State Taxation of Foreign Income: Section 163(j), GILTI, Section 250 Deduction, Repatriation Payments

THURSDAY, OCTOBER 1, 2020, 1:00-2:50 pm Eastern

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Katie Girmscheid, CPA
State and Local Tax Senior Manager
BDO USA
kgirmscheid@bdo.com

Ilya A. Lipin
Managing Director, State & Local Tax
BDO USA
ilipin@bdo.com

Scott Smith
National Technical Practice Leader - State & Local Tax
BDO USA
ssmith@bdo.com

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STATE TAXATION OF FOREIGN INCOME

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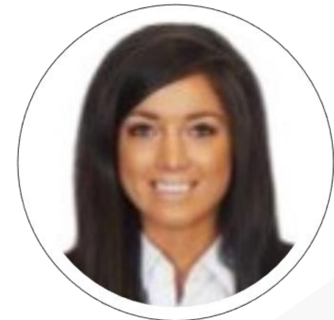
With You Today

SCOTT SMITH
Technical Practice Leader
State and Local Taxes

615-493-5629
ssmith@bdo.com

ILYA LIPIN
Managing Director
State and Local Taxes

215-241-1463
ilipin@bdo.com

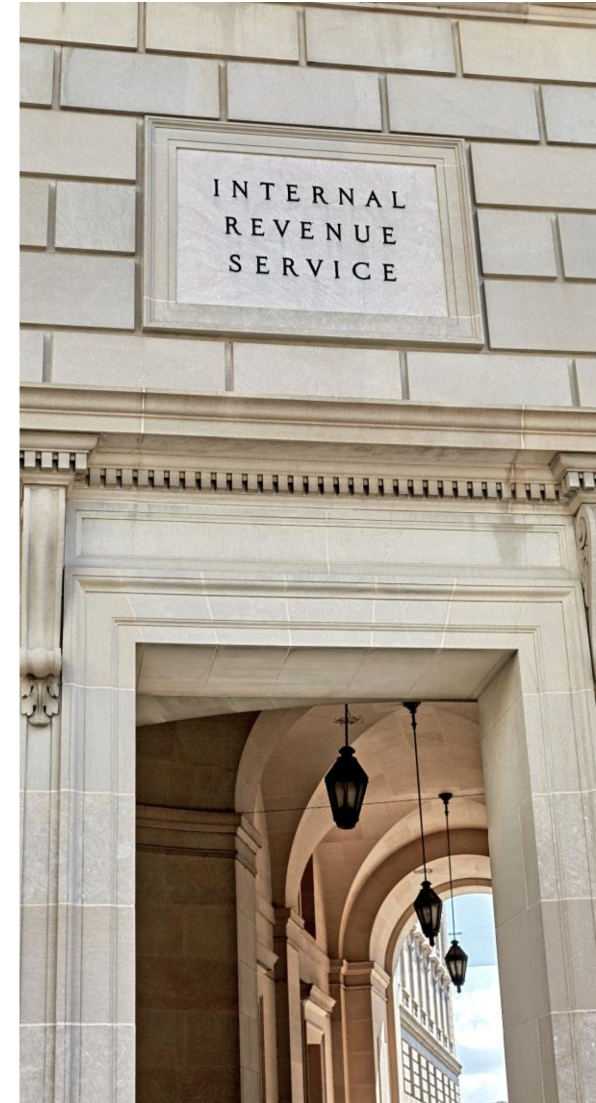


KATIE GIRMSCHEID
Senior Manager
State and Local Taxes

312-730-1406
kgirmscheid@bdo.com

Agenda

- Basic Federal and SALT Rules
- TCJA and CARES Act: GILTI, FDII, BEAT
- State Taxation of Foreign Source Dividends and Subpart F Income
- State Filing Methodologies
- 163(j)



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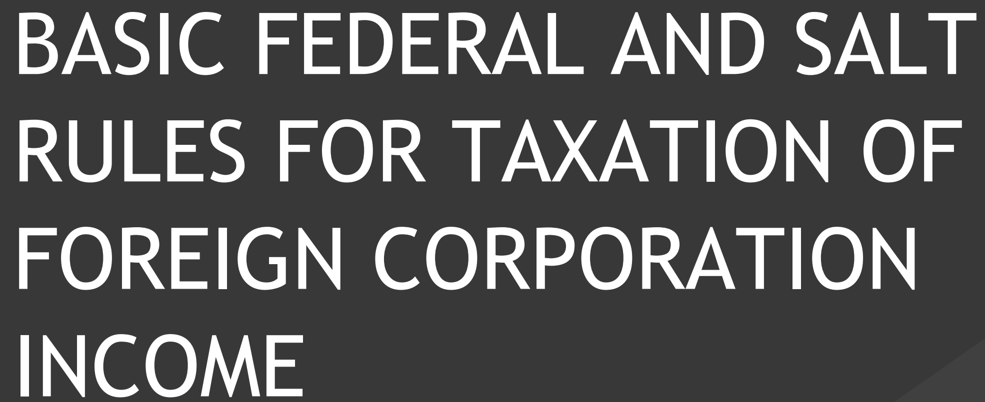

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Basic Federal Rules for Taxation of Foreign Corporations

- IRC Section 882 – Federal income tax imposed on a foreign corporation having income effectively connected with the conduct of a U.S. trade or business ("ECI") – manufacturing, sales, services

- U.S. Tax Treaties
  - Permanent establishment requirement
  - Inapplicable to states and localities
  - Nondiscrimination article

- IRC Section 881 – "FDAP" (fixed or determinable annual or periodic income) – interest, dividends, royalties, rents
  - 30% withholding
  - Tax treaty may eliminate or reduce the withholding rate

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Basic State Rules for Taxation of Foreign Corporations

- *Complete Auto* – Four-prong test
- *Japan Line* – Plus two more tests must be satisfied for a state to impose a tax on foreign commerce
  - State tax may not prevent the federal government from speaking with one voice.
  - State tax may not create a substantial risk of international multiple taxation.
- Public Law 86-272 – by its terms applies only to interstate commerce
  - Discrimination under *Complete Auto?*
  - Nondiscrimination article of U.S. tax treaties?

