

Senate & House Ways & Means Joint Economic Briefing Impact of Federal Tax Reform

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Impact of Federal Tax Reform

This presentation is intended for informational purposes only, and is not a substitute for seeking professional advice or for reviewing the applicable laws and rules. This presentation represents some positions of the Department on the limited issues discussed herein, based on the law in effect at the time of the presentation and Department interpretation thereof, as well as the opinions and conclusions of its presenter.

For the current status of any tax law, practitioners and taxpayers should consult the source documents (i.e., Revised Statutes Annotated, Rules, Case Law, Session Laws, etc.) for independent verification.

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Federal Tax Reform Timeline

- **June 24, 2016** – House Republicans release federal tax reform proposal (“the Blueprint”).
- **April 26, 2017** – President Trump releases outline of business tax reform.
- **September 27, 2017** – President and Congressional Republicans release “the Unified Framework for Fixing Our Broken Tax Code.”
- **November 2, 2017** – House Ways & Means Committee releases the first version of the Tax Cuts and Jobs Act (totaling 429 pages).
- **November 9, 2017** – Senate releases federal tax reform proposal.
- **November 16, 2017** – House passes its tax reform proposal.
- **December 2, 2017** – Senate passes its tax reform proposal.
- **December 4, 2017** – Conference Committees begin work on reconciling differences between the House and Senate versions.
- **December 20, 2017** – Both bodies agree to the Conference report.
- **December 22, 2017** – President signs the Tax Cuts and Jobs Act (TCJA) (185 pages).

Internal Revenue Code Conformity

Internal Revenue Code Conformity

- Every state with some form of a corporate income tax uses federally reported income as a starting point for the calculation of taxable income for state purposes.
 - Static Conformity: When a state adopts the Internal Revenue Code (IRC) up to a specific date, thus requiring taxpayers to make additions or deductions to income to the extent the version of the IRC adopted is not the version applicable to the current federal tax year. NH is a static conformity state.
 - Rolling Conformity: When a state automatically adopts the IRC as it is amended.
 - There is an even split between states with rolling conformity and states with static conformity.
- Considerations:
 - Rolling conformity results in automatic adoption of federal tax policy objectives at the state level.
 - Rolling conformity may result in federal tax law changes that materially impact state revenues.
 - Static conformity requires taxpayers to contend with two versions of the IRC for federal and state purposes, increasing compliance costs and the likelihood of error.

New Hampshire Conformity: Line 28

- The definition of “gross business profits” in the BPT statute specifically references federally reported taxable income prior to net operating losses (NOLs) and deductions.
- This figure appears on Line 28 of the federal corporate income tax return.
- Any provision of the TCJA that is reported below Line 28 on the federal return will have no impact on the NH BPT regardless of whether NH conforms.

Federal Form 1120

Income	1a Gross receipts or sales	1a			
	b Returns and allowances	1b			
	c Balance. Subtract line 1b from line 1a				1c
	2 Cost of goods sold (attach Form 1125-A)				2
	3 Gross profit. Subtract line 2 from line 1c				3
	4 Dividends (Schedule C, line 19)				4
	5 Interest				5
	6 Gross rents				6
	7 Gross royalties				7
	8 Capital gain net income (attach Schedule D (Form 1120))				8
	9 Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)				9
10 Other income (see instructions—attach statement)				10	
11 Total income. Add lines 3 through 10				11	
Deductions (See instructions for limitations on deductions.)	12 Compensation of officers (see instructions—attach Form 1125-E)				12
	13 Salaries and wages (less employment credits)				13
	14 Repairs and maintenance				14
	15 Bad debts				15
	16 Rents				16
	17 Taxes and licenses				17
	18 Interest				18
	19 Charitable contributions				19
	20 Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)				20
	21 Depletion				21
	22 Advertising				22
	23 Pension, profit-sharing, etc., plans				23
	24 Employee benefit programs				24
	25 Domestic production activities deduction (attach Form 8903)				25
	26 Other deductions (attach statement)				26
	27 Total deductions. Add lines 12 through 26				27
	28 Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.				28
	29a Net operating loss deduction (see instructions)	29a			
	b Special deductions (Schedule C, line 20)	29b			
	c Add lines 29a and 29b				29c
Tax, Refundable Credits, and Payments	30 Taxable income. Subtract line 29c from line 28. See instructions				30
	31 Total tax (Schedule J, Part I, line 11)				31
	32 Total payments and refundable credits (Schedule J, Part II, line 21)				32
	33 Estimated tax penalty. See instructions. Check if Form 2220 is attached			<input type="checkbox"/>	33
	34 Amount owed. If line 32 is smaller than the total of lines 31 and 33, enter amount owed				34
	35 Overpayment. If line 32 is larger than the total of lines 31 and 33, enter amount overpaid				35
36 Enter amount from line 35 you want: Credited to 2018 estimated tax ▶			Refunded ▶	36	

