COST
COUNCIL ON STATE TAXATION

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Utah State Senate
Revenue and Taxation Interim Committee

Re: COST Supports Legislation That Would Decouple from Global Intangible Low-Taxed Income

Dear Senate Chair Stephenson, House Chair Eliason, and Members of the Committee:

On behalf of the Council On State Taxation (COST), I write in support of a legislative proposal to decouple Utah from certain provisions of federal tax reform (commonly referred to as the Tax Cuts and Jobs Act (TCJA)), specifically "global intangible low-taxed income" (I.R.C. Sec. 951A), which will negatively impact Utah businesses and place the State at a competitive disadvantage.

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 Utah.

COST's Research on the State Corporate Tax Impact of Federal Tax Reform

In March of this year, COST, through its affiliated State Tax Research Institute (STRI), issued a study entitled *The Impact of Federal Tax Reform on State Corporate Income Taxes*.[1] The study, conducted by Ernst & Young LLP, determines that state tax conformity with federal tax reform will result in an average corporate tax base increase of 12 percent over the 10-year period between 2018 through 2027. For purposes of this estimate, the study assumes that states will update their conformity dates to link with the Internal Revenue Code as of January 1, 2018 (thus including the changes under the Tax Cuts and Jobs Act) but remain decoupled from specific federal provisions as they have in the past.

The study concludes that Utah would experience an approximately 12 percent increase in its corporate income tax base as a result of conformity to federal tax reform. This increase is averaged over the next 10 years and will vary depending on the timing of the various federal changes. Further, Utah's estimated corporate income tax base expansion could possibly increase an additional 4 percent to 16 percent if it does not adopt I.R.C. Section 250, which is considered a "special deduction" for federal income tax purposes and may not be picked up by states such as Utah that generally conform to "line 28" of the federal income tax form 1120.

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 if 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 Utah 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 Utah 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. The associated uncertainty and complexity of administration, as well as the likely litigation from challenges relating to the state taxation of foreign commerce, would distort business decisions and unduly burden the State Tax Commission.

As a result, to date, ten states have decoupled from the GILTI provisions and more are likely to follow. Among the states decoupling (by legislation or regulation) from GILTI are Connecticut, Georgia, Hawaii, Indiana, 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 that would decouple Utah completely from GILTI. If the state decides to conform to the taxation of GILTI, however, it is important that it also conforms to the offsetting GILTI deduction and the foreign derived intangible income (FDII) deduction and address factor representation. First, at the federal level a taxpayer is able to offset its GILTI income with a 50 percent GILTI deduction and may be entitled to a FDII deduction, both of which are allowed for federal purposes pursuant to I.R.C. § 250. To the extent that these deductions are considered "special deductions" under the Internal Revenue Code, there is the potential that Utah would not allow them pursuant to Utah Code Ann. § 59-7-101(29). This issue should be addressed if the Committee decides to retain conformity to GILTI. Further, if Utah ultimately taxes GILTI, it must also provide factor representation. Multijurisdictional taxpayers are constitutionally entitled to factor representation for income being included in their tax base. *See Container Corp. v. FTB*, 463 U.S. 159 (1983). Thus, if a taxpayer is required to include GILTI in its Utah income tax base, the taxpayer is also entitled to factor relief for this income (*e.g.*, including foreign receipts in the denominator of the sales factor).

Conclusion

Utah should consider decoupling from certain federal tax reform provisions, such as GILTI that inadvertently expand the corporate tax base and harm Utah's competitiveness for business investment and growth.

If you have any questions or would like me to provide further information regarding COST's research relating to conformity with federal tax reform, please do not hesitate to contact me.

Respectfully,

Nikki E. Dobay

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