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Reshaping the Code: Understanding the new tax reform law

The impact of tax reform (H.R. 1)

On 22 December 2017, the president signed a bill into law that provides for comprehensive US tax reform. The law reduces the general corporate tax rate to a flat 21% (instead of 20% as originally proposed) effective in 2018, eliminating the brackets that have a maximum tax rate of 35%, and repeals the corporate alternative minimum tax. The law also lowers tax rates on pass-through entities, individuals and estates, and moves the US toward a participation exemption-style system for taxing foreign-source income of domestic multinational corporations, with some of the cost of the tax relief offset by provisions that scale back or eliminate many longstanding deductions, credits, and incentives for businesses and individuals. For a detailed discussion of the new law, see Deloitte Tax LLP's report *Reshaping the code: Understanding the new tax reform law* and learn more about:
URL: https://www2.deloitte.com/us/en/pages/tax/articles/understanding-the-tax-reform-law.html?id=us:2em:3na:usic:awa:tax:021918

- Corporate tax provisions
- Impact on pass-through entities
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Tax reform hands passthrough entities some parity, with caveats

The recently signed tax reform legislation introduces new rules aimed at providing greater parity between the tax rates applicable to owners of passthrough entities and corporations by providing a 20% deduction for qualified business income. Taking the 20% deduction could result in an effective top tax rate of approximately 29.6% of the taxpayer's combined qualified business income for those taxpayers in the highest rate bracket of 37%.

The definition of qualified business income is limited to items effectively connected with the conduct of a US trade or business, but does not generally include income that is investment in nature, such as short and long-term capital gains and losses, dividends and nonbusiness interest. In addition, there is a limitation on the ability to take the deduction above certain thresholds, which limitation is generally tied to either wages paid by the business or the basis of tangible assets used in the business. "When crafting the bill, Congress seemed to reflect the President's desire to bring more jobs to the US, which may account for the provision's wage limitation and the fact that income earned outside of the US does not benefit from the deduction," notes Erich Hahn, co-managing principal, Passthrough Group, Deloitte Tax LLP.

In addition, aside from a carve-out for engineering and architecture, income earned from traditional "services" businesses such as doctors, lawyers and accountants making over $207,500 (single) and $415,000 (married filing jointly) will not benefit from the passthrough deduction.

Jim Calzaretta, partner, Passthrough Group, Deloitte Tax LLP, noted that while the specifics of the passthrough deduction were unclear for a while, many of us never believed these type of "services" businesses would qualify. However, the manner in which the law addresses these disqualifying businesses creates additional ambiguity, something that hopefully will be addressed in regulation."

The computation of the deduction and the limitations are done business by business: "Because the computation of the deduction and the limitations are done on a business by business basis, regardless of whether the businesses are held in one or multiple entities, it will be important for taxpayers to take a close look at their businesses to determine the benefit and to determine if restructuring would be beneficial for business purposes," says Jennifer Alexander, co-managing principal, Passthrough Group, Deloitte Tax LLP.

Taxpayers performing analyses on their passthrough structures in light of the new bill should understand how the passthrough deduction affects state taxes.

The advantage or disadvantage of any passthrough structure could depend in which state the business is operating, and in the case of individuals, where the owners live and have residences," notes Wolfe Tone, partner, Deloitte Tax LLP, and national tax leader of Deloitte Growth Enterprise Services. The passthrough deduction is a deduction against adjusted gross income to get to taxable income. Thus, if a state income tax starts with federal adjusted gross income, that state would need to pass its own law to allow the taxpayer from benefitting from the passthrough deduction in that state. If the state income tax starts with federal taxable income, that state might decouple from the federal deduction.

Other passthrough considerations

Following is a summary of other more notable elements of the tax reform legislation that pertain to passthrough entities.

Accuracy-related penalty: The tax reform legislation imposes an accuracy-related penalty on taxpayers with substantial understatements of tax, the threshold for which is reduced if the passthrough deduction is taken.

Business interest expense limitations: Prior to tax reform, subject to certain limitations, business interest was generally deductible. The new law replaces the existing section 163(j) with a rule that applies to every business – regardless of its form – and disallows the deduction for business interest expense in excess of the sum of (i) business interest income, (ii) 30% of the taxpayer's "adjusted taxable income," and (iii) interest from certain floor plan financing arrangements. Of note to passthrough owners, the 30% limitation is applied at the partnership (or S corporation level), which may produce incongruous results for economically similar situations.