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Basic State Rules for Taxation of Foreign Corporations

- State economic presence nexus statutes and factor presence statutes
- Most states start with federal taxable income
  - Foreign corporation without ECI or a permanent establishment will have a zero FTI starting point reported on an 1120F.
  - IRC Section 894 exclusion for treaty protection.
  - However, certain states require a worldwide income calculation in spite of no ECI or permanent establishment.
  - Determination of ECI and permanent establishment are two separate determinations.

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Basic State Rules for Taxation of Foreign Corporations

- How do the Tax Cuts and Jobs Act international tax provisions, new federal regulations, and CARES Act amendments impact state taxation of foreign corporation income?

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GLOBAL INTANGIBLE LOW-TAXED INCOME (“GILTI”)

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Global Intangible Low-Taxed Income (GILTI)

- Effective for taxable years beginning after December 31, 2017, new IRC Section 951A will impose a 10.5% tax on a U.S. shareholder's share of a CFC's GILTI
- Generally will impact U.S. shareholders of CFCs that have heavy concentration of intangible assets compared to fixed/tangible assets (or high income relative to low depreciable assets).
  - Industries most likely impacted: technology; pharmaceutical; manufacturing; banking and financial services
- GILTI is included in the U.S. shareholder's FTI under section 951A and then a new "Foreign Derived Intangible Income" (or "FDII") deduction is provided by new IRC Section 250 in an amount under a calculation that arrives at a 10.5% effective federal tax rate on the GILTI.

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GILTI

- Did you know that a company's Global Intangible Low-Taxed Income (GILTI) amount can be different for state purposes and federal purposes?

- In certain states, GILTI income will be deductible while in other states it will be taxable. Moreover, many states have not indicated whether GILTI is includable or excludable from state taxable income. For these states, you will need to check their DRD or exclusion for Subpart F income, if any, and see if it is broad enough to encompass GILTI. Analysis is also needed to determine whether the IRC Section 250 GILTI deduction is added back.

- If a state includes all or a portion of GILTI in state taxable income, only a handful have indicated if the taxable GILTI amount is included in the state's sales factor of the apportionment formula.

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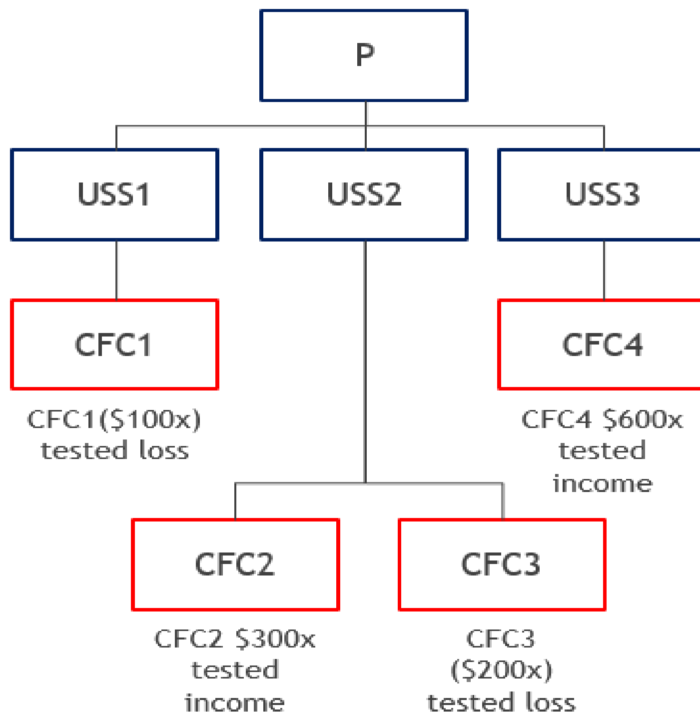
GILTI Example – Federal Consolidation



	Federal Consolidated Group				
	CFC 1	CFC 2	CFC 3	CFC 4	Total
CFC Tested Income	(100)	300	(200)	600	600
					-
CFC Tested Income	-	300	-	600	900
Total CFC Tested Income	900	900	900	900	3,600
GILTI Allocation Ratio	0%	33%	0%	67%	100%
					-
Total CFC Tested Loss	(300)	(300)	(300)	(300)	(1,200)
GILTI Allocation Ratio	0%	33%	0%	67%	100%
Allocated Tested Loss	-	(100)	-	(200)	(300)
					-
CFC Tested Income		200		400	600
					-
Gross GILTI Inclusion	-	200	-	400	600
250 GILTI Deduction	-	100	-	200	300
Net GILTI Inclusion	**-**	**100**	**-**	**200**	**300**

