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Multistate Tax
EXTERNAL ALERT

Multistate Impact of the Tax Increase Prevention Act of 2014

December 22, 2014

Overview

On December 19, 2014, President Obama signed into law the Tax Increase Prevention Act of 2014 ("the Act"),[1] which includes a one-year retroactive extension of many of the temporary tax deductions, credits and incentives that had expired effective December 31, 2013. Among the dozens of provisions that are now renewed retroactively through the end of 2014 under the Act are the following:

- Credit for certain research and experimentation expenses
- 50 percent bonus depreciation provisions for qualified property and the election to accelerate some alternative minimum tax credits in lieu of bonus depreciation
- Active financing income exception and the controlled foreign corporation look-through
- Increased expensing limits for Internal Revenue Code ("IRC") Sec. 179 property and the expanded definition of Sec. 179 property
- 15-year straight-line cost recovery provision that applies to certain leasehold, restaurant, and retail improvements and restaurant buildings
- Reduced holding period for the S-corporation built-in gains tax
- Capital gain exclusion on qualified small business stock

These federal law changes may have a significant effect on state corporate income taxes, depending on each state's adoption of the IRC and each state's decoupling provisions. In general, states with automatic or "rolling" IRC conformity would adopt the provisions of the Act, unless specific state legislative action is taken to decouple from some or all of the federal law changes. Some states effectively adopt the IRC by referencing federal taxable income as the state income starting point. Although these states do not specifically adopt the IRC in whole or in part, they would generally be viewed as following provisions of the Act that affect federal taxable income. Other states adopt the IRC as of a specific date, do not adopt the IRC provisions in totality, and/or provide for delineated modifications, variations or exceptions to certain adopted IRC provisions. For these states, further analysis is needed to determine the extent to which certain provisions of the Act are followed (*i.e.,* does the state adopt the IRC as of December 19, 2014, or include the specific provisions in the state's code?), bearing in mind that many states do not make such conformity updates or decoupling determinations until the tax filing season begins.

In this Tax Alert we provide examples of the effect of certain provisions of the Act on state corporate income taxation.

State Analysis of the Federal Law Changes – Some Examples

Research and experimentation credit – The Act retroactively extends through the end of 2014 the modified credit under IRC Sec. 41 for certain research and experimentation expenses. States with rolling or automatic conformity and that do not have other specific provisions addressing the research credit will continue to follow the provisions of the Act relating to this credit. States with specific date conformity will continue to follow the federal rule in effect on that date (*i.e.*, if the conformity date is before December 19, 2014, the new federal provisions may not apply to the state). Finally, states that refer to the rules of IRC Sec. 41 without regard to a specific date will automatically incorporate the changes in the rule and/or may have their own state modifications that may not be impacted.

Bonus depreciation – The Act extends 50 percent bonus depreciation for certain qualified property through the end of 2014. The provision applies to certain qualified property placed in service before January 1, 2015. A handful of states that have rolling conformity and that incorporate bonus depreciation without modification will likewise follow this change. States with a specific date of conformity will continue to follow the IRC rules as of that date and

[1] H.R. 5771, 113th Cong. (Dec. 19, 2014) (enacted).

therefore may or may not include bonus depreciation. Many states never conformed to bonus depreciation and will continue to follow their own modification provisions and not be affected by this provision of the Act absent additional state legislation.

AMT credit in lieu of bonus depreciation – The Act provides for another temporary election to accelerate some alternative minimum tax ("AMT") credits in lieu of bonus depreciation for property placed in service in 2014. This election allows corporations to effectively "monetize" a portion of their AMT credits in lieu of claiming bonus depreciation. In general, states with rolling conformity will follow this change. States with specific date conformity will continue to follow the IRC rules as of that date and therefore may not follow this change. Finally, some states may not conform to the federal AMT provisions or have state modifications to such provisions and thus would not be impacted.

Active financing income exception and controlled foreign corporation ("CFC") look-through – The federal exception in Subpart F allowing deferral of the active financing income of a CFC engaged predominantly in banking, financing, or similar business activity expired at the end of 2013. The Act retroactively extends the exception through the end of 2014. Similarly, the Internal Revenue Service rules for look-through treatment for payments between related CFCs expired in 2013. The Act retroactively extends that treatment through 2014. States that start with federal taxable income would automatically follow the federal impact. However, there will be little or no impact to states that require an adjustment or do not follow the federal provisions for Subpart F income. Finally, a few states, such as California,[2] generally have distinct rules that might require a separate calculation altogether.

Considerations / ASC 740 Treatment

The numerous federal tax law changes contained within the Act may impact state corporate income tax computations depending on each state's adoption of the IRC and/or each state's decoupling provisions, and the timing attributed to such treatment. Pursuant to ASC 740 (formerly known as "Statement 109, *Accounting for Income Taxes*" or "FAS 109"), companies are required to account for the effect of a change in income tax law in the period that includes the enactment date of that law change. In this respect, companies may wish to consult with applicable advisors for state tax guidance regarding the ASC 740 impact of these law changes.

Contacts

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[2] *See* Cal. Rev. & Tax. Code §§ 24402, 24411, and 25116.