The State Tax and Budget Implications of Federal Tax Reform

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Karl Frieden, VP & General Counsel, Council On State Taxation
The Drivers of Comprehensive Federal Tax Reform
Improve the International Competitiveness of the U.S. Income Tax System
Increase U.S. Reliance on Consumption Tax-Like Principles. Share of Consumption Taxes: 33% OECD vs. 17% US
Accelerate U.S. Growth

Annualized growth in real GDP

The Major Constraint: Long-term Federal Budget Outlook

![Graph showing Total Revenues and Outlays as a percentage of Gross Domestic Product from 1966 to 2026.](Graph.png)

Source: Congressional Budget Office.
State Tax and Budget Implications of Federal Tax Reform
Three Federal Tax Reform Concepts in One

- **Business and personal income tax rate cuts and base broadening**
  - A potential cap on the PIT rate for flow through entities.
  - The possible curtailment/elimination of the state and local tax deduction

- **Territorial taxation and “deemed” repatriation**

- **Transformative proposals:**
  - Full expensing, business interest expense, border adjustments (off the table)
## Federal Tax Reform: Impact on the States Based on Current IRC Linkage

<table>
<thead>
<tr>
<th>Federal</th>
<th>States</th>
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</thead>
<tbody>
<tr>
<td>Reduce the top corporate income tax (CIT) rate</td>
<td>States have own rates</td>
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<tr>
<td>Broaden the CIT tax base</td>
<td>State conformity</td>
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<tr>
<td>Border adjustability</td>
<td>State conformity (But no longer included)</td>
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<tr>
<td>Denial of interest deduction</td>
<td>State conformity</td>
</tr>
<tr>
<td>Expensing investments</td>
<td>State conformity</td>
</tr>
<tr>
<td>Reduced repatriation rate</td>
<td>Modest impact</td>
</tr>
<tr>
<td>Territorial tax regime</td>
<td>Minimal conformity</td>
</tr>
<tr>
<td>Reduce flow-through rate</td>
<td>States have own rates</td>
</tr>
<tr>
<td>Other personal income tax changes</td>
<td>States have own rates, but generally conform to base broadening</td>
</tr>
</tbody>
</table>
Key Issues to Watch For in the Federal Tax Reform Debate

- Will any significant tax reform be enacted?
- Reconciliation process or bi-partisan bill?
- How far will rates be lowered?
  - What are the pay-fors?
  - Fate of the state and local tax deduction?
  - Revenue neutral or deficit financed?
- Relative effective tax rate for C Corporations and flow-through businesses?
- State Conformity (or non-conformity) to key provisions.
- Revenue windfalls or future state fiscal pressures?