

Proposed IRC section 250 Regulations – Impact on State Returns

The IRS and Treasury released proposed regulations¹ under IRC section 250 (Section 250) on March 4, 2019. These regulations provide guidance for the calculation of the deductions for Foreign Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI). These proposed regulations provide meaningful guidance for calculating the Section 250 deductions for FDII and GILTI. These deductions work in concert to a certain degree, but also may apply separately. This alert highlights some key federal-state differences that taxpayers may want to consider when computing these deductions.

Corporate State Issues Raised by Section 250 Proposed Regulations

The proposed regulations raise several state tax issues regarding GILTI and FDII, including:

- States may require separate company GILTI and FDII calculations: States that do not follow the federal consolidated return regulations (e.g., separate filing states and certain combined filing states) may not follow the requirements in the Proposed Regulations to perform portions of the GILTI and FDII calculations on a consolidated group basis.
- A FDII deduction may be available for state income tax purposes even if no federal deduction is available: A taxpayer may have no federal Section 250 FDII deduction if they are in a consolidated loss position. In states that require a separate company calculation, there may be a FDII deduction if that particular corporation has both qualified FDII and taxable income as a separate company.
- State Section 250 GILTI deduction calculation may be different from the federal due to section 78 gross-up: The Section 250 deduction is taken with respect to the GILTI inclusion, plus IRC section 78 gross-up, for which almost every state allows a subtraction. If the section 78 gross-up amount is not backed out of the federal deduction amount, it could result in a 150% deduction of the IRC section 78 gross-up amount, which at least one state, New York, has specifically disallowed.
- Taxable income limitation: Section 250(a)(2) provides that if, for any tax year, the taxpayer's FDII and GILTI deductions exceed the taxpayer's taxable income, then the FDII and GILTI deductions will be reduced pro-rata by the amount of such excess. The proposed regulations provide detailed ordering rules for taxpayers to apply these inter-related deductions, along with IRC sections 163(j) and 172. See Prop. Treas. Reg. § 1.250(a)-1(f). Many states do not conform to the federal provisions for IRC sections 163(j) and 172. Accordingly, state-specific application of these ordering rules may be required.
- If the Section 250 deduction is limited, further analysis may be required in states that decouple from only one part of the deduction: Some states only conform to one piece of the section 250 deduction. Georgia, for example, generally conforms to the FDII but not the GILTI deduction, while New York State conforms to the GILTI but not the FDII deduction. Accordingly, if the FDII deduction was reduced proportionally due to an income limitation, it may potentially be recalculated in a state such as Georgia as if the GILTI deduction did not exist, or vice versa in a state like New York.
- FDII/Appportionment sourcing differences: The FDII deduction is based on federal definitions of foreign sales of property and services (e.g., the taxpayer must establish that property sold is for a "foreign use"). The proposed regulations provide extensive documentation requirements

¹ REG. 104464-18.
01

External Multistate Tax Alert

for establishing the required foreign use of the property and/or services by the taxpayer. The foreign source determinations for the FDII deduction are a self-contained rule-set. Accordingly, while a particular taxpayer's apportionment workpapers may indicate that the taxpayer makes foreign sales – that determination is not adequate for calculating the FDII deduction as the rules are not based on state sourcing rules. A separate sourcing analysis under the proposed regulations methodology may be required for taxpayers seeking to claim the FDII deduction.

As detailed above, the proposed regulations contain numerous areas that may create federal-state differences regarding the FDII and GILTI deductions. Affected taxpayers can expect states to require state-specific calculations for most state income tax returns for FDII and GILTI. Further, it should not be assumed that states will accept federal consolidated group allocations of FDII and GILTI deductions to specific group members. Any taxpayer considering reliance solely on federal consolidated group allocations of GILTI and FDII for state income tax purposes should consider state-specific guidance regarding the GILTI calculation and the FDII deduction as well as general state provisions for accuracy-related penalties and state requirements for taxpayer disclosures of positions taken on tax returns.

Final Points

IRC sections 250 and 951A, as well as the proposed regulations thereunder, are complex and nuanced. While this alert highlights certain state corporate income considerations related to the Section 250 proposed regulations, it is not an all-inclusive list. As a further complexity, states may also continue to provide additional guidance regarding IRC sections 951A and 250, whether through new legislation or administrative guidance, as state treatment of the GILTI and FDII deductions is anticipated to be a priority for many state legislatures and taxing agencies in 2019.

Contacts:

If you have any questions regarding the state considerations of the IRC section 250 proposed regulations, please contact any of the following Deloitte professionals:

Valerie Dickerson

Tax Partner

Deloitte Tax LLP, Washington DC
+1 202-220-2693
vdickerson@deloitte.com

David M. Vistica

Tax Managing Director

Deloitte Tax LLP, Washington DC
+1 202-340-5093
dvistica@deloitte.com

Scott Schiefelbein

Tax Managing Director

Deloitte Tax LLP
Portland, OR
sschiefelbein@deloitte.com
+1 503 727 5382

Ken Jewell

Tax Managing Director

Deloitte Tax LLP
Parsippany, NJ
kjewell@deloitte.com
+1 973 602 4309

Alexis Morrison-Howe

Senior Manager

Deloitte Tax LLP
Boston
alhowe@deloitte.com
+1 617 437 2345

External Multistate Tax Alert

For further information, visit our website at www.deloitte.com/us/multistatetax

Follow [@DeloitteTax](https://twitter.com/DeloitteTax)

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

As used in this document, "Deloitte" means Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2019 Deloitte Development LLC. All rights reserved.