"There is a lot to consider with respect to new section 163(j)," notes Ms. Alexander. "Because the limitation is determined at the partnership level, posing limitations not otherwise applicable at the partner level, taxpayers should model the various placements of leverage. Consideration should also be given to the use of other, more secure, equity arrangements, in lieu of debt, to reduce the impact of section 163(j). Finally, do not lose sight of the fact that section 163(j) also applies to internal, related-party debt. Thus, taxpayers should consider the impact of related-party debt and partner debt," Ms. Alexander observes.

Recharacterization of certain gains in the case of partnership profits interests held in connection with performance of investment services: The provision calculates long-term capital gains as if a three-year (not one-year) holding period applies with respect to a partnership profits interests held in connection with performance of investment services. The new law treats any amount not satisfying the three-year holding period requirement as short-term capital gains, which are taxed at ordinary income rates.

Tax gain on the sale of a partnership interest on lookthrough basis: Under the new legislation, a gain or loss from the sale or exchange of a partnership interest may be treated as effectively connected with a US trade or business. The amount treated as effectively connected income (ECI) is calculated by reference to the amount of the ECI that would be allocated to the transferor if the partnership sold all of its assets at fair market value as of the date of the sale or exchange. Withholding now may also be required.

Repeal of technical termination of partnerships: Under the provision, the rule regarding technical terminations would be repealed. Thus, a partnership would be treated as continuing even if 50% or more of the total capital and profits interests of the partnership are sold or exchanged within a 12-month period. "Although the repeal of technical terminations eliminates some foot-faults and complexity, it takes away the ability to make new elections upon a change in control of the partnership," says Ms. Alexander.

Modification of the definition of substantial built-in loss in the case of transfer of partnership interest: Section 743 aims to ensure inside-outside basis parity upon a transfer of a partnership interest. In general, a section 743 adjustment is elective, but in the case of certain negative adjustments it's mandatory if the partnership has a substantial built-in loss in its assets. Under the new law, a substantial built-in loss also exists if the transferee would be allocated a net loss in excess of $250,000 upon a hypothetical disposition of all partnership assets. "Effectively, the modification closes a gap and ensures that basis adjustments will be made when the net loss allocated to the transferee exceeds $250, 000," says Mr. Hahn.

Charitable contributions and foreign taxes taken into account in determining limitation on allowance of a partner's share of loss: Currently, charitable deductions (to the extent of the partnership's basis in the contributed asset) and foreign tax expense decrease a partner's basis in the partner's partnership interest, but these amounts may be taken in excess of a partner's basis in its partnership interest. The legislation now limits a partner's ability to deduct the partner's distributive share of partnership charitable contributions (to the extent of the partnership's basis in the contributed asset) and foreign tax to the partner's basis in its partnership interest. Any amount disallowed is carried forward until the partner has basis.

Loss limitation rules applicable to individuals: The law expands the limitation on excess farm losses to apply to excess business losses of a taxpayer. Under the provision, excess business losses of a taxpayer other than a C corporation are not allowed for the taxable year. Such losses are carried forward and treated as part of the taxpayer's net operating loss (NOL) carryforward in subsequent taxable years. NOL carryovers are allowed for a taxable year up to the lesser of the carryover amount or 80% of taxable income determined without regard to the deduction for NOLs.

Special subchapter S provisions

For subchapter S corporations, the tax reform legislation includes provisions related to electing small business trusts (ESBTs), special rules for conversions to C corporation status, and an election for S corporation shareholders to defer the recognition of accumulated foreign income.

ESBTs: The law expands the qualifying beneficiaries of an electing small business trust to include nonresident aliens. It also amends the ESBT charitable deduction rules to provide that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts but rather by the rules applicable to individuals.

Special rules on conversion of S corporations to C corporations: Under the provision, any section 481(a) adjustment of an eligible terminated S corporation attributable to the revocation of its S corporation election, such as a change from the cash method to an accrual method, is taken into account ratably during the six-taxable-year period beginning with the year of change.

Deferral election allowed for S corporation shareholders for recognition of accumulated foreign income: A special rule permits deferral of the transition net tax liability for shareholders of a US shareholder that is an S corporation until there is a triggering event, which includes the termination of the S corporation status, liquidation and sale. The S corporation is required to report on its income tax return the amount includible in gross income and provide a copy of this information to its shareholders.