Federal Consolidating Schedules would reflect:

- USS2 Net GILTI Inclusion = $100 (owns CFC2)
- USS3 Net GILTI Inclusion = $200 (owns CFC4)

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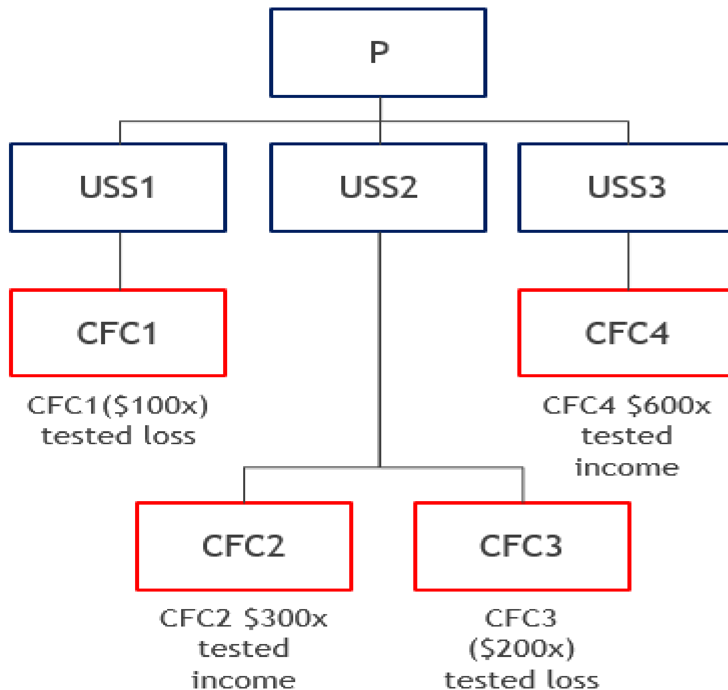
GILTI Example – Separate Company



	Subsidiary 2		
	CFC 2	**CFC 3**	**Total**
CFC Tested Income	300	(200)	100
CFC Tested Income	300	-	300
Total CFC Tested Income	300	300	600
GILTI Allocation Ratio	100%	0%	100%
Total CFC Tested Loss	(200)	(200)	(400)
GILTI Allocation Ratio	100%	0%	100%
Allocated Tested Loss	(200)	-	(200)
CFC Tested Income	100		100
Gross GILTI Inclusion	100	-	100
250 GILTI Deduction	50	-	50
Net GILTI Inclusion	**50**	**-**	**50**

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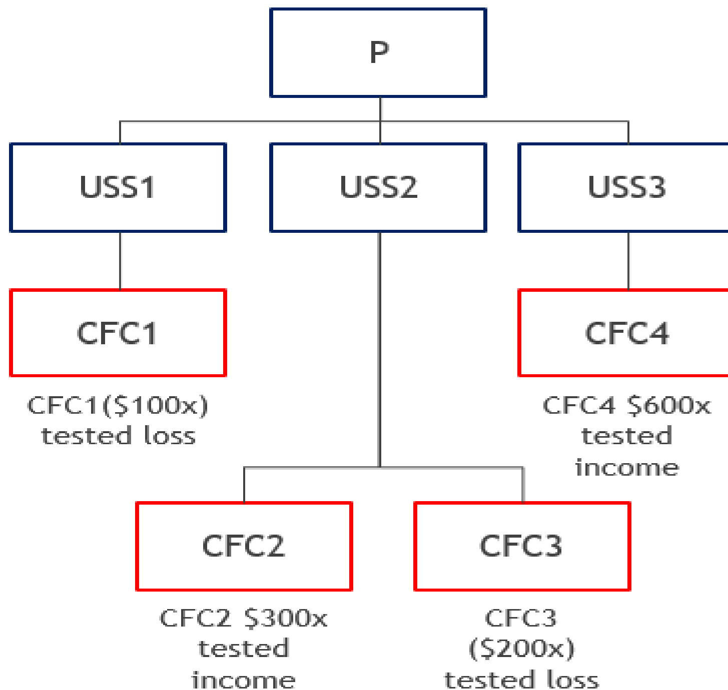
GILTI Example – Nexus Consolidated



	Subsidiary 2 and Subsidiary 3			
	CFC 2	**CFC 3**	**CFC 4**	**Total**
CFC Tested Income	300	(200)	600	700
				-
CFC Tested Income	300	-	600	900
Total CFC Tested Income	900	900	900	2,700
GILTI Allocation Ratio	33%	0%	67%	100%
				-
Total CFC Tested Loss	(200)	(200)	(200)	(600)
GILTI Allocation Ratio	33%	0%	67%	100%
Allocated Tested Loss	(67)	-	(133)	(200)
				-
CFC Tested Income	233		467	700
				-
Gross GILTI Inclusion	233	-	467	700
250 GILTI Deduction	117	-	233	350
Net GILTI Inclusion	**117**	**-**	**233**	**350**

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Considerations

- If GILTI is included in the state tax base need to consider factor representation in apportionment factors

- Are additional calculations required?
  - Only one entity owns all the CFCs?
  - Different filing groups for state purposes

- 250 Deduction
  - Section ***250(a)(1)(B)*** allows a corporation a deduction equal to 50 percent of their GILTI inclusion (as well as any related section 78 gross-up), subject to a taxable income limitation.