New Hampshire Conformity

- For TY2000 through TY2016, NH referenced the IRC as of December 31, 2000.
- For TY2017, NH references the IRC as of December 31, 2015. For TY2018, NH references the IRC as of December 31, 2016.
- Some provisions of the TCJA apply to TY2017. Most provisions apply to TY2018.
- In order to incorporate the TCJA into the NH Business Profits Tax (BPT), NH would need to amend RSA 77-A:1, XX to reference the IRC of December 31, 2017.
- The TCJA represents the most expansive package of tax law changes enacted since the 1986 overhaul of the IRC. The TCJA has and will continue to alter the various costs and incentives impacting businesses at the federal level in a way that will impact the state tax landscape regardless of whether New Hampshire legislatively adopts the IRC as amended by the TCJA.

Multinational Tax Issues

Foreign Dividends

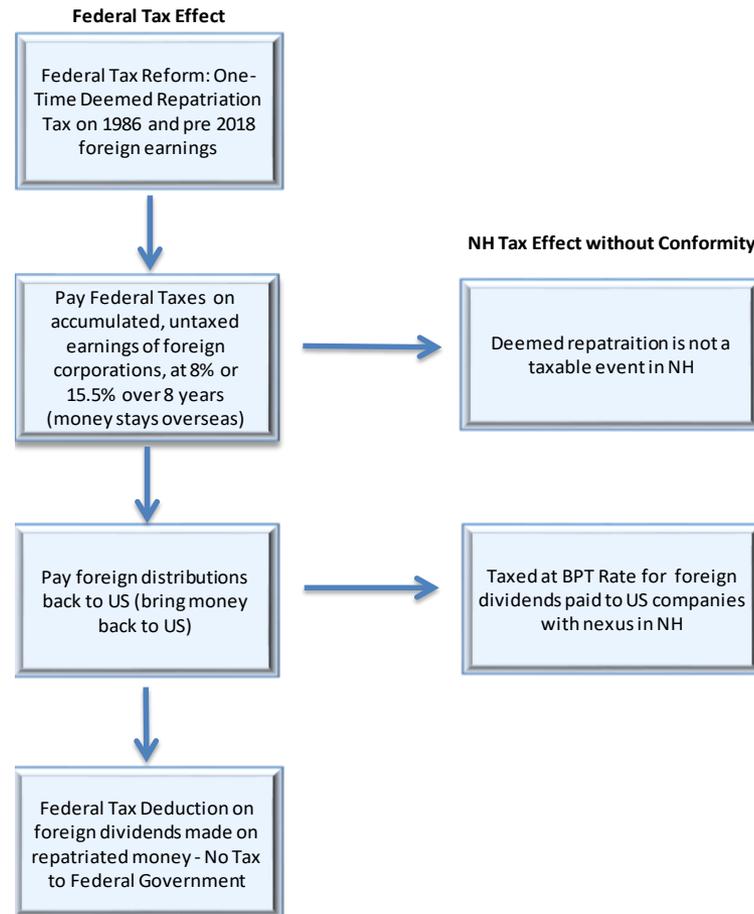
- In NH, taxation of foreign earnings from a foreign subsidiary is deferred until the foreign subsidiary pays a dividend to a domestic parent.
- The federal government will no longer tax foreign dividends by providing taxpayer's with a dividends received deduction.
- NH references federally reported income prior to deductions and NOLs (NH references Line 28, NOLs are reported on Line 29). Therefore, conformity will have no impact on NH's taxation of foreign dividends.
- However, the new federal dividends received deduction is expected to incentivize the payment of dividends and therefore, NH may see increased revenue from foreign dividends regardless of whether NH conforms to the TCJA.

