Jersey Gross Income Tax purposes, dividends are an enumerated category of income. Thus, deemed repatriation dividends reported under IRC Section 965 must be included in New Jersey gross income in the same tax year and in the same amount as reported for federal purposes.

Guidance may be obsolete after enactment of P.L. 2018 c. 48 (A 4202).

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Can states tax it? Transition Tax, GILTI – Their own statutes

- First, why would this be a problem?
  - Under NJ's notice, corporations get a dividend received deduction (DRD) of 100% if they own 80% or more of the shares of any subsidiary (foreign or domestic) from which the distribution is made
    - Not Taxable (under Corporate Business Tax)
  - NJ gross income tax does NOT provide a DRD for individuals – the Transition tax is 100% TAXABLE
    - No IRC §965(c) Deduction (ouch!!!!)
    - Remember, individuals, including partners in a partnership as well as shareholders of S corporations, are subject to the federal transition tax (but they get the IRC §965(c) deduction)
- More importantly, is the NJ Division of Taxation right?
  - **Arguably* NO!**
  - Why?
    - Even before you get to the US Constitutional questions (e.g., foreign commerce clause), the NJ statute does not allow it …

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Can states tax it? Transition Tax, GILTI – Their own statutes

- New Jersey Gross Income Tax Act ("GIT) is not based on the IRC.
- Instead, the NJ GIT Act defines sixteen ***exclusive*** categories of "gross income" that are subject to tax
  - Exclusive – if they are not "in" the definition, they are not taxable
- N.J.S.A. 54A: 5-1(f): Dividends received by individuals are includible in "gross income"
  - Dividends are specifically defined, however, to mean:

    "any distribution ***in cash or property*** made by a corporation….(1) out of accumulated earnings and profits or (2) out of earnings and profits of the year in which such a dividend is paid…." (emphasis added).
- Under IRC §965, neither cash nor property is being distributed by a corporation and thus, for NJ GIT purposes it should not be recognized as "gross income"

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Can states tax it? Transition Tax, GILTI – Their own statutes

pennsylvania
DEPARTMENT OF REVENUE

INFORMATION NOTICE

CORPORATION TAXES AND PERSONAL INCOME TAX

2018-1: Tax Cuts and Jobs Act of 2017

April 20, 2018

IV. Application of Repatriation Transition Tax to Personal Income Tax

PIT is imposed on eight separate classes of income, one of which is dividends. For PIT purposes, a dividend is defined as a distribution in cash or property made out of current or accumulated E&P. The RTT is imposed even though no actual distribution of cash or property out of E&P occurs. Because this "deemed dividend" does not involve an actual distribution of cash, it is not a dividend for PIT purposes. If and when an actual distribution of cash out of E&P is made to a PIT taxpayer, it will be subject to PIT as a dividend. PIT taxpayers must report this taxable dividend income regardless of whether they receive a Form 1099-DIV with respect to the actual distribution.

- Pennsylvania's Department of Revenue concluded that the IRC §965 transition tax was NOT subject to its "gross income" tax.
- Why is that important for New Jersey purposes?
  - Little known fact: New Jersey's gross income tax law was derived from Pennsylvania's
  - How does Steve W. know that?
    - I was issues advisor to Gov. Tom Kean when he ran for Governor in 1981 (and won!) …
    - His predecessor, Hon. Brendan T. Byrne, brought about the NJ personal income tax in 1976 and modeled it after Pennsylvania's without perceived federal loopholes.

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Can states tax it? Transition Tax, GILTI – Their own statutes

- Same analysis likely applies for Global Intangible Low Taxed Income (GILTI) under IRC §951A/250
  - Applicable to any foreign corporation that has a 10% or more corporate shareholder
- NJ/PA analysis is just an example of what has to be done under every state's personal income tax law
- Constitutional protections are still there
  - Except in the individual's state of residence – can it really tax EVERYTHING?
- BEAT Tax (IRC §59A) won't apply
  - Different tax base (base erosion tax amount) states don't follow
  - But, more importantly, only applies to an "**applicable taxpayer**" – corporation (other than a RIC, REIT or S corporation) (IRC §59A(e)(1))

Section 163(j) Overview

- A taxpayer generally cannot deduct business interest expense for a taxable year to the extent that such interest exceeds the sum of (a) the taxpayer's business interest income, and (b) 30% of the taxpayer's adjusted taxable income (**ATI**) for such taxable year.
  - Business interest expense means any interest paid or accrued on indebtedness properly allocable to a trade or business and business interest income means any interest includible in the gross income of the taxpayer which is properly allocable to a trade or business.
  - ATI means the taxable income of the taxpayer computed without regard to (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business, (2) any business interest expense or business interest income, (3) any NOL deduction under Section 172, (4) any deduction allowable under Section 199A, (5) for taxable years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion.