In summary, there is a lot of new information to consider for passthrough entities with regard to the new legislation, according to Mr. Calzaretta. “Board members, owners, as well as executives, may want to consider assessing whether their organizations are structured correctly to increase their after-tax profitability. This is not only about tax but also includes business considerations. Modeling will be critical in this analysis,” he notes.

Regardless of what provisions taxpayers with passthrough entities will focus on in the coming year, many consider the rate reduction the key element of the tax reform bill. In a recent Deloitte poll of 5,143 participants, 42% of respondents called the tax rate deduction the most important outcome of tax reform. “However, the potential tax scenario for passthrough entities depends on the operations of the organization, the make-up of its ownership and where it does business,” observes Mr. Tone.

OECD updates Model Tax Convention

The Organization for Economic Co-operation and Development (OECD) on December 18 released a revised version of its model income tax convention (the 2017 OECD Model). The 2017 OECD Model provides the basis for negotiation and application of bilateral tax treaties between countries to prevent tax evasion and avoidance. Though not binding on any country, the 2017 OECD Model provides a means for settling common problems that arise in the field of international double taxation when bilateral tax treaties are negotiated.

The 2017 OECD Model primarily reflects a consolidation of the treaty-related measures resulting from the work on the base erosion and profit shifting (BEPS) project under action 2 (Neutralizing the Effects of Hybrid Mismatch Arrangements), action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status), and action 14 (Making Dispute Resolution More Effective).

Of particular note to transfer pricing practitioners are changes to the commentaries to Article 7 (Business Profits), the commentaries to Article 9 (Associated Enterprises), and both the text and commentaries to Article 25 (Mutual Agreement Procedure). A discussion of those changes is provided below.

Summary of changes to Articles 7 (Business Profits), 9 (Associated Enterprises), and 25 (Mutual Agreement Procedure)

The language and overall approach to each article generally has remained the same. The text of Articles 7 and 9 has not been changed, but as noted above, the commentaries have been modified. The most important modifications address certain issues such as taxpayer-initiated adjustments and time limits during which an adjustment may be made. In addition, certain conforming changes take into account the work on the BEPS project.

Article 25 has been subject to the most revisions. The text of Article 25.1 has been broadened so that now an application for competent authority relief may be made to either country, not just the country of which the person is a resident or national (as applicable). The rules in Article 25.5 related to arbitration have also been modified, and the commentaries to Article 25 have been substantially revised. Many of the revisions to the commentaries merely reflect the changes made to Articles 25.1 and 25.5. Other revisions, however, reflect changes resulting from the work on the BEPS project and the changes made to other articles, such as Articles 7 and 9.

Changes to Article 7 (Business Profits)

The language and overall approach of Article 7 has remained the same as the prior version of the OECD Model from 2014 (2014 OECD Model). That approach is referred to as the "Authorized OECD Approach" (AOA). Under the AOA, when an enterprise of one country carries on business in the other country through a permanent establishment (PE), the profits attributable to the PE are those that the PE might be expected to make if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used, and risks assumed. Any transactions with associated enterprises attributed to the PE are priced in accordance with the OECD transfer pricing guidelines, and those guidelines are applied by analogy to dealings between the PE and the other parts of the enterprise.

Even though the text of Article 7 has remained the same, the commentaries have been updated to take into account changes made by the BEPS project. For example, conforming changes have been made to take into account the restriction in scope to Article 5.4(d), which deals with the exception for fixed places of business of PEs.

In addition, new language has been added to the commentaries to Article 7 discussing (i) taxpayer-initiated adjustments; and (ii) a limitation on the length of time during which an adjustment may be made (see new paragraph 59.1 and the new language in paragraph 62 of the Article 7 commentaries). As discussed below, the same changes have been made to the commentaries to Article 9 (modified as appropriate in the context of each article).

Changes to Article 9 (Associated Enterprises)

As with Article 7, the language of Article 9 has remained the same. Nevertheless, two changes have been made to the commentaries – one concerning taxpayer-initiated adjustments and another including additional language to the paragraph concerning the length of time during which an adjustment may be made. The details of those changes are as follows.

