
Hearing on H.B. 2553 providing income tax modifications for global intangible low-taxed income, business interest, capital contributions and FDIC premiums
Kansas House
Committee on Taxation
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Speaking before the Committee

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Agenda

1. **Kansas taxation of corporate income**
2. Overview of global intangible low-taxed income (GILTI)
3. The multistate response to GILTI

Kansas taxation of corporate income
Federal conformity

- **Imposition of tax:** Kansas imposes a corporate income tax on the Kansas taxable income of every corporation doing business within the state or deriving income from sources within the state.

- **Tax base construction:** A corporation's Kansas taxable income is its federal taxable income from Kansas sources, after net operating losses (NOL) and special deductions, as adjusted by Kansas-specific additions and subtractions.
  - "Any reference in this act to the 'federal internal revenue code' shall mean the provisions of the **federal internal revenue code of 1986, and amendments thereto**, and other provisions of the laws of the United States relating to federal income taxes as the same may be or become effective at any time or from time to time for the taxable year." K.S.A. § 79-32,109(a)(1).
    - Thus, **Kansas tax law automatically incorporates federal changes to the IRC definitions of taxable income**, unless existing provisions or new tax law modify such federal chances.

Kansas taxation of corporate income
Combined reporting and apportionment

- **Domestic combined reporting:** To capture apportionable business income of a unitary business organized as multiple legal entities, Kansas utilizes a **combined reporting method** for members of a unitary business group.
  - A Kansas unitary business group is determined on a domestic combination basis and **foreign group members are excluded**. *See*, e.g., *Pioneer Container Corp. v. Beshears*, 684 P.2d 396 (Kan. 1984).

- **Apportionment:** Kansas apportions multistate combined business income using a **three-factor apportionment formula containing (i) property, (ii) payroll, and (iii) sales** factors of profitability.
  - All else equal, the more payroll and property a company has in the state, the higher its apportionment.

Kansas taxation of corporate income
Dividends

- **Dividend defined:** Distribution of current or accumulated earnings and profits from a corporation to its shareholders.
  - Foreign corporation to US corporation: Transfer of property (cash or other property) paid from a foreign corporation and received by a US corporation.
  - Economic event – transfer of property/value between two corporations.

- **Domestic dividends:** Kansas conforms to the federal deduction for dividends received from domestic subsidiaries.
  - 100% deduction for dividends from a wholly-owned subsidiary.

- **Foreign dividends:** A corporate taxpayer subtracts 80% of dividends received from corporations incorporated outside of the US which are included in federal taxable income. K.S.A. § 79-32,138(c)(v).

Kansas taxation of corporate income
Other foreign income

- **Kansas Supreme Court precedent:** Under the domestic combination methodology adopted in *Pioneer Container Corp.*, **only dividend income** from unitary foreign subsidiaries may be included in the Kansas tax base and apportioned. **All other foreign income may not be included in a Kansas domestic combined report**. *Appeal of Morton Thiokol, Inc.*, 864 P.2d 1175 (Kan. 1993).
  - GILTI is not a dividend (not a distribution of earnings and profits) and therefore presumably not taxable under existing Kansas case law – *to be further discussed in next section.*

- **IRC § 78:** This section requires certain taxpayers to include in federal taxable income deemed taxes paid for purposes of computing the federal foreign tax credit. Such income is hypothetical and necessary to appropriately compute the federal foreign tax credit.
  - Kansas corporations do not have a state equivalent foreign tax credit so including such income would be illogical. Kansas exempts such income by statute. K.S.A. § 79-32,138(c)(iv).
  - GILTI, although intended for another purpose, is analogous to IRC § 78 deemed income in that income is included federally for the purpose and effect of interacting with the foreign tax credit.

