Conformity to International Provisions of the TCJA in Maine

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This presentation represents the views of the author only and not necessarily the views of Maine Revenue Services or the State of Maine.
Maine Corporate Income Tax

• Water’s Edge Income
• Combined reporting
• Pre-TCJA: 50% dividend received deduction (DRD) for dividends from an affiliated corporation that is not part of the Maine combined report
  – Subpart F income is taxable and eligible for DRD
• Dividends in taxable income also added to the denominator of the sales factor (Maine uses single sales factor apportionment)
• Financial institutions pay franchise tax and insurance companies pay premiums tax rather than income tax
I. Deemed Repatriation

• Without conformity, deemed repatriation not included in Maine taxable income

• Final conformity bill (passed 9/2018)
  – Add back participation exemption (C-corp)
  – 80% deduction for deemed repatriation included in Maine taxable income for C-Corps
Deemed Repatriation Estimate

• Starting point is list of public corporations and their estimated amount of deemed repatriation, covers $2.6 trillion of deemed repatriation*
• Match list to Maine 1120s, recalculate liability with 20% inclusion
  – Two changes: Income increases and sales factor falls
• Technical Considerations
  – Sometimes sales factor is missing when return has negative income, find sales factor for earlier return
  – Matching on names can be challenging
    • Corporation files under name of an affiliate, must look at Schedule CR (combined report)

Deemed Repatriation Estimate (Cont.)

• Account for deemed repatriation not covered by list
  – Cautious about how much to increase revenue estimate for this group
    • Maine possibly underrepresented in residual
    • Don’t have solid estimate of full deemed repatriation

• Timing
  – Little better than guesswork
  – A small number of corporations have tax credit carryforwards that will delay the impact on their liability
  – A large number of corporations routinely overpay and don’t claim refunds, possibly delaying the cash flow impact

• Main Risks
  – Concerns about alternative apportionment
  – Estimate for taxpayers not on C-corp list

• The estimate
  – About $30 million total, $23 million in FY 19
II. FDI deduction, GILTI inclusion, 100% DRD

– Challenges
  1) Baseline and interactions
  2) Limited data
  3) Interpreting the JCT estimates
Challenge #1: Baseline and Interactions

– 100% DRD: Baseline Issues

• Revenue forecast assumes current level of activity, very little revenue from foreign affiliate dividends

• Federal changes: could be significant increase in dividends due to 100% DRD; on the other hand, what’s a taxable dividend and what’s previously-taxed income (PTI) has changed due to deemed repatriation and GILTI

• Nonconformity: Major differences between what’s dividend vs PTI for federal and state purposes

• Stacking: Is estimate before or after conforming to deemed repatriation and GILTI inclusion?
Challenge #2: Limited Data

• Do not have the data required for a sophisticated estimate
• Time constraints
• Challenges understanding the small amount of data we have
  – Potential misreporting on the line for 50% dividends received (i.e. claiming a 100% dividends received deduction for dividends that cannot constitutionally be taxed by the state)
• Limited data → Rely on JCT estimate
Challenge #3: Interpreting JCT Estimate

– Dangers of “scaling down” JCT estimate (beyond question of scalar)
  • JCT estimate includes behavior
  • The behavior would occur regardless of Maine’s conformity decision and should be included in a revenue forecast, not a fiscal note
  • Would like to purge JCT estimate of behavior and scale down only direct cost of the deduction/direct revenue increase from GILTI
    – JCT estimate = Revenue(\(y_1 - \text{deduction}\)) - Revenue(\(y_0\))
    – Want to scale down: Revenue(\(y_1 - \text{deduction}\)) - Revenue(\(y_1\))
  • Behavior likely very important
    – JCT stacks 100% DRD first in the international section
      » Base erosion concerns
    – Many of the tax provisions after the DRD are intended to reduce income shifting
Interpreting JCT Estimate (Cont.)

– Example: FDII deduction

• Possible response to FDII/GILTI regime: Foreign affiliates sells intangible assets to U.S. parent, resulting in increase in Subpart F income for the U.S. corporation

• FDII deduction estimate in TCJA revenue estimates: Initial increase in revenue!
  – FY 18-21: Raises $18.1 billion
  – FY 22-27: Loses $81.8 billion

• FDII tax expenditure
  – FY 18-21: Tax expenditure totals $67.3 billion

• Can’t naively multiply JCT estimate by tax rate and income ratios
  – Conforming to FDII deduction is a tax cut
Conformity Bill

• Conformity Bill
  – Maine conforms to FDII deduction and 100% DRD
  – Maine conforms to GILTI inclusion but not the deduction and instead allows a 50% deduction for GILTI (just like Subpart F)
Conformity Bill Estimate

• 100% DRD based on Maine’s history with 50% DRD
  • Baseline did not recognize potential increase in dividends
  • Large share of payments from foreign affiliates to U.S. parent, especially in early years, would be PTI after conforming to repatriation and GILTI
  • The cost of 100% DRD likely increases in out years

• FDII and GILTI estimates based on educated guesses, JCT scores
Lessons learned along the way

• Collaborate with attorneys and auditors
  – Practices that are not written down
  – Learn about disputes related to foreign affiliate dividends
  – Verify understanding of how the law works

• When using historical corporate tax data, if a small number of corporations have outsized influence, try to understand their returns and be especially careful to interpret their data correctly