Debbie Longman

From:	Ferdinand Hogroian <FHogroian@cost.org>
Sent:	Monday, August 20, 2018 10:59 AM
To:	CITReview
Cc:	Karl Frieden
Subject:	Comments for August 22 Corporate Income Tax Review Public Meeting
Attachments:	08202018 COST FL Corporate Tax Conformity Letter.pdf

Florida Department of Revenue, Corporate Income Tax Review
c/o Ms. Debra J. Longman, Director of Legislative and Cabinet Services

Dear Ms. Longman,

Attached please find testimony from Karl Frieden, Vice President & General Counsel at the Council On State Taxation (COST), for consideration at the Department's August 22 Corporate Income Tax Review public meeting. Mr. Frieden also intends to provide oral comments telephonically at that meeting.

Sincerely,

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August 20, 2018

Florida Department of Revenue
Corporate Income Tax Review
c/o Ms. Debra J. Longman, Director of Legislative and Cabinet Services

Via e-mail: CITReview@floridarevenue.com

Re: August 22 Public Workshop – Topics Under Review, Items J. (Global Intangible Low-Taxed Income) and L. (Net Interest Deduction)

Dear Ms. Longman:

On behalf of the Council On State Taxation (COST), I write to provide COST's research and analysis regarding conformity issues for Florida with federal tax reform (the Tax Cuts and Jobs Act of 2017). COST appreciates that the Department's August 3, 2018 Status Report cites our research on the corporate income tax base impact of state conformity to federal tax reform.[1]

In this testimony, I wish to highlight two critical issues to corporate taxpayers, included as Items J. and L. in the Department's Status Report: global intangible low-taxed income, or GILTI, under I.R.C. Sec. 951A; and limitations on the net interest deduction under I.R.C. Sec. 163(j). For the reasons cited below, COST believes the Department should recommend that the Legislature decouple from both of these federal corporate tax provisions.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 550 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST has a significant number of members that own property, have employees, and make substantial sales in Florida.

[1] *The Impact of Federal Tax Reform on State Corporate Income Taxes*, by EY for the State Tax Research Institute (STRI), March 2018, available at: https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/cost-federal-tax-reform-3-1-2018-cost-v2.pdf. STRI is a subsidiary of COST.

Global Intangible Low-Taxed Income

Over the last 30 years, states have generally limited their corporate income tax base to the water's edge (*i.e.*, to income earned in the U.S.). With federal tax reform, the federal government is moving from the taxation of all foreign source income primarily on a "deferred" basis to taxing a more limited range of foreign source income – including global intangible low-taxed income (GILTI) – primarily on a "current" basis. However, federal taxation of GILTI is very different than state taxation of GILTI from both a policy and a practical outcome perspective.

First, Congress is raising $324 billion over 10 years from the international tax reform provisions (including GILTI) to help pay for $654 billion over 10 years in other business tax reform cuts. The states, by contrast, do not conform to the federal corporate tax rate cuts and therefore have no reason to expand their tax base to make up for the lost revenue. Conforming to the GILTI provisions would represent a selective and arbitrary conformity that harms a segment of Florida businesses competing internationally, without advancing any compelling tax policy goal for the state.

Second, at the federal level, the focus of the GILTI provision is to include in the federal income tax base "low-taxed" foreign source income – basically income that is taxed in foreign countries at less than 13.125 percent. To achieve this practical outcome the federal government imposes a tax rate of 10.5 percent (one-half of the federal statutory rate) on the GILTI income and allows a credit for 80 percent of foreign taxes paid on such income. However, state corporate income tax laws in Florida and in other states do not allow for foreign tax credits, and therefore all of the GILTI income, from low and high-tax countries, would be subject to state corporate income tax. This would constitute a vast and unprecedented expansion of the state corporate income tax base to include previously untaxed foreign earnings.

As a result, to date, eleven states have decoupled from the GILTI provisions and more are likely to follow. Among the states decoupling (by new legislation or administrative action) from GILTI are Connecticut, Georgia, Hawaii, Indiana, Kentucky, Michigan, North Carolina and Wisconsin. Further, Illinois, Montana, and South Carolina do not include GILTI in their corporate tax base due to existing decoupling from the Internal Revenue Code.

For these reasons, COST supports legislation or regulatory guidance that would decouple Florida completely from GILTI. However, even without decoupling legislation, Florida is likely foreclosed from taxing GILTI under the U.S. Constitution's Commerce Clause. U.S. Supreme Court precedent forbids discriminatory taxation against foreign commerce (*see Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Finance*, 505 U.S. 71 (1992)). Because Florida does not tax similar domestic income earned by U.S. subsidiaries of Florida corporate taxpayers, GILTI is likely beyond Florida's taxing authority.

Interest Expense Limitation

Corporate tax "base broadeners" under federal tax reform funded, in part, the substantial reduction in federal corporate tax rates to make the U.S. more competitive internationally. As noted above, these rate reductions do not flow through to the states, and therefore updating

Florida's conformity results in a substantial corporate income tax increase. The largest component of this base increase over the 10-year period is the interest expense limitation under I.R.C. Sec. 163(j) that will increase the Florida corporate tax base by an average of more than 7% over the next 10-year period. This outcome is inadvertent and arbitrary, based solely on mechanical state conformity with the federal corporate tax base broadeners but not the federal corporate tax cuts.

The state-specific outcomes are inconsistent in other ways with the goals of federal tax reform. For example, the new federal law provides for immediate expensing of capital assets, but Florida is already decoupled from federal "bonus" depreciation. Therefore, this benefit, available at the federal level, is not available to Florida taxpayers for their capital investments, but Florida taxpayers at the same time are limited in their ability to deduct interest expense on financing such investments.

Moreover, the I.R.C. Sec. 163(j) provisions are not tailored to abusive or distortive intercompany lending. Rather, the provisions limit interest expenses across the board, for both intercompany and third-party borrowing, and thus impact all borrowing by Florida taxpayers for both business operations and investment/expansion, *without exception*. This result harms Florida's competitiveness, especially in light of the actions (or policy) of other southeastern states to decouple from the provisions (see, *e.g.*, Georgia, Mississippi, and Tennessee).

Applying the interest expense limitation in Florida will also significantly increase the complexity of corporate tax compliance, and much remains to be determined, both at the federal level and by the Florida Department of Revenue, on how to implement this provision. It is uncertain how the interest expense limitation will be computed and reflected in federal consolidated return filings, and commensurately how to determine if, and in what amount, the limitation would apply at the separate state filing level. No state has answered these questions to date (and answers to these questions will depend on federal guidance yet to be issued). For all of the above reasons, COST supports legislation that would decouple Florida completely from the interest expense limitation.

Conclusion

Florida should consider decoupling from provisions of federal tax reform that would otherwise inadvertently expand the corporate tax base and harm Florida's competitiveness for business investment and growth, such as "GILTI" and the interest expense limitation, which together would expand the Florida corporate tax base by an average of 10% over the next ten-year period.

I am happy to answer any questions regarding this testimony or COST's research on this issue.

Respectfully,

Karl Frieden

Karl A. Frieden

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director