One-Time Deemed Repatriation of Foreign Earnings

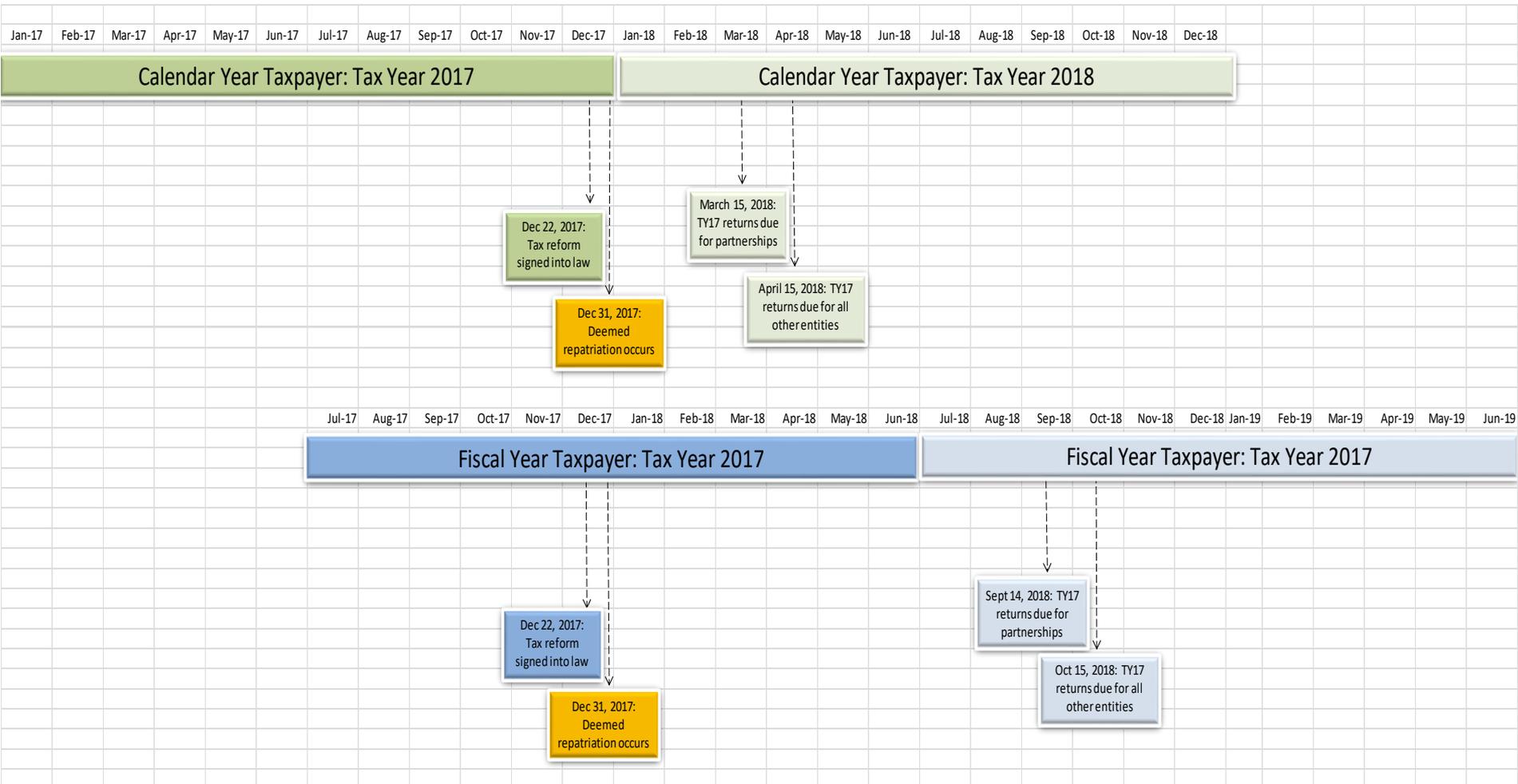
- Taxpayers who have untaxed foreign earnings accumulated since 1986 and located outside the U.S. will be “deemed” to repatriate those foreign earnings and pay a reduced federal tax rate.
- To the extent those foreign earnings are actually repatriated concurrently or at a later date, those actually repatriated dividends will not be subject to any additional federal taxation.
- NH will not tax any foreign earnings through this deemed repatriation unless NH conforms to the TCJA. Federally, this deemed repatriation will begin appearing on the federal return for taxable periods ending on or after December 31, 2017.
- Under current NH law, NH would tax foreign earnings that are actually repatriated as dividends concurrently or at a later date.