- Potential for double deduction?
  - Line 30 states that don’t decouple from the 250 GILTI deduction and provide a DRD for GILTI

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SALT Implications of the CARES Act Business Tax Provisions

- CARES Act NOL carryback could impact prior year state treatment of GILTI/Section 250.
- Section 250(a)(2) includes a taxable income limitation that reduces a corporation's Section 250 deductions.
  - A federal NOL carryback will reduce taxable income and possibly the Section 250 deduction.
  - A sufficient federal NOL carryback may replace some or all of the Section 250 deduction.
- Most states don't allow NOL carrybacks, but some states include "net GILTI" or gross GILTI and allow a Section 250 deduction.

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SALT Implications of the CARES Act Business Tax Provisions

- By reducing an allowed state Section 250 deduction, federal NOL carrybacks could increase state “net GILTI” inclusions or reduce state Section 250 deductions (without a corresponding state NOL carryback.)

  - “Line 28” states that include GILTI and allow Section 250 deductions: NJ, NM (2018 and 2019 combined/consolidated filers), NY (2018 and GILTI deduction only), and NYC.

  - “Line 30” states that include GILTI and allow Section 250 deductions: AZ (2018 only), IA (starting 2019), MD, NE, and VT.

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SALT IMPLICATIONS

CARES Act NOL Carrybacks and Section 250

Federal NOL carryback could impact state GILTI treatment.

- States that include GILTI and allow Section 250 deductions:
  - AZ (2018 only)
  - IA (starting in 2019)
  - MD
  - NE
  - NJ
  - NM (2018 and 2019 combined/consolidated filers)
  - NY (2018 and allowed only GILTI deduction)
  - NYC
  - VT
- States that provide a full or partial “net GILTI” subtraction.
- States that provide a full or partial GILTI subtraction and addition modification for GILTI 250 deduction.

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Overview of State Methods of Taxing Foreign Income:

GILTI High-Tax Exclusion

- On July 23, 2020, U.S. Treasury issued Final Regulations on the "GILTI High-Tax Exclusion"
  - Generally apply to tax years of foreign corporations starting on or after 7/23/2020 and tax years of U.S. shareholders in which such foreign corporation tax year ends.
  - May elect to apply to tax years of foreign corporations that begin after 12/31/2017 and tax years of U.S. shareholders in which such foreign corporation tax year ends.
- If election is made, then GILTI is excluded from a U.S. shareholder's federal gross income if the CFC's income was subject to an effective foreign tax rate greater than 90% of the maximum federal rate (currently, 18.9% based on a maximum federal corporate rate of 21%).

- State treatment
  - Generally favorable for state taxpayers; some technical details to unwind on amended returns.
  - Questions concerning fixed-date IRC conformity states?

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FOREIGN DERIVED
INTANGIBLE INCOME
(“FDII”)

- The 2017 Tax Act provides US companies with a new permanent deduction: FDII An incentive for C corporations to generate revenue from serving foreign markets, the provision applies a preferential tax rate to eligible income.

- Did you know that a company's Foreign Derived Intangible Income (FDII) amount can be different for state purposes and federal purposes?
  - FDII should be calculated on an entity by entity basis if any separate returns are filed.

- Certain states will incorporate the IRC section 250 FDII deduction while other states may not. The state income tax starting point (Line 28 vs. Line 30) will impact the treatment.

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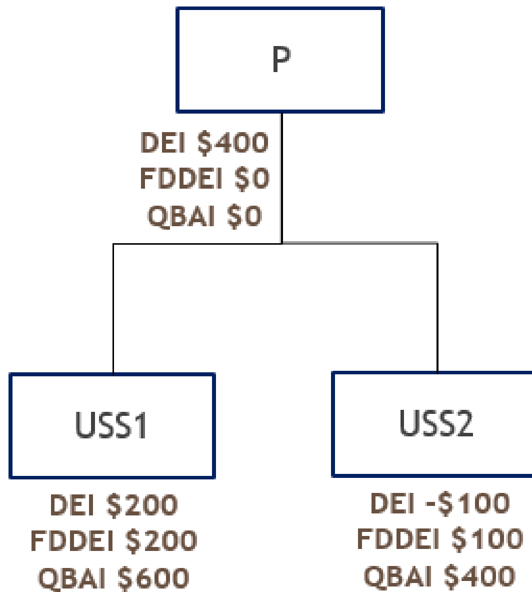
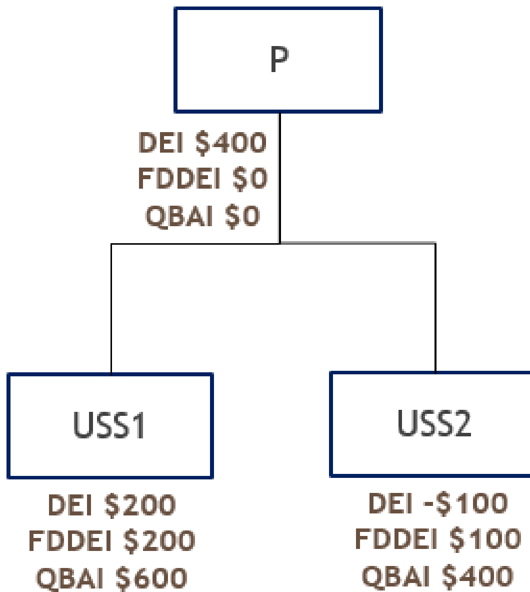
FDII Example – Federal Consolidation



