Multistate impact of federal PATH act's "business extenders" provisions

Overview

On December 18, 2015, President Obama signed into law the federal Protecting Americans from Tax Hikes Act of 2015, a component of H.R. 2029 (PATH),[1] which makes permanent several lapsed business incentives, including the research credit and the subpart F exception for active financing income, as well as renews a handful of provisions—such as bonus depreciation—for five years. Other provisions are extended through 2016. In some cases, provisions are extended with modifications, while certain others are extended subject to a phaseout. Among the dozens of provisions that are now made permanent or extended retroactive to the end of 2014 and/or modified prospectively under PATH 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 application of the controlled foreign corporation look-through rule (the later of which is extended five years)
- Increased expensing limits for Internal Revenue Code (IRC) § 179 property and the expanded definition of § 179 property
- 15-year straight-line cost recovery provision that applies to certain leasehold, restaurant, and retail improvements, as well as 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 PATH 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 PATH 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 PATH are followed (i.e., does the state adopt the IRC as of December 18, 2015, 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.

For example, the following table outlines how California, Florida, Illinois, New York, and Texas conform to the IRC generally.

State	IRC general conformity
California	Conforms to the IRC as of January 1, 2015,[2] with certain modifications and exceptions.
Florida	Presently conforms to the IRC as of January 1, 2015,[3] with certain modifications and exceptions. Each year, the Florida legislature must consider adoption of the current IRC and could conceivably pass legislation this year to retroactively adopt the IRC as of December 18, 2015, or later.

[1] Protecting Americans from Tax Hikes Act of 2015; P.L. 114-113; 2015 Enacted H.R. 2029. See Deloitte Tax LLP's *Tax News & Views* (Dec. 18, 2015) for more details on this federal legislation, located here.
[2] Cal. Rev. & Tax code § 23051.5(a)(1) & §17024.5(a). Pursuant to Laws 2015, ch. 349, 2015-2016 Regular Session (A.B. 154), the January 1, 2015 conformity date applies to taxable years beginning on or after January 1, 2015. Prior to this bill, California conformed to the IRC as of January 1, 2009, for taxable years beginning on or after January 1, 2010. See our previously issued Multistate Tax Alert, "California updates federal tax conformity to January 1, 2015," dated October 5, 2015, for more details on this 2015 law change, located here.
[3] Fla. Stat. ch. 220.03(1)(n) & (3).

State	IRC general conformity
Illinois	Provides for rolling conformity to the IRC, with certain modifications and exceptions.[4]
New York	Effectively provides for rolling conformity to the IRC through reference to federal taxable income (before the special dividends received deduction and net operating loss deduction) as the state income starting point,[5] with certain modifications and exceptions.
Texas	Conforms to the IRC as of January 1, 2007,[6] with modifications for the "margin" tax.

This Tax Alert provides examples of the effect of certain provisions of PATH on state corporate income taxation in general.

State analysis of the federal law changes—some examples

Research and experimentation credit

PATH retroactively makes permanent the modified credit under IRC § 41 for certain research and experimentation expenses. For taxable years beginning after 2015, the credit is modified to allow an eligible small business (as defined in IRC § 38(c)(5)(C)) to claim the credit against both its regular tax and alternative minimum tax (AMT) liabilities. Beginning in 2016, certain small businesses also may claim the credit against the employer portion of their payroll tax liability, rather than against their income tax liability.

States with rolling or automatic conformity and that do not have other specific provisions addressing the research credit may potentially continue to follow the provisions of PATH 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 18, 2015, the new federal provisions may not apply to the state). Finally, states that refer to the rules of IRC § 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

PATH retroactively extends 50 percent bonus depreciation for certain qualified property placed in service over the next five years (i.e., through 2019), subject to a phaseout schedule: 50 percent bonus depreciation continues for 2015, 2016, and 2017, with the percentage falling to 40 percent in 2018, and 30 percent in 2019. After 2015, PATH also allows bonus depreciation to be claimed on qualified improvement property regardless of whether the property is subject to a lease, and removes the requirement that an improvement be placed in service more than three years after the building was placed in service.

A handful of states that have rolling conformity and that incorporate bonus depreciation without modification may likewise follow these changes. States with a specific date of conformity will continue to follow the IRC rules as of that date and therefore may or may not include bonus depreciation. Many states never conformed to bonus depreciation; these states will continue to follow their own modification provisions and not be affected by this provision of PATH absent additional state legislation.

Alternative minimum tax credit in lieu of bonus depreciation

PATH retroactively extends through 2019 the election to accelerate some AMT credits in lieu of bonus depreciation and, beginning in 2016, increases the amount of unused AMT credits that may be claimed in lieu of bonus depreciation. 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 look-through

The federal exception in subpart F allowing deferral of the active financing income of a controlled foreign corporation (CFC) engaged predominantly in banking, financing, or similar business activity expired at the end of 2014. PATH retroactively makes permanent, without modification, the exception from subpart F for certain foreign income derived in the active conduct of a banking, financing, securities, or insurance business. Similarly, the Internal Revenue Service rules for look-through treatment for payments between related CFCs expired in 2014.

[4] 35 ILCS 5/203.
[5] N.Y. Tax Law §208.9; 208.9(b)(2); 208.9(b)(6).
[6] Tex. Tax Code Ann. §171.0001(9).

PATH retroactively extends through 2019, without modification, the application of the look-through rule which excludes from subpart F certain payments of interest, dividends, rents, and royalties between related CFCs under the foreign personal holding company rules.

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[7]—generally have distinct rules that might require a separate calculation altogether.

Considerations and ASC 740 treatment

The numerous federal tax law changes contained within PATH 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, 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 advisers for state tax guidance regarding the ASC 740 impact of these law changes.

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[7] *See* Cal. Rev. & Tax. Code § 25116.