New paragraph 6.1 of the commentaries to Article 9 includes a discussion regarding taxpayer-initiated adjustments. The new paragraph affirms that competent authorities are able to eliminate double taxation in situations whereby a taxpayer makes an adjustment to amend a previously filed return. The commentaries explain that such adjustments, when made in good faith, may facilitate the reporting of taxable income by taxpayers in accordance with the arm's length principle. In those situations, the competent authorities may meet to determine whether the taxpayer-initiated adjustment meets the conditions of the arm's length standard and, if so, the appropriate adjustment that should be made in the other country. This change is consistent with the new language concerning taxpayer-initiated positions under the US rules for competent authority procedures (see section 2.01(2) of Rev. Proc. 2015-40, 2015-35 I.R.B. 236).

The second change involves new language added to paragraph 10 of the commentaries to Article 9 concerning the length of time during which an adjustment may be made. As with the 2014 OECD Model, the 2017 OECD Model leaves open the question whether there should be a period of time after the expiration of which one country would not be obliged to make an appropriate corresponding adjustment following an upward revision of profits by the other state. Nevertheless, new language in paragraph 10 recommends a provision that should be included by countries that consider an open-ended commitment to be unreasonable. If a country wishes to impose such a time limit, the 2017 OECD Model now recommends that the following paragraph be added after Article 9.2:

> 3. A Contracting State shall not include in the profits of an enterprise, and tax accordingly, profits that would have accrued to the enterprise but by reason of the conditions referred to in paragraph 1 have not so accrued, after [bilaterally agreed period] from the end of the taxable year in which the profits would have accrued to the enterprise. The provisions of this paragraph shall not apply in the case of fraud, gross negligence or willful default.

As discussed above, conforming changes have been made to the commentaries to Article 7 for this rule too.

Changes to Article 25 (Mutual Agreement Procedure)

Overall, Article 25 of the 2017 OECD Model maintains the same policies and procedures as the version of this article in the 2014 OECD Model. Nevertheless, as noted, the text of Article 25 of the 2017 OECD Model has been modified, as have the commentaries. The changes to the text of Article 25 generally expand on policies that were present in the 2014 OECD Model, as well as implement changes resulting from the work on the BEPS project. Similarly, the changes to the commentaries of Article 25 make conforming revisions based on changes to the text of Article 25, changes to the commentaries to other articles of the 2017 OECD Model, and on changes resulting from the other BEPS action items.

The first change to the text of Article 25 occurs in Article 25.1. It states that a person seeking competent authority relief may now present his or her case to the competent authority of either country. Under the 2014 OECD Model, the case had to be presented to the country of which the person was a resident (or, in the case of a nondiscrimination claim under Article 24.1, the country of which the person was a national). This change, as explained in new paragraph 17 of the Commentaries to Article 25, is intended to reinforce the general principle that access to the mutual agreement procedure should be as widely available as possible. In addition, this change is intended to ensure that the decision of whether a case should be discussed is open to consideration by both competent authorities.

The other changes to the text occur in Article 25.5, and they concern the rules relating to arbitration. Article 25.5 now specifies that the commencement date for arbitration should begin two years from the date when “all the information required by both competent authorities” has been presented to both competent authorities. In contrast, Article 25.5 of the 2014 OECD Model merely stated that the time frame would begin from the “presentation of the case” to the other competent authority. The new language provides a more precise way to determine the commencement date. In addition, Article 25.5 now specifies that a request for arbitration must be in writing.

Finally, the text of the 2017 OECD Model has deleted a footnote from Article 25.5 that was included in the 2014 OECD Model. That footnote discussed when it would be appropriate for a treaty to include an arbitration provision. As explained in new paragraph 65 of the commentaries to Article 25, the footnote was deleted in recognition of how important the OECD considers arbitration to be.

The commentaries on Article 25 have been revised as well. As discussed above, many of the changes are conforming revisions based on the changes to the text of Article 25. Other revisions conform the commentaries on Article 25 to changes that have been made to the commentaries on other articles.

For example, new language has been added regarding taxpayer-initiated adjustments, and this parallels the changes made to the commentaries on Articles 7 and 9. Other revisions represent changes resulting from the work on BEPS. As explained in new paragraph 75 of the commentaries to Article 25, for instance, the sample mutual agreement on arbitration has been revised to reflect a process that is similar to the one used in Part VI of the BEPS Multilateral Instrument.