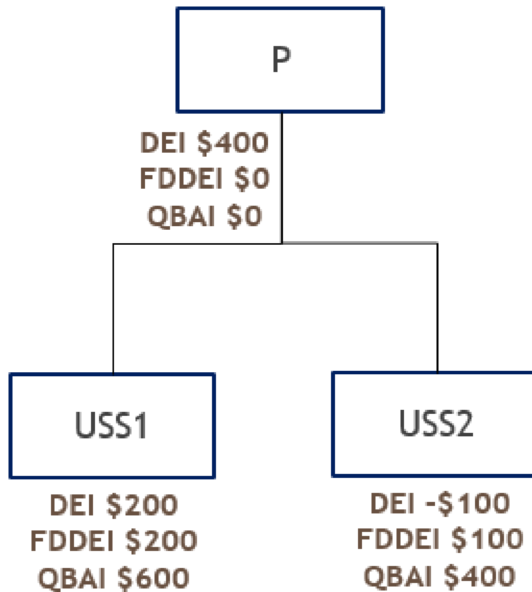
	Federal Consolidate Group			
	Parent	**Sub 1**	**Sub 2**	**Total**
Deduction Eligible Income	400	200	(100)	500
Foreign Derived Deduction Eligible Income	-	200	100	300
Qualified Business Asset Investment	-	600	400	1,000
10% of QBAI	-	60	40	100
Deemed Intangible Income	400	140	(140)	400
Foreign Derived Ratio				60%
Foreign Derived Intangible Income				240
FDII Deduction Amount				**90**

FDII Example – Separate Company



	Separate Company
	Sub 1
Deduction Eligible Income	200
Foreign Derived Deduction Eligible Income	200
Qualified Business Asset Investment	600
10% of QBAI	60
Deemed Intangible Income	140
Foreign Derived Ratio	100%
Foreign Derived Intangible Income	140
FDII Deduction Amount	**53**

FDII Example – Nexus Consolidated



	Subsidiary 1 & 2		
	Sub 1	**Sub 2**	**Total**
Deduction Eligible Income	200	(100)	100
Foreign Derived Deduction Eligible Income	200	100	300
Qualified Business Asset Investment	600	400	1,000
10% of QBAI	60	40	100
Deemed Intangible Income	140	(140)	-
Foreign Derived Ratio			
Foreign Derived Intangible Income			-
FDII Deduction Amount			-

Considerations

Are additional calculations required?

- Does the state allow for a FDII deduction?
- Separate state returns v. combined state returns

Consolidated loss but profitable separate companies

- Consider if FDII deduction could be beneficial in separate reporting states that allow for it even if the deduction might not be utilized on a combined/consolidated level

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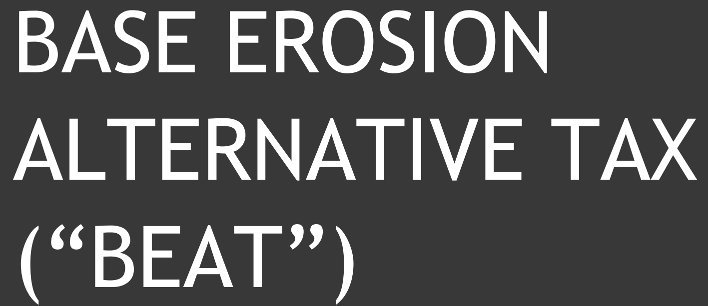
BASE EROSION
ALTERNATIVE TAX
(“BEAT”)

State Impact of Base Erosion and Anti-Abuse Tax – IRC § 59A

The "BEAT" Tax

- Effective for taxable years beginning after December 31, 2017, new IRC § 59A targets corporations that erode their tax base by making payments totaling 3% or more (2% or more for certain banks and securities dealers) of the corporation's total deductions for the year to related foreign entities.
- **States do not generally conform to a federal alternative minimum tax and BEAT is a separate tax base (similar to AMT); BEAT is not directly incorporated into FTI.**
- Since states generally begin with FTI, the IRC § 59A provision should have no effect on calculation of state taxable income.
- However, states already have provisions that subject related party intangible, interest, and other payments to an add-back modification.

Overview of State Methods of Taxing Foreign Income:

BEAT and BEAT Waiver Election

- IRC Section 59A base erosion and anti-abuse tax (BEAT)
  - Federal 10% minimum tax imposed on corporations, other than RICs, REITs, and S corporations.
  - (1) three tax-year average annual gross receipts of $500 million or more, and (2) a “base erosion percentage” that is generally 3% or higher.
  - Certain deductible payments to foreign related parties enter into the “base erosion percentage” calculation.
- Proposed regulations issued 12/6/2019 (now final as of 9/1/2020) provide a BEAT waiver election. Taxpayers may retroactively elect to waive BEAT for tax years starting after 12/31/2017.
- Effect of election: “For all purposes of the Code and regulations,” federal deductions are waived.
- State effect

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STATE TAXATION OF FOREIGN-SOURCE DIVIDENDS AND SUBPART F INCOME

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State Taxation of Foreign Source Dividends

- *Kraft General Foods*
- Dividends Received Deductions
  - Full DRDs – may require certain ownership thresholds be met (e.g., 80% or more) or any foreign-source dividend.
  - Partial DRDs – may also require ownership thresholds to be satisfied (e.g., more than 20% or more than 50%).
    - Several water's-edge combined reporting states
  - Conformity to IRC Section 243 (foreign-source dividends treated as domestic dividends) or Section 245A
  - Special rules – CA, CO

State Taxation of Foreign Source Dividends

- Expense Attribution Disallowance of Deductions
- Many states disallow deductions for expenses attributable to deductible dividends or other exempt/non-taxable income
  - Attribution formula or methodology may be required
  - Direct and indirect expenses
  - “Safe harbor” elections (e.g., NY)
  - Arbitrary disallowance (e.g., CT, MA, NJ)
- Expense attribution will also apply to Subpart F income subtractions.