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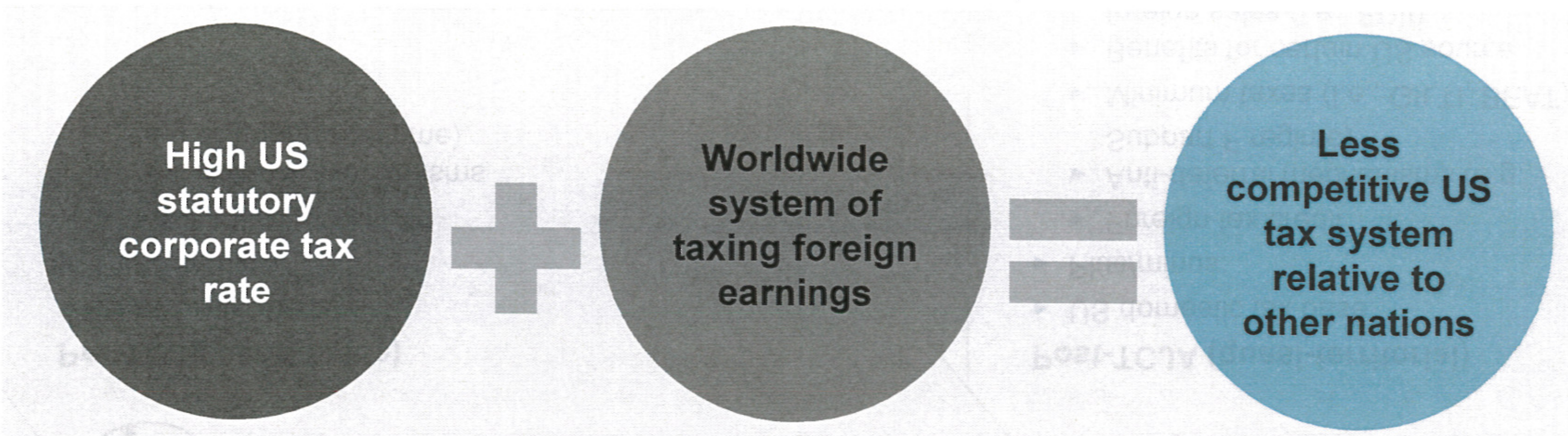
Major drivers of "Tax Cuts and Jobs Act" (P.L. 115-97)



- Per the "Unified Framework" released in 2017, tax reform would be focused on lowering the corporate rate and moving to a "territorial" system intended to put US rate below average of other industrialized countries and promote greater investment in the US while eliminating incentives to keep foreign profits offshore.

Shift to quasi-territorial federal taxation of multinationals

Pre-TCJA (worldwide)

- Worldwide tax base
- Plus/minus:
  - Foreign tax credit
  - Anti-deferral mechanisms (e.g., Subpart F regime)

Post-TCJA (quasi-territorial)

- US domestic tax base
- Plus/minus:
  - Foreign tax credit
  - Anti-deferral mechanisms (e.g., Subpart F regime)
  - Minimum taxes (i.e., GILTI, BEAT)
  - Benefits for certain US source foreign sales (i.e., FDII)

GILTI income and deduction

- **GILTI is an annual federal income inclusion intended to operate, in conjunction with the FTC, as a federal minimum tax on certain worldwide income:**
  - The effect of this new provision is to tax at a reduced rate and on a global basis the foreign profits of US multinational corporations.
  - GILTI is a **minimum tax** for federal income tax purposes:
    - It is **not** economic income of a US corporation resulting from a sale of a good, the provision of a service, or the use of an intangible by the corporation's foreign subsidiary.
    - It is **not** US income, which is already subject to federal tax.
    - It **is** a minimum tax on income earned in foreign taxing countries and does not itself constitute an actual distribution to the US.

GILTI income and deduction (cont.)

- **Essential components of the federal GILTI calculation:**
  - **IRC § 951A:** Includes all global income earned by the taxpayer's foreign subsidiaries in excess of a certain return. Makes assumption on how much is intangible based on a set rate of return on tangible assets.
  - **IRC § 250(a)(1)(B)):** Provides an offsetting deduction to lower the effective tax rate.
  - **Foreign tax credits**: Finally, a credit is provided for 80% of taxes paid to foreign jurisdictions on the GILTI income, which ensures only low-taxed foreign income is subject to federal taxation. Generally, a taxpayer will not be subject to residual US tax if the average foreign tax rate imposed on such income is at least 13.125% (increased to 16.406% in 2026).

GILTI income and deduction (cont.)

Simplified example (in millions USD)

Federal income tax:	
Net GILTI	$ 75.00
GILTI gross-up (foreign taxes deemed paid)	$ 30.00
Federal taxable income	$ 105.00
Federal tax rate	21%
Tentative federal tax	$ 22.05
Less: foreign tax credit (80% * $30.00 = $24.00)	$ (22.05)
Federal tax on GILTI	$ -

- In this example, a US shareholder of a CFC has $75 of net GILTI ($150 GILTI less GILTI deduction).
- The CFC paid foreign taxes at a 20% rate for a foreign tax expense of $30.
- Because its foreign tax rate exceeds the minimum threshold, the US shareholder owes no federal income tax on its GILTI.

GILTI income and deduction (cont.)

Simplified example (in millions USD)

Kansas income tax:	**A**	**B**	**C**	**D**
Starting point: federal taxable income	$ 105.00	$ 105.00	$ 105.00	$ 105.00
Less: GILTI gross-up	$ (30.00)	$ (30.00)	$ (30.00)	$ (30.00)
Kansas taxable income	$ 75.00	$ 75.00	$ 75.00	$ 75.00
Apportionment factor	1%	5%	20%	40%
Kansas tax rate (assume top marginal)	7%	7%	7%	7%
Kansas tax on GILTI	**$ 0.05**	**$ 0.26**	**$ 1.05**	**$ 2.10**

- In Kansas, which does not offer a foreign tax credit to corporations, GILTI becomes only a base-expanding income inclusion. Scenarios A-D represent varying apportionment factors.
- In all scenarios, **the Kansas tax liability exceeds the US federal tax liability**. The impact grows as the Kansas apportionment factor – indicative of in-state presence – grows.