Section 163(j) Overview

- **Exceptions**
  - Any activities that are not attributable to a trade or business;
  - Performing services as an employee;
  - Any electing real property trade or business;
  - Any electing farming business;
  - Certain utility businesses;
  - Floor plan financing interest.

State Issues – Interest Limitation

- Interest deduction limitation
  - Purpose of federal rule: to prevent double tax benefit when coupled with expensing.
  - If states do not adopt the federal expensing regime, arguably they should not limit interest deductions.

State Issues – Interest Limitation (cont'd)

- Interest deduction limitations
  - In most states, the corporate income tax base is based on a taxpayer's federal taxable income.
  - Federal statute says determination of interest limitation is at the "tax filer" level (without defining it)
    - Separate company? Consolidated? (IRS says it will be "consolidated")
  - In both combined-filing states and separate-filing states that conform to Section163(j), will alternative computations be needed to determine the interest expense limitation?

State Issues – Interest Limitation (cont'd)

- In separate return states, will a different computation be needed to determine the interest limitation for each corporate taxpayer that files within the state?
- In combined-filing states, if the state combined group is not the same as the federal consolidated group, will additional interest expense limitation computations be required to adjust for differences between the federal and state groups?

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What are SEATA states doing regarding TCJA changes (business tax changes)?

State	IRC Conformity	Statutory update	Guidance
Alabama	Current IRC		IRC §965
Arkansas	Selective		
Florida	Fixed - 1/1/2018	Studying impact of TCJA	IRC §965
Georgia	Fixed – 2/9/2018	IRC §§118, 163(j), 179, 245A, 250, 951A, 965	IRC §965
Kentucky	Fixed – 12/31/2017	IRC §§168(k), 179, 199A	KY tax reform webpage – Adopts IRC §§172, 163(j), 250 (FDII only)
Louisiana	Current IRC		
Mississippi	Selective		
North Carolina	Fixed – 2/9/2018	IRC §§250, 951A, 965, 1400Z-2	
South Carolina	Fixed – 12/31/2016		
Tennessee	Current IRC	IRC §§118, 163(j)	IRC §965
Virginia	Fixed – 2/9/2018	TCJA exceptions to IRC conformity	
West Virginia	Fixed – 12/31/2017		

Georgia HB 918 & SB 328

- Does not adopt the IRC §199A 20% qualified business income deduction.
- Does not adopt the IRC §163(j) 30% limitation on business interest deductions.
- Does not adopt the new rules relating to contributions to capital.
  - Georgia follows the provisions of IRC §118 that existed before enactment of federal Public Law 115-97.

Georgia HB 918 & SB 328 (cont.)

- Significant Federal provisions that are adopted are as follows:
  - Increase in IRC §179 deduction limit to $1 million from $500,000.
  - Changes to federal itemized deductions including the $10,000 limitation on state and local taxes.
  - Changes to use of net operating losses:
    - Net operating losses may now be carried forward indefinitely, but may not be carried back to apply against prior years' tax liabilities (except for farmers) and may only offset 80% of taxable income in a tax year.
  - Elimination of the business deduction for entertainment expenses.
  - GILTI inclusion
    - Federal deductions that lower the federal tax rates are explicitly made deductible for Georgia purposes as well to the extent the GILTI income is included in Georgia income.
    - Further, GILTI income is specifically considered subpart F income and considered a foreign dividend and hence excluded for Federal C Corporations.