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Subpart F

States define Subpart F differently and amounts can differ by jurisdiction.

- Illinois
  - Subpart F Income included in federal gross income under IRC §§ 951-965.
- Florida
  - Subpart F income included in federal gross income under IRC § 951
- California
  - Subpart F income defined in IRC § 952

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Subpart F

State modifications related to Subpart F can vary by jurisdiction

- Illinois
  - Subtraction allowed equal to:
    - 100% of Subpart F income from wholly owned foreign subsidiaries;
    - 65% (80% for tax years before 2018) of Subpart F income from 20%-or-more-owned foreign corporations; and
    - 50% (70% for tax years before 2018) of Subpart F income from less-than-20%-owned foreign corporations.
- Florida
  - Subtraction allowed equal to 100% of Subpart F income received from foreign corporations, less associated expenses.
- California
  - Subtraction allowed equal to 100% of Subpart F income to extent included in federal taxable income. Additional CFC inclusion needs to be calculated.

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Interplay and proper filing of Schedule H and Form 2416:

- Dividend received deduction taken on Schedule H for Regular Corp and Schedule H (100W) for Water's-Edge filer.
- For Water's-Edge filer, can be 100% or 75% elimination.
- See Forms attached after this slide.

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Common errors seen on the California return

Regular Corporation Schedule H:

TAXABLE YEAR **2018** **Dividend Income Deduction** CALIFORNIA SCHEDULE **H (100)**

Attach to Form 100. Attach additional sheets if necessary.

Corporation name	California corporation number

Part I Elimination of Intercompany Dividends (R&TC Section 25106)

	(a) Dividend payer	(b) Dividend payee
1		
2		
3		

	(c) Total amount of dividends received	(d) Amount that qualifies for 100% elimination	(e) Amount from column (d) paid out of current year earnings and profits	(f) Amount from column (d) paid out of prior year earnings and profits	(g) Balance column (c) minus column (d)
1					
2					
3					
4					

Enter total amounts of each column on line 4 above. Enter total from Part I, line 4, column (d) on Form 100, Side 2, line 10.

Part II Deduction for Dividends Paid to a Corporation by an Insurance Company (R&TC Section 24410)

	(a) Dividend payer	(b) Dividend payee
1		
2		
3		

	(c) Percentage of ownership of dividend payer (must be at least 80%)	(d) Total insurance dividends received	(e) Qualified dividend percentage (see instructions)	(f) Amount of qualified insurance dividends column (d) x column (e)	(g) Deductible dividends 85% of column (f)
1					
2					
3					

4 Total amounts in column (g). Enter here and on Form 100, Side 2, line 11 . . . .

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Common errors seen on the California return

Waters-Edge Corporation

Schedule H (100W):

TAXABLE YEAR **2018** **Dividend Income Deduction — Water's-Edge Filers** CALIFORNIA SCHEDULE **H (100W)**

Attach to Form 100W. Attach additional sheets if necessary.

Corporation name	California corporation number

Part I Elimination of Intercompany Dividends (R&TC Section 25106)

	(a) Dividend payer	(b) Dividend payee
1		
2		
3		

	(c) Total amount of dividends received	(d) Amount that qualifies for 100% elimination	(e) Amount from column (d) paid out of current year earnings and profits	(f) Amount from column (d) paid out of prior year earnings and profits	(g) Balance column (c) minus column (d)
1					
2					
3					
4					

Enter total amounts of each column on line 4 above. Enter total from Part I, line 4, column (d) on Form 100W, Side 2, line 10.

Part II Deduction for Qualifying Dividends Paid to a Member of a Water's-Edge Combined Report (R&TC Section 24411)

(Foreign dividends paid by partially included members of a water's-edge combined report cannot be computed on this schedule.)

	(a) Dividend payer	(b) Name of member of the water's-edge group receiving dividend
1		
2		
3		

	(c) Percentage of ownership of dividend payer	(d) Amount of qualifying dividends received by payee (see instructions)	(e) Amount from column (d) paid out of current year earnings and profits	(f) Amount from column (d) paid out of prior year earnings and profits	(g) Deductible dividends column (d) X .75 or 100% dividends from construction projects
1					
2					
3					
4	Total amounts in column (g). Enter here and on Form 100W, Side 2, line 11a				

Part III Deduction for Dividends Paid to a Corporation by an Insurance Company (R&TC Section 24410)

	(a) Dividend payer	(b) Dividend payee
1		
2		
3		

	(c) Percentage of ownership of dividend payer (must be at least 80%)	(d) Total insurance dividends received	(e) Qualified dividend percentage (see instructions)	(f) Amount of qualified insurance dividends column (d) x column (e)	(g) Deductible dividends 85% of column (f)
1					
2					
3					
4	Total amounts in column (g). Enter here and on Form 100W, Side 2, line 11b				

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Schedule H (100W) 2018

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Common errors seen on the California return

California Form 2416

Purpose:

- Revenue and Taxation Code (R&TC) Section 25110(a)(2)(A)(ii) provides that the income and apportionment factors of any Controlled Foreign Corporation (CFC) (as defined in Internal Revenue Code [IRC] Section 957) that has Subpart F income (defined in IRC Section 952) are to be included in the combined report of a taxpayer making a water's-edge election.
- Use form FTB 2416, Schedule of Included Controlled Foreign Corporations (CFC), to compute the net income and apportionment factors required to be included in the water's-edge combined report.