One-Time Deemed Repatriation of Foreign Earnings

Federal and NH Tax Effect on Federal One-Time Deemed Repatriation Tax



Deemed Repatriation: Timing



Notes:

(1) There are numerous other possible tax years, however the two above tax years represent the chosen tax year for the vast majority of NH's business taxpayers.

(2) The relevant language from federal tax reform is as follows: "SEC. 965. TREATMENT OF DEFERRED FOREIGN INCOME UPON TRANSITION TO PARTICIPATION EXEMPTION SYSTEM OF TAXATION. (a) TREATMENT OF DEFERRED FOREIGN INCOME AS SUBPART F INCOME. — In the case of the last taxable year of a deferred foreign income corporation which begins before January 1, 2018, the subpart F income of such foreign corporation (as otherwise determined for such taxable year under section 952) shall be increased by greater of— (1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or (2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017."

Expense Deductions Applicable to All Taxpayers

General Concepts

- Ordinary and necessary business expenses are generally deductible when calculating taxable income.
- Capital expenditures generally must be capitalized and depreciated over the useful life of the item (as defined by the IRC).

Business Interest

- Prior to the TCJA, business interest was wholly deductible as an ordinary business expense.
- The TCJA limits the deduction of business interest to the taxpayer's interest income plus 30% of adjusted taxable income. This limitation does not apply to certain small businesses.
- If NH conformed to the TCJA NH would similarly limit the deduction of business interest which could increase revenues.

IRC Section 179

- Federally, prior to the TCJA, taxpayers could elect to immediately deduct up to \$500,000 of the cost to acquire otherwise depreciable property.
- The TCJA will now allow taxpayers to elect to immediately deduct up to \$1 million of the cost to acquire depreciable property federally.
- NH “decouples” from the IRC Section 179 deduction as follows:
 - Prior to 1/1/2017 - \$25,000
 - 1/1/2017-12/31/2017 - \$100,000
 - 1/1/2018-Present - \$500,000
- Conforming to the TCJA will not alone accomplish conformity. Additionally, RSA 77-A:3-a, which decouples NH from the IRC Section 179 deduction, would need to be repealed.
- In theory the IRC Section 179 deduction is a timing issue because any deduction disallowed by NH in the year of acquisition would be deducted as depreciation in later years. However, because of the time value of money, businesses moving, going out of business, or their NH apportionment changing, it cannot be said with any certainty that there is long-term revenue neutrality.

Bonus Depreciation

- IRC Section 168 accelerates the depreciation deduction (termed “bonus depreciation”) depending on the type of capital asset.
- The TCJA permits taxpayers to immediately deduct 100% of the cost to acquire certain capital assets until December 31, 2022, at which point the permissible percentage deduction is reduced by 20% in each calendar year until such time as “bonus depreciation” is phased out entirely.
- NH decouples from IRC Section 168(k) “bonus depreciation” in RSA 77-A:3-b, I.
- NH could conform to federal “bonus depreciation” and thereby increase the amount of the cost to acquire depreciable property that may be immediately deducted until such time as “bonus depreciation” is phased out federally. Updating NH’s reference to the IRC will not alone accomplish conformity. Additionally, RSA 77-A:3-b, I would need to be repealed.
- In theory “bonus depreciation” is a timing issue because any deduction disallowed by NH in the year of acquisition would be deducted as depreciation in later years. However, because of the time value of money, businesses moving, going out of business, or their NH apportionment changing, it cannot be said with any certainty that there is long-term revenue neutrality.