— Philippe G. Penelle (Washington, DC)
Principal
Deloitte Tax LLP
ppenelle@deloitte.com

Dave Varley (Washington, DC)
Principal
Deloitte Tax LLP
dvarley@deloitte.com

United States Tax Reform Update: Qualified equity grants by private companies under newly added Section 83(i)

Overview

On December 22, 2017, the US tax reform legislation (formally referred to as "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018") (the "Act") passed, following successful reconciliation of the House and Senate versions of the bill. This publication provides a summary of the changes to treatment of qualified equity grants by certain private companies under newly created Section 83(i) of the Internal Revenue Code.

Section 83(i) qualified equity grants

Under existing tax rules, nonstatutory stock options (*i.e.*, options that are not incentive stock options or options granted under an employee stock purchase plan) granted at fair market value are generally not taxable until the exercise of the option if the service recipient receives fully vested stock. Additionally, restricted stock units (RSUs) that are exempt from, or comply with, the nonqualified deferred compensation rules under Section 409A are generally not taxable until delivery of fully vested stock.

Under the Act, and in addition to the existing tax rules described in the preceding paragraph, a "qualified employee" may elect to defer the income attributable to a stock option or RSU received in connection with the performance of services for up to five years if the corporation's stock is an "eligible corporation." Instead of including income at exercise of a stock option (assuming fully vested stock is received) or at delivery of fully vested stock as required under current law, if the qualified employee makes a timely "inclusion deferral election," then the employee will be subject to income tax at the earlier of the following dates:

- The date the qualified stock is transferrable;
- The date the employee becomes an "excluded employee";
- The date on which any stock of the employer becomes publicly traded;
- Five years after the employee's right to the stock is substantially vested; or
- The date the employee revokes the election.

A "qualified employee" is generally an individual who is not an excluded employee and who agrees, in the inclusion deferral election, to meet the requirements necessary to ensure the income tax withholding requirements with respect to the qualified stock are met. An "excluded employee" includes the following:

- An individual who becomes a 1 percent owner during the taxable year;
- A 1 percent owner of the corporation at any time during the 10 preceding calendar years;
- The current or former chief executive officer or chief financial officer of the corporation (or an individual acting in either capacity);
- A family member of an individual described above;
- One of the four highest-compensated officers of the corporation during the taxable year; or
- The four highest-compensated officers of the corporation for any of the 10 preceding taxable years.

A corporation is an "eligible corporation" with respect to a calendar year if no stock of the employer corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year. Additionally, the corporation must have a written plan under which, in the calendar year, not less than 80 percent of all employees who provide services to the corporation in the United States (or any US possession) are granted stock options or RSUs with the same rights and privileges to receive qualified stock (the "80- percent requirement"). This test must be met with respect to options only or RSUs only, not a combination of the two. Note that the amount granted to each employee need not be identical under the plan.

Under the Act, corporations that are members of the same controlled group are treated as one corporation.

An inclusion deferral election must be made no later than 30 days after the first date the employee's right to the stock is substantially vested or is transferable, whichever is earlier. An election is generally made in the same manner as a Section 83(b) election. An inclusion deferral election may be made on a statutory stock option (*i.e.*, incentive stock options or options granted under an employee stock purchase plan). If an election is made with respect to a statutory stock option, then the option is not subject to the statutory stock option rules.

With respect to the employer's deduction, if an employee makes an inclusion deferral election, the employer's deduction is also deferred until the employer's taxable year in which or with which ends the taxable year of the employee for which the amount is included in the employee's income. Also, the inclusion deferral election affects only the deferral of income tax and does not affect the timing of FICA (Federal Insurance Contributions Act) and FUTA (Federal Unemployment Tax Act).

The Act includes certain employee notice requirements. Specifically, a corporation that transfers qualified stock to a qualified employee must provide notice to the employee at, or a reasonable period of time prior to, the point qualified stock becomes substantially vested certifying that the stock is qualified stock. Additionally, the employee must be notified:

- That the employee may (if eligible) elect to defer income inclusion with respect to the stock;
- If the employee makes an inclusion deferral election, the income inclusion amount at the end of the deferral period will be based on the value of the stock at the time the employee's right to the stock first becomes substantially vested, notwithstanding whether the value of the stock has declined during the deferral period (including whether the value of the stock has declined below the employee's tax liability with respect to such stock); and
- That the amount of income to be included at the end of the deferral period will be subject to withholding.