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California Form 2416:

TAXABLE YEAR **2018** — **Schedule of Included Controlled Foreign Corporations (CFC)** — CALIFORNIA FORM **2416**

Attach to Form 100W. Attach additional sheets if necessary.

Corporation name | California corporation number

	(a) Corporation name	(b) Country of incorporation	(c) Country of primary bus. activity	(d) Principal bus. activity code	(e) Subpart F income	(f) Current year earnings and profits	(g) Percentage (e) ÷ (f)
1							
2							
3							
4							
5							
6							
7							
8							

	(h) Net income	(i) * (g) x (h)	(j) Average property everywhere	(k) (g) x (j)	(l) Rent expense x 8	(m) (g) x (l)	(n) Payroll everywhere	(o) (g) x (n)	(p) Sales everywhere	(q) (g) x (p)
1										
2										
3										
4										
5										
6										
7										
8										
9	TOTAL									

*Enter total from column (i) on Form 100W, Side 1, line 7a.

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FTB2416 2018 Side 1

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STATE WATER'S-EDGE COMBINED REPORTING

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Overview of “Water’s-Edge” Unitary Combined Reporting

- Water’s-Edge vs Worldwide Unitary Combined Reporting
- “Commonly owned or controlled” group of corporations engaged in a unitary business . . .
- Eligible water’s-edge unitary group members generally limited to:
  - U.S. incorporated/organized entities, and
  - DISCs, FSCs, Section 936 corporations.
  - The “80/20” test.
- Worldwide required, with water’s-edge election: AK, CA, ID, MT, ND.
- Other states require water’s-edge, with worldwide election, including MA, NJ.
- Election: timing, mechanics, and duration.

- Rule of Exclusion from the water’s-edge group – a U.S. corporation or “any member” with 20% or less factors assigned to U.S. locations is excluded from the water’s-edge combined reporting group.

- Rule of Inclusion from the water’s-edge group: a foreign corporation or “any member” with 20% or more factors assigned to U.S. locations is included in the water’s-edge combined reporting group.

- Some states apply other provisions to include foreign corporations in the water’s-edge group.

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The “80 / 20” Measurement

- Average of property, payroll, and sales assigned overseas: AZ, DC, NM
- Average of property and payroll assigned overseas: CO, CT, IL, TX (and other states)
- 80% or more “active foreign business income”: AK, MI, WI
  - Referenced to IRC Section 861(c) – repealed effective for tax years after 12/31/2010
  - Foreign source income? KY

"80 / 20" Companies

- Notable "80/20 Company" Conditions

  - Arizona: Definition of "foreign corporation" includes domestic 80/20, but measured by average of three year property, payroll and sales ending with current tax year.

  - Colorado: S.B. 233 (enacted in 2019) requires a domestic U.S. corporation with de minimis or no property and payroll to be included in a CO combined report.
    - Legislation overturned CO Supreme Court decisions in *Agilent Technologies, Inc. v. Dept. of Revenue (2019)* and *Oracle Corp. v. Dept. of Revenue (2019)*, which held that U.S. holding companies with no property and payroll were excluded from a CO combined report. Holding companies owned foreign DREs.
    - Proposed regulations issued on 8/25/2020 to address tax periods to which S.B. 233 applies and how de minimis standard will be applied.

"80 / 20" Companies

- Notable "80/20 Company" Conditions

  - Utah: Provides a subtraction for 50% of "foreign operating company" income.
    - FOC still treated as a member of a UT water's-edge group, but 50% of the FOC's income is subtracted.
    - FOC must have 80% of more of average property and payroll assigned overseas <u>and</u> have at least $2 million of property and $1 million of payroll both located outside US.
    - FOC income subtraction does not apply to capital gain, dividends, interest, royalties, rent, or similar income from an asset held for investment.

"80 / 20" Companies

- Notable "80/20 Company" Conditions
  - Vermont: Requires 80% overseas average property and payroll for at least two of the three most recent tax years, and at least 70% overseas average property and payroll for current year. If 80/20 company in existence for two years or less, then must satisfy the 80% or more test.
  - Wisconsin: Characterized as a "consolidated foreign operating corporation." Income and factors are included in the WI combined report to the extent of the entities U.S. source income (e.g., if 15% of income is U.S. source, then 15% of the "consolidated foreign operating corporation" income and factors are included in the WI combined report.)