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State conformity to provisions of the TCJA

- **Impact of the TCJA on corporations:**
  - A **federal** tax decrease of about 10%.
  - A **Kansas** tax increase of about 11%
    - COST/ EY study *"The Impact of Federal Tax Reform on State Corporate Income Taxes"* (March 2018) (based on state conformity to IRC as of TCJA enactment).

- **This projected outcome is inadvertent and may be arbitrary:**
  - States that conform to the TCJA – either automatically or by updating its IRC conformity date – and take no further action, incorporate federal corporate base-broadening measures.
  - States do not conform to the reduced federal rate.
  - Therefore, if Kansas does **not** decouple from the TCJA this inaction would effect a significant state tax increase on businesses.

State considerations for GILTI

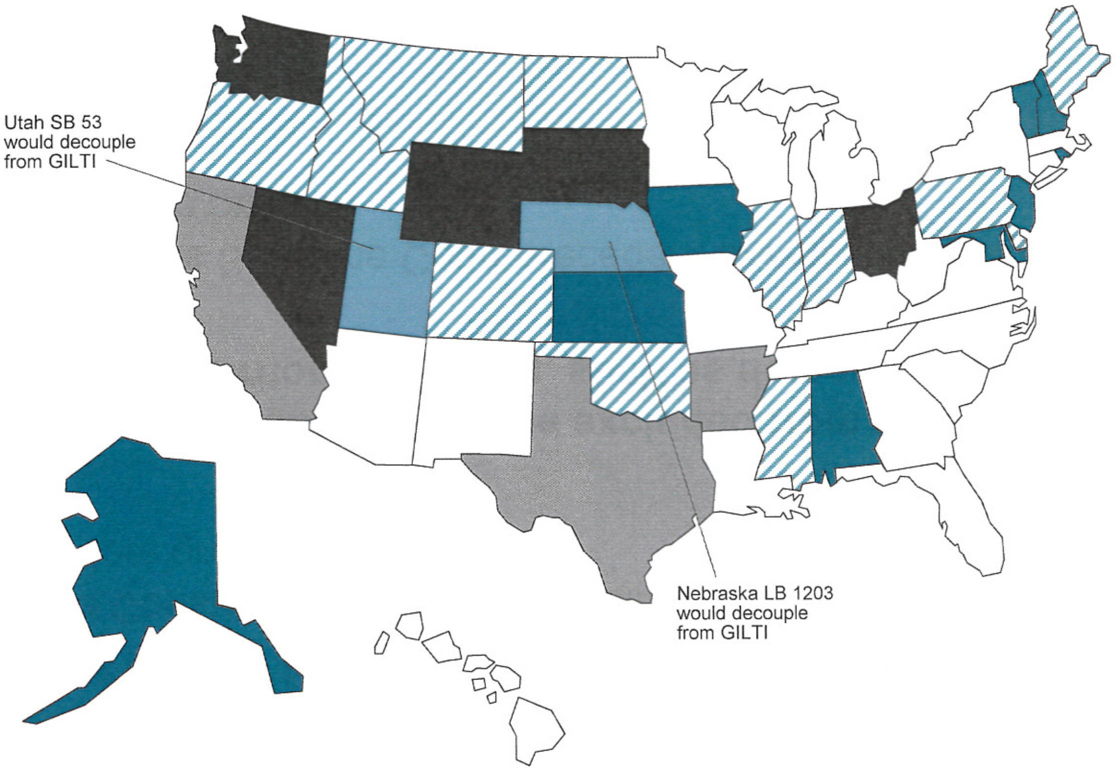
- **The TCJA was designed, in relevant part, to favor US employment and investment.**
  - States, however, are limited by the Constitution's Commerce Clause and are not permitted to favor domestic commerce over foreign commerce.

- **GILTI is foreign-source income and presumably should be excluded from taxation pursuant to state tax policies that seek territorial taxation, such as domestic unitary combined reporting, like in Kansas.**
  - This approach is consistent with Kansas Supreme Court precedent exempting foreign non-dividend income from Kansas corporate taxation.

State responses to GILTI for the 2020 taxable year

Key

- Pre-TCJA fixed conformity (not taxable)
- ≥ 95% modification to GILTI (generally not taxable)
- Special rules (taxability typically impacted by percentage ownership of subsidiary or state return filing methodology) or partial modification to GILTI *
- No modification to GILTI, but decoupling legislating is proposed
- No modification to GILTI (generally taxable)
- No state corporate income tax



*Map reported prior to effects of GILTI deduction and state expense disallowance statutes.
Source: Ernst & Young LLP analysis of state laws as of January 1, 2020 (exceptions may apply)

Questions

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