Failure to provide the notice may result in the imposition of a penalty of $100 for each failure, subject to a maximum penalty of $50,000 for all failures during any calendar year.

The provision is generally applicable to options exercised, or restricted stock units granted, in 2018 and later taxable years.

The Act includes a transition rule providing that, until regulations or other guidance related to implementing the 80-percent and employer notice requirements is issued, a corporation will be treated as complying with those requirements if it complies with a reasonable good-faith interpretation of the requirements.

Additionally, the provisions related to coordination with Sections 83 and 409A are intended to be limited to the specific issues raised by coordination with Section 83(i).

Deloitte's view

Following the passing of the Act, the most important steps for employers to take immediately include:

- Private corporations with broad-based compensatory stock option or RSU programs should evaluate whether resulting shares are qualified stock for which notification requirement applies:
    - If so, confirm that payroll systems and brokerage accounts properly handle differences in income tax and FICA tax timing, and that proper notice is provided to recipients.
    - If not, determine what is necessary to fall within the qualified stock definition to confirm deferral opportunity for employees.

— Elizabeth Drigotas (Washington, DC)
Principal
Deloitte Tax LLP
edrigotas@deloitte.com

Multistate tax considerations of the federal tax reform international tax provisions

Overview

On December 22, 2017, President Trump signed legislation (P.L. 115-97) commonly referred to as "The 2017 Tax Reform Act" ("the Act"), which is the most comprehensive tax reform legislation passed in over thirty years.1 The Act lowers tax rates on individuals, C corporations, passthrough entities and estates. To offset these costs, a number of deductions, credits and incentives were reduced or eliminated.

The Act's corporate income tax provisions and new deduction for passthrough entities will have broad implications for businesses of all sizes, but many of the far-reaching provisions pertain to the United States ("US") taxation of foreign operations. Certain of these provisions, such as the deemed repatriation tax (commonly referred to as the transition tax), have immediate impacts which must be considered when filing 2017 tax returns. Accordingly, this tax alert highlights some of the most prominent international tax changes created by the Act and the associated multistate tax considerations.

Transition tax / deemed repatriation

The transition tax requires a US shareholder owning at least 10 percent of the vote of a foreign subsidiary (where there is at least one US corporation that is a 10 percent voting shareholder) to add to its subpart F income the shareholder's pro rata share of the foreign subsidiary's net post-1986 historical earnings and profits ("E&P"), as determined as of November 2, 2017, or December 31, 2017, whichever is higher. This income is to be reported as of the foreign subsidiary's last tax year beginning before 2018, and is taxed at one of two rates:

1. 15.5 percent for E&P held as cash or cash equivalents; and
2. 8 percent for all other E&P.

The deemed repatriation raises a number of significant state issues, including whether and how the respective states tax subpart F income. The concept behind the deemed repatriation is that once the federal tax is paid on the deemed repatriation, the actual repatriation of these amounts will be tax-free at the federal level. One key issue for companies to consider is, to the extent a particular state does not tax the deemed repatriation, whether such a state will attempt to tax the funds upon their actual repatriation. Another issue for companies to consider is whether the company has already paid tax on any of this E&P (*i.e.*, by filing a worldwide state income tax return) and, if so, whether a position may exist to exclude the deemed repatriated dividends from income. Another consideration is to what degree the computation of gross income inclusion may differ from the federal computation taking into account combined group composition and/or separate filings.

Further, the potential state tax treatment of this deemed repatriation varies. Some states have a fairly straight forward approach for taxing or exempting the addition to subpart F income. For example, a rolling (automatic) conformity state may conform to the amended IRC Section 965 immediately upon enactment, whereas states which have a static or lagging conformity approach to the IRC may not explicitly conform to section 965, leaving out the addition, or at a minimum, leaving the conclusion in question. Therefore, state conformity to the IRC – or a lack thereof – can result in varying treatment among the states. As a result, it is important for taxpayers to closely monitor a state's conformity status.

Other considerations

The Act also provides that US shareholders of controlled foreign corporations must include in gross income the amount of its global intangible low-taxed income ("GILTI"), but is permitted a deduction equal to 50 percent of the GILTI. US corporations will also be required to include foreign-derived intangible income ("FDII") in gross income, but will then be permitted a deduction on the FDII. As such, each state's tax regime must be examined to determine if the GILTI or FDII (and the related deduction) is included in the state taxable income calculation.