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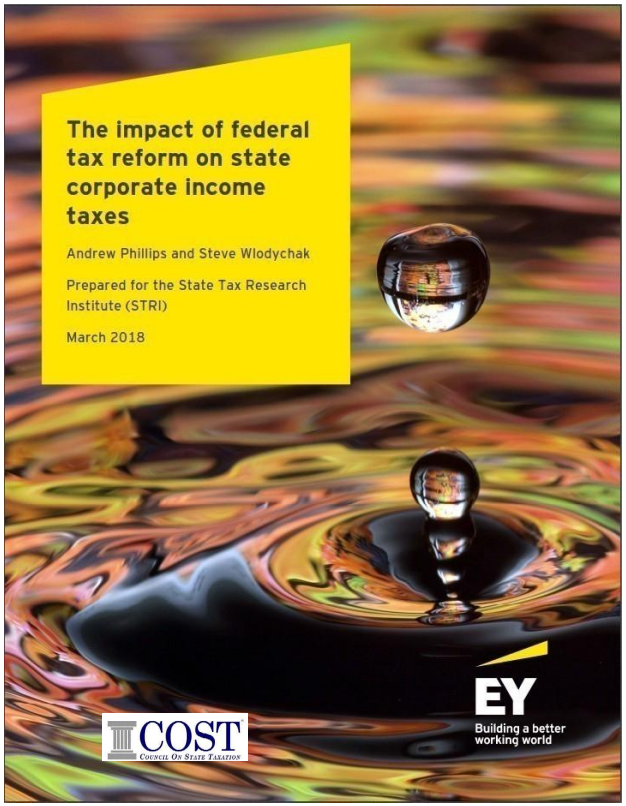
Quantifying the impacts of TCJA on state corporate taxes

- EY/COST study (March 5, 2018) provides estimates of the impacts of TCJA on state corporate tax bases.
- Study examines the impact of all states updating their corporate tax codes to the TCJA but remaining coupled to specific provisions as they have in the past:
  - Not what will happen, not what the states will do but what could happen if the states conform to federal tax law changes as they have in the past
- The estimated percentage change in the state corporate tax base from TCJA is **about 12% over the first 10 years** (2018–27), with significant variation among the states.



Corporate tax base changes for major provisions in TCJA (2018-2027)

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Business provision	% change in federal corporate tax base
One-time transition tax on un-repatriated foreign earnings	+9.0%
Net interest expense limitation (30% of ATI)	+6.4%
Modification of net operating loss deduction	+5.3%
GILTI inclusion	+5.5%
Deduction for GILTI	(2.6%)
Amortization of research and experimental expenditures	+2.9%
Repeal of domestic production activities deduction (IRC §199)	+1.9%
Limit deduction of fringe benefits	+0.7%
Limit like-kind exchanges of personal property	+0.5%
BEAT*	0.0%
Increased expensing under IRC §179	(0.3%)
Small business accounting method reform and simplification	(0.8%)
FDII deduction	(1.7%)
Bonus expensing (IRC §168(k))	(1.8%)
Move to territorial system of taxation	(5.9%)
Total change in federal corporate taxable income from major provisions**	+19.1%

Source: Ernst & Young LLP analysis incorporating Joint Committee on Taxation (JCT) revenue estimates
* BEAT is a minimum tax and does not impact the regular tax base
** Total reflects only major provisions shown in this table

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Estimated percentage change in state corporate tax base from TCJA (2018-2027)

State	% increase in state corporate tax base	State	% increase in state corporate tax base
Alabama	11%	Nebraska	11%
Alaska*	12%	Nevada	n/a
Arizona	14%	New Hampshire*	13%
Arkansas	12%	New Jersey*	12%
California**	12%	New Mexico*	11%
Colorado	12%	New York*	12%
Connecticut*	12%	North Carolina	12%
Delaware	10%	North Dakota	10%
Florida	13%	Ohio	n/a
Georgia	12%	Oklahoma	13%
Hawaii*	13%	Oregon*	10%
Idaho	9%	Pennsylvania*	14%
Illinois	9%	Rhode Island*	11%
Indiana*	12%	South Carolina	12%
Iowa	13%	South Dakota	n/a
Kansas	11%	Tennessee*	12%
Kentucky*	12%	Texas	n/a
Louisiana	12%	Utah*	12%
Maine	12%	Vermont	14%
Maryland*	12%	Virginia	13%
Massachusetts*	12%	Washington	n/a
Michigan	9%	West Virginia	9%
Minnesota*	12%	Wisconsin*	9%
Mississippi*	4%	Wyoming	n/a
Missouri	11%	District of Columbia	12%
Montana*	9%	Overall change	12%

* State starts with IRS Form 1120, Page 1, Line 28. To the extent IRC §250 deductions are not allowed, this impact would be higher by 4%.