Research & Experimental Expenditures

- Under the TCJA, beginning January 1, 2022, research and experimental expenditures will now generally be amortized and deducted over a 5-year period. Previously, these expenses were generally immediately deductible.
- Conformity to the TCJA would conform NH to the 5-year amortization period for research & experimental expenditures.
- This change is essentially a timing issue, with what was once an immediate deduction being instead taken ratably over a 5-year period. However, because of the time value of money, businesses moving, going out of business, or their NH apportionment changing, it cannot be said with any certainty that there is long-term revenue neutrality.

Qualified Opportunity Zones

- Under the TCJA, payment of tax on capital gains can be deferred if the capital gains are reinvested in “qualified opportunity zones.” The gain will be recognized when the taxpayer sells their investment in the qualified opportunity zone, unless the investment is held for 10 years or more, in which case the gain is no longer subject to tax.
- Qualified opportunity zones will be certain designated low-income areas nominated by the chief executive of each state.
- This is an entirely new tax deferral mechanism that would apply in NH if NH adopts the TCJA. This new deferral mechanism could reduce revenue.

Net Operating Losses

- Previously, under the IRC, NOLs could be carried back 2 years and forward 20 years and were available to reduce taxable income to zero.
- Under the TCJA, NOLs can no longer be carried back and can now be carried forward indefinitely. The NOL deduction taken in any year will be capped at 80% of taxable income.
- Because NH picks up federally reported taxable income prior to the line where taxpayers report NOLs, adopting the TCJA will not impact NH's specific treatment of NOLs.
- In NH, RSA 77-A:4, XIII permits only a 10-year carryforward of NOLs, limited to \$10,000,000 in any tax year.

Domestic Production Activities

- Under prior law, the IRC allowed a 9% deduction from income (with certain limitations) for income attributable to a very broad class of domestic production activities (mining, oil extraction, farming, construction, manufacturing, engineering, film production).
- The TCJA repeals this deduction for domestic production activities.
- NH already decouples from the federal deduction for domestic production activities and therefore conformity to the TCJA will have no impact.

Other Deductions Modified by TCJA

- **Like-Kind Exchanges:** The ability to defer the recognition of capital gains to the extent sale proceeds are used to purchase “like-kind” property has been limited to real property. Previously was applicable to the purchase of like-kind personal property.
- **Fringe Benefit Deduction:** The ability to deduct meal and entertainment expenses and the cost to provide on-premises meals to employees has been limited.
- **Fines and Penalties:** The ability to deduct expenses incurred for a law violation has been limited. Previously, a fine paid was not deductible but associated expenses were deductible.
- **Sexual Harassment Settlements:** Settlement payments are generally deductible. The cost to settle sexual harassment or assault claims will no longer be deductible if subject to a nondisclosure agreement.

Other Deductions Modified by TCJA (Continued)

- **Lobbying Expenses:** State and local lobbying expenses may no longer be deducted.
- **FDIC Premiums:** The deduction of FDIC premiums will be limited for certain large banks.
- **Commission and Performance-Based Wages:** The ability to deduct commission or performance-based employee remuneration in excess of \$1 million is limited.
- All of the items on Slides 22 and 23 would increase revenue to NH were NH to synchronize to the most recent version of the IRC.

Partnership- Specific Changes

Partnership-Specific Changes

- Federally, a partnership is not subject to taxation. Instead, each item of partnership income or loss is passed through to each partner, reported on each partner's individual income tax return, and subject to the individual income tax rates.
- The TCJA makes a number of changes to the taxation of partnership income at the federal level, including:
 - Allowing a deduction of up to 20% of pass through income in order to create parity with the new lower corporate tax rates.
 - Modifying the determination of the taxability of gain earned on the sale of a partnership interest.
- New Hampshire does not have an income tax and therefore, imposes the BPT at the partnership level.
- Because of this differential tax treatment, federal tax provisions relevant to partnerships and other disregarded entities have limited direct impact on the taxation of partnerships and disregarded entities in New Hampshire.