For example, the New York Department of Taxation and Finance recently presented to New York Governor Andrew Cuomo a "Preliminary Report on the Federal Tax Cuts and Jobs Act" (the "Report"), in which it attempted to estimate the impact the Act would have on the tax system and economy of the State of New York. When analyzing the Act's international tax provisions, the Report notes that Subpart F income and dividends paid by foreign affiliates to US corporations are “generally not taxed in New York.” With regard to GILTI income, however, the Report states:

> Although this new GILTI income is treated similarly to Subpart F income, it is specifically not characterized as Subpart F income under the IRC and therefore would not qualify as other exempt income. Thus, the income would flow through to New York, be treated as business income, and be subject to tax.

With New York weighing in, it is anticipated other state agencies may follow suit soon.

Taxpayers will also need to consider whether the foreign income under the transition tax, GILTI or FDII will be included in the sales factor numerator and/or denominator for apportionment purposes. If the foreign income is treated as a dividend, states may exclude the dividends altogether from the sales factor or only include a portion of the dividend.

Finally, because the Act allows for the repatriation of funds under beneficial terms, it is anticipated that a portion of those funds may be reinvested in the US economy. This is especially true as the Act modifies the IRC section 168 bonus depreciation rules to allow for full expensing of qualified property placed into service after September 27, 2017 and before January 1, 2023. Accordingly, companies who anticipate repatriating and reinvesting a substantial amount of E&P following the deemed repatriation should consider state and local credits and incentives opportunities for such reinvestment.

State budgets and legislative responses

The Act represents “deficit spending” by the federal government and includes roughly $1.46 trillion in unoffset costs for the 10-year federal budget window covering 2018-2027 according to the Joint Committee on Taxation. State governments, however, cannot engage in deficit spending and generally must run balanced budgets. Each state that imposes income taxes will therefore need to evaluate which provisions of federal tax reform that pertain to the calculation of taxable income to determine if the state can afford to conform to any federal tax provision that would reduce state revenues (or, conversely, if they can afford to disconnect from any revenue-raising provisions included in the Act.)

State conformity to the IRC is generally set by statute, and a summary of each state’s current conformity to the IRC as of January 1, 2018, is attached to this Alert as Appendix A.

States typically address conformity to the IRC through legislation, although certain states may seek to address essential details through administrative guidance as well. Legislative responses are expected throughout 2018, depending upon when each state is in session. Included below is a summary of each state’s 2018 legislative calendar (based on information currently available).

Jurisdiction	**State Legislative Calendar**
Alabama	January 9, 2018 – April 24, 2018
Alaska	January 16, 2018 – May 16, 2018 (Alaska Constitution limits regular legislative sessions to 121 consecutive days; may be extended).
Arizona	January 8, 2018 – April 17, 2018
Arkansas	February 12, 2018 – Will last for 30 days, with the possibility of three- fifteen day extensions
California	January 3, 2018 – August 31, 2018
Colorado	January 10, 2018 – May 9, 2018
Connecticut	February 7, 2018 – May 9, 2018 (dates for regular sessions in even-numbered years set by Connecticut Constitution; session may adjourn prior to final date)
Delaware	January 9, 2018 – June 30, 2018
District of Columbia	January 2, 2018 – December, 2018 (generally in session year-round)
Florida	January 9, 2018 – March 9, 2018
Georgia	January 8, 2018 – (no more than 40 working days)
Hawaii	January 17, 2018 – May 3, 2018
Idaho	January 8, 2018 – March 27, 2018
Illinois	January 23, 2018 (House) and January 30, 2018 (Senate) – May 31, 2018 (both House and Senate)