"80 / 20" Companies

- Other "80/20 company" Considerations
  - Must address treatment of dividends received from an excluded 80/20 company and whether whole, partial, or no state DRD applies to such dividends.
  - Must address sales factor sourcing of dividends, interest, royalties, GILTI, etc. received by the 80/20 company for qualification purposes, if applicable.
  - Are intercompany sales counted for qualification, if applicable?
  - Are the factors evenly weighted?
- Federal tax treatment, including Subchapters C and N and consolidated returns

Foreign Corporations Included in the Water's-Edge Group

- "80/20 company" Rule of Inclusion
  - 20% or more U.S. assigned property, payroll, and sales: AK, CA, DC, MA, NM, WV
  - 20% or more U.S. assigned property and payroll: CT, MT, NJ, ND, UT, VT
  - 20% or more U.S. sourced sales: RI, WI (U.S. source income)
- IHCO/Service Co Inclusion – 20% or more of FC's income is intangible or service income that generated deductions for water's-edge group member(s): DC, KY, MA, NJ, RI (with U.S. tax treaty exclusion)
- Foreign corporation with ECI: CA, NY, WV
  - ECI and treaty exemption under IRC Section 894 are separate determinations.
  - Tax treaties usually do not apply to states.
  - ECI and factor presence nexus.

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Foreign “Tax Haven” Corporations

- Criteria Based Inclusion: AK, CT, DC, KY, RI, WV
- “Blacklist”: MT
- Doing business or organized?

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163(j)

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CARES ACT MODIFICATIONS

Section 163(j) Limitation

- TCJA Section 163(j) limit is calculated as the sum of a taxpayer's:
  - Business interest income
  - 30% of adjusted taxable income (ATI) (generally, EBITDA through 2021)
  - Floor plan financing interest.
- CARES Act Section 163(j):
  - Increased limit from 30% to 50% of ATI for 2019 and 2020.
  - For any taxable year beginning in 2020, a taxpayer may elect to substitute 2019 ATI for 2020 ATI (this is also a partnership election).
  - A taxpayer may elect out of increased limit.
  - Increase in limit does not apply to partnerships for 2019.
    - Other special rules and elections apply to partnerships and partners.

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SALT IMPLICATIONS

CARES Act and Section 163(j)

IRC SECTION 163(J) MODIFICATIONS:

- No CARES Act impact for states that have already decoupled from Section 163(j): CT, IN, MO, SC, WI
- Fixed-date IRC conformity states that conformed to TCJA Section 163(j) must update to conform to CARES Act amendments to Section 163(j) – limitation increase and elections.
- Other states will continue to follow the pre-TCJA version of Section 163(j): AR, CA, GA
- Rolling IRC conformity states that conformed to TCJA Section 163(j) will conform to the CARES Act modifications unless they decouple.

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SALT IMPLICATIONS

CARES Act and Section 163(j)

HOW WILL STATES RESPOND?

- New York Budget Legislation (S. 7508 - B, enacted April 3, 2020)
  - Rolling IRC conformity state
  - Decoupled from the CARES Act amendments of Section 163(j)(10(A)(i) - retains 30% limitation for 2019 and 2020.
    - Did not decouple from Section 163(j)(10)(B) or the special partnership rule - should still be able to substitute 2019 ATI for 2020 ATI for NY purposes.
  - Decoupling applies to NYS corporation franchise tax and NYC corporation tax, general corporation tax, and unincorporated business tax.
  - Also State and City personal income tax – froze IRC conformity for tax years beginning before 1/1/2022 and amendments to the IRC after 3/1/2020 do not apply.

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SALT IMPLICATIONS

CARES Act and Section 163(j)

- CARES Act adds another layer of complexity to an already complicated issue of state tax conformity.
  - Tennessee: conforms to TCJA Section 163(j) for 2018, should conform to the CARES Act amendments for 2019, but reverts to pre-TCJA Section 163(j) starting 2020.
  - Will need to track and reconcile different federal/state excess interest carryforwards as between federal, pre-TCJA 163(j) conforming states, TCJA 163(j) conforming states, and CARES Act 163(j) conforming states.
  - Virginia already provided an additional 20% interest expense deduction.
- Complexities of separate state limitations, related party interest expense add-back statutes, partnership calculations (including composite returns and PTE tax states) continue to apply.

SALT IMPLICATIONS

Section 163(j) and GILTI

- On July 28, 2020, the Treasury and the IRS released final regulations under Section 163(j).
- On the same date, Treasury released proposed regulations under Section 163(j), which includes among many other items, guidance for how the business interest deduction limitation rules under Section 163(j) apply to U.S. shareholders, as defined in Section 951(b), of controlled foreign corporations (CFCs), as defined in Section 957(a), and to foreign persons with effectively connected income (ECI) in the United States.
- Section 163(j) and regulations apply to determine the deductibility of a relevant foreign corporation’s business interest expense for purposes of computing its taxable income for U.S. income tax purposes (if any) in the same manner as those provisions apply to determine the deductibility of a domestic C corporation’s business interest expense for purposes of computing its taxable income.
- This creates issues for the U.S. shareholders of CFCs that have inclusions under the GILTI rules of Section 951A and where the CFCs have interest expense.
- U.S. shareholders of CFCs ATI is computed by subtracting from taxable income the amount of their GILTI inclusions, Subpart F inclusions and the IRC Section 78 gross-up, reduced by the portion of the Section 250 deduction allowed on GILTI or the gross-up on GILTI.
- The subtraction required by GILTI/Subpart F taxable income “haircut” will reduce Section 163(j) limitation for U.S. multinationals, which is needed to avoid double counting a CFC’s taxable income already considered in determining the CFC’s Section 163(j) limitation.
- Consider impact on calculations for state income tax purposes, especially in separate company reporting states.

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