** There may be a California impact relating to cash repatriation for waters' edge filers once the deemed repatriated earnings have been actually distributed as dividends to US corporate shareholders. The California Franchise Tax Board has estimated this amount at approximately $350 million.

State and local tax deduction

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- State and local tax deduction for individuals limited to $10,000 annually ($5,000 married filing separately) (amended IRC §164)
  - House version would have completely eliminated it
- Part of federal income tax law since 1913
  - Thought to be a constitutional requirement
    - Intergovernmental Immunity Doctrine (states can't tax federal government and vice-à-versa)
  - U.S. Supreme Court rejected the doctrine in *South Carolina v. Baker*, 485 U.S. 505 (1988) (tax exempt muni-bond interest case)
- Retains deduction for taxes "on a trade or business"
  - Corporations still entitled to deductions (including income tax)
  - PTE's eligible for deduction, but not for personal income tax of owners
    - TCJA Conf. Comm. Report makes clear that business owner income taxes are NOT "on a trade or business"
      - FN. 168 (citing to 1944 Congressional report for Individual Income Tax Act of 1944) ("tax on trade or business" provision wasn't even in the IRC!)

State and local tax deduction (cont.)

- Direct revenue impact on states?
  - None (most state income tax laws (individual and corporate) always added it back – for different policy reasons
  - In fact, if New York continued to conform to limiting the SALT deduction for personal income tax purposes, it was estimated to RAISE $650 million annually
- Direct impact on electorate?
  - Probably 80% of US individual taxpayers UNAFFECTED
  - Covered by Standard Deduction increase to $24,000
  - The other 20%?
    - High-income earners in states with high personal income and property tax rates (e.g., California, New York, New Jersey, Connecticut – Blue (Democratically controlled) states)
    - Politically active, business decision makers à most mobile part of the workforce, most vocal

State and local tax deduction (cont.)

- Political impact?
  - Local politicians have to respond to the fall out
- No matter how you look at this, it is NOT directly a state and local tax issue
  - Interpretation of FEDERAL tax law
  - That doesn't mean SALT professionals shouldn't know about it

State and local tax deduction

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- Recent responses?
  - Gov. Cuomo (in response to IRS May 23 notice)
    - Economic missile … aimed at New York
  - NY Congressman Peter King (R) and Congresswoman Nita Lowey (D) introduce bill to repeal the SALT Deduction limitation
  - Republican Congressmen heading for the exits?
    - Rep. Issa (R-Orange-San Diego, CA) (nearly lost last time, wealthiest member of Congress)
    - Rep. Tiberio (R-Ohio) – Chair of W&M Tax Subcommittee resigning to lead Ohio Business Roundtable
    - Rep. Shuster (R-PA)
    - Sen. Heitkamp (D-ND) – her most likely opponent just decided not to run

MAY 23, 2018 | Albany, NY

Statement from Governor Andrew M. Cuomo on Potential IRS Regulations on Salt Deductions

STATEMENT TAXES

"The federal government passed a disastrous tax bill that put corporations over people and specifically targeted New York and other Democratic states with the elimination of full state and local tax deductibility. New York was the first to take action to protect our residents from this hostile assault and ensure New York families weren't being used as a piggy bank to pay for tax cuts for big corporations.

"Now, the administration appears poised to attack again through new tax regulations, showing its true hostility to New Yorkers and middle-class taxpayers. It is particularly ironic that Donald Trump is in Long Island today while the IRS aims its sights on Long Island homeowners.

"Make no mistake: We have been and will continue to fight against this economic missile with every fiber of our being. The IRS should not be used as a political weapon, and I urge this administration to stop its partisan assault on New Yorkers and instead work with us to deliver real, lasting relief for hardworking families."

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State and local tax deduction: States attack!