Jurisdiction	State Legislative Calendar
Indiana	January 3, 2018 – March 14, 2018
Iowa	January 8, 2018 – April 17, 2018
Kansas	January 8, 2018 – April 6, 2018
Kentucky	January – Late March
Louisiana	March 12, 2018 – adjourn no later than June 4, 2018
Maine	January 3, 2018 – April 18, 2018 (may be extended)
Maryland	January 10, 2018 – April 9, 2018
Massachusetts	January 10, 2018 – June 30, 2018 (may be extended into July)
Michigan	Current session runs through December 2018
Minnesota	February 20, 2018 – May 21, 2018
Mississippi	January – Late March
Missouri	January 3, 2018 – May 18, 2018
Montana	Montana holds legislative sessions on odd-numbered years so there is not a regular session scheduled for 2018. There is a possibility that the governor could call a special session this year to address the changes.
Nebraska	January 3, 2018 – April 18, 2018
Nevada	Legislative regular sessions held biennially in odd-numbered years. Special sessions may be called.
New Hampshire	January 3, 2018 – June 30, 2018
New Jersey	No fixed legislative period – generally in session
New Mexico	January 16, 2018 – February 15, 2018
New York	January 2018 – June 20, 2018
North Carolina	January 10, 2018 – (approximately) June 30, 2018
North Dakota	The next regular session will be from January 3, 2019 – April 26, 2019
Ohio	The legislative schedule is set in six-month increments. The last currently scheduled session for the first half of 2018 is June 27, 2018.
Oklahoma	February 5, 2018 – May 25, 2018, but is currently in a special session
Oregon	February 5, 2018 – March 11, 2018 (date of adjournment sent by Oregon Constitution but may be extended by Legislature)
Pennsylvania	January 22, 2018 – June 29, 2018 (Senate) and June 30, 2018 (House)
Rhode Island	January 2, 2018 – mid-July, 2018 (estimated)
South Carolina	January 9, 2018 – no later than May 10, 2018
South Dakota	January 9, 2018 – March 26, 2018
Tennessee	January 9, 2018 – Late April/Early May
Texas	The next regular session will begin on January 8, 2019
Utah	January 22, 2018 – March 8, 2018
Vermont	January 3, 2018 – May 4, 2018
Virginia	January 10, 2018 – March 10, 2018, with reconvened session to commence on April 18, 2018
Washington	January 8, 2018 – March 8, 2018
West Virginia	January 10, 2018 – March 10, 2018
Wisconsin	January 16, 2018 – March 22, 2018
Wyoming	February 12, 2018 – March 10, 2018

Taxpayer considerations

While the foregoing is not an exhaustive list of all state tax issues raised by the Act's international income tax provisions, the summary is intended to provide an overview of the range of state and local tax issues presented. Each taxpayer is encouraged to consider these state and local issues, including the ASC740 implications, when evaluating the impact of the Act on current and prospective tax planning.

— Valerie Dickerson (Washington, DC)
Partner
Deloitte Tax LLP
vdickerson@deloitte.com

Jason Wyman (Chicago)
Partner
Deloitte Tax LLP
jwyman@deloitte.com

Calendars to watch

Each edition, be sure to mark your calendars for some of the more important events (recent and upcoming) as well as tax developments making in impact on businesses investing into the United States.

Recent and Upcoming Activities

January 16 On demand	**Dbriefs archive:** (Special Edition) US tax reform: The growing complexity of multistate taxation Watch **URL:** https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/january/2018/dbriefs-us-tax-reform-january-2018-updates-for-businesses-and-individuals.html?id=us:2em:3na:usic:awa:tax:021918
January 23 On demand	**Dbriefs archive:** US tax reform: Considerations for non-US-headquartered companies Watch **URL:** https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/january/2018/dbriefs-us-tax-reform-considerations-for-non-us-headquartered-companies.html?id=us:2em:3na:usic:awa:tax:021918
January 30 On demand	**Dbriefs archive:** (Special Edition) US tax reform: Impacts to global mobility and rewards programs Watch **URL:** https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/january/2018/dbriefs-us-tax-reform-impacts-to-global-mobility-and-rewards-programs.html?id=us:2em:3na:usic:awa:tax:021918
February 7 On demand	**Dbriefs archive:** (Special Edition) US tax reform: A fresh look at M&A transactions Watch **URL:** https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/february/2018/dbriefs-us-tax-reform-a-fresh-look-at-m-and-a-transactions.html?id=us:2em:3na:usic:awa:tax:021918
March 20 2:00 p.m. ET	**Dbriefs webcast:** US tax reform: March 2018 updates for businesses and individuals Register **URL:** https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/march/2018/dbriefs-us-tax-reform-march-2018-updates-for-businesses-and-individuals.html?id=us:2em:3na:usic:awa:tax:021918