- New York Gov. Andrew Cuomo
  - Former A.G. Eric Schniederman to sue the federal government – Double Taxation!
    - Due Process and 10th Amendment (you don't see that everyday!)
  - Enacts
    - Employer Compensation Expense Tax (ECET or payroll tax)
      - Employers (not the employees) could annually elect to pay a phased-in 5% tax on compensation paid to their employees
      - Purported to be deductible to the employer for federal income tax purposes (shifts to a "tax on the business")
      - Employees can deduct the amount of the wages subject to the ECET from their NY personal income
      - Ohhh … one more thing … The employer cannot reduce an employee's wages for the ECET it pays on behalf of the employee … hmmm, what employer is actually going to do this?
    - Government sponsored "charities"
      - State and municipal governments authorized to create "charities" (for healthcare and education)
      - Taxpayers make "contributions" to the "charities" for which they get a percentage credit (93%) against their New York state personal income, or local property, tax liabilities
      - The contributions are purported to be fully deductible for federal income purposes
      - Just a thought … what will the IRS say about the charities' tax exempt status? The treatment of the "deductions"?

State Reactions to the State and Local Tax (SALT) Deduction Limitations – Payroll Tax

- New York State – Employee Compensation Expense Tax (ECET)
  - Under the program, an employer required to withhold income tax on wages and salaries paid to its employees may elect to participate in the payroll expense tax for employees receiving more than $40,000 annually in wages and compensation.
  - An election to participate is to be made each year by December 1 to take effect for wages paid beginning with the immediately following January 1.
  - An electing employer is subject to a tax on the wages paid to each of its covered employees in excess of $40,000 per year at a rate of 1.5 percent in 2019, 3.0 percent in 2020, and 5.0 percent in 2021 and forward.
  - A covered employee is allowed a credit against New York's personal income tax for a portion of the employer's payroll expense tax paid with respect to the wages of the employee.

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State Reactions to the SALT Deduction Limitations – Charitable Contributions

- New York State Charitable Contributions Provisions
  - The contribution is intended to be deductible for federal income tax purposes, in addition to qualifying for a state income tax credit.
  - Creates the “charitable gifts trust fund” with two accounts: a “health charitable account” and an “elementary and secondary charitable account.”
  - For tax years beginning on or after January 1, 2019, an individual income taxpayer is allowed a credit against income tax for 85 percent of the total contributed in the immediately preceding tax year to the two accounts

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State Reactions to the SALT Deduction Limitations – Pass-Through Entity Taxes

- Connecticut Senate Bill 11
  - Designed to preserve SALT deduction for Connecticut residents on certain non-wage revenue
  - Entity level tax on partnerships and S-corporations doing business in Connecticut
  - Proposed tax rate: 6.99%
  - Proposed credit: 93.01%
  - Alternative tax base designed to exempt income attributable to C corporations and to tax income attributable to Connecticut residents on 100% of income

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State Reactions to the SALT Deduction Limitations – Pass-Through Entity Taxes

- Proposed New York State Unincorporated Business Tax – new Article 24-A
  - Designed to preserve SALT deduction for New York State residents on certain non-wage revenue
  - New law would impose a new business tax on partnerships doing business in New York while creating a corresponding tax credit for individual and corporate partners of those partnerships (and partnerships holding lower-tier partnership interests)
    - Proposed apportionment: Three factor
    - Proposed tax rate: 5%
    - Proposed credit: 93%

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State and local tax deduction: So? What does the federal government think?

- IRS ruling on prepaid property tax (IR-2017-210, Dec. 27, 2017)
  - Not deductible in 2017 unless assessed
  - Secretary Mnuchin calls state proposals "ridiculous"
  - Acting IRS Commissioner Dave Kautter says they won't work
- Treasury and IRS Notice 2018-54 (May 23, 2018)
  - Proposed regulations will be issued addressing the deductibility of state and local tax payments for federal income tax purposes
  - Federal law controls the characterization of the payments for federal income tax purposes regardless of the characterization of the payments under state law
    - Substance over form … harks back to *Gregory v. Helvering*!
- How do these state law changes affect the federal tax treatment of the "old" existing state tax credits that function like the "new" workarounds?

Questions

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