

Effect of TCJA on PA

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Tax Cuts and Jobs Act

Effect on Personal Income Tax

- Major federal tax reform, commonly known as the Tax Cuts and Jobs Act (TCJA), was signed into law on December 22, 2017. The bill made sweeping changes to both personal and corporate income taxes.
- The Personal Income Tax (PIT) reform consisted of broad marginal rate cuts along with doubling of the standard deduction. Other deductions were also either capped or eliminated.
- The changes to the PIT do not directly affect PA (with a few minor exceptions), as PA PIT does not rely on Adjusted Gross Income as a starting point.

PIT Estimated Payments (\$thousands)			
<u>December 2016</u>	<u>December 2017</u>	<u>Difference</u>	
150,159.2	240,568.6	90,409.4	60.2%
<u>January 2017</u>	<u>January 2018</u>	<u>Difference</u>	
439,888.7	546,325.6	106,436.9	24.2%

PIT Final Payments (\$thousands)			
<u>April 2017</u>	<u>April 2018</u>	<u>Difference</u>	
820,509.5	915,379.2	94,869.8	11.6%

Effect on Corporate Net Income Tax

- The Corporate Tax Reform consists of broadening the base, along with a tax rate cut from 35% to 21%, as well as a shifting of the taxation of multinational businesses into a more territorial regime.
- The base broadening effects and other tax changes will affect the Pennsylvania Corporate Net Income (CNIT) base. The Council of State Taxation has estimated the increase in the Pennsylvania CNIT base to be 14% (2018-2027). DOR analysis has a lower estimate, especially in the earlier years while it may essentially be a small net effect.
- It may be difficult to measure the impact of some of these changes, even when the 2017 and 2018 tax forms are filed.

Effect on Corporate Net Income Tax

- As part of the budget passage each year, the Department of Revenue assists in certifying the official revenue estimate for that year.
- For 2018-19, the General Fund official estimate is \$33.974 billion. CNIT is \$2.926 billion.
- While analysis has been done to measure the revenue impact of the federal bill, those figures were not added to the official estimate with the exception of the bonus depreciation adjustment for CNIT which reduced the estimate by over \$100 million.

Major Provisions of Corporate Tax Reform

Items that do not Affect the PA CNIT Base

- The rate is decreased from 35% to 21%.
- The NOL for a given year is limited to 80% of taxable income.
- The Alternative Minimum Tax is eliminated.

Major Items that Affect the PA CNIT Base

Cost Recovery

Bonus Depreciation

- Before Act 72 of 2018 – Bonus Depreciation was permitted but was required to be added back and recovered over several years.
- The formula that passed for 30% depreciation doesn't work for 50% or 100%.
- The General Assembly passed Act 72-2018 in response to allow depreciation to be recovered.

Net Interest Expense Deduction

- Is limited to 30% of taxable income. DOR is planning to publish guidance in the fall on the interaction of this with the state addback provision.

Small Business Reform

- Section 179 expensing election is increased to \$1 million (from \$500,000).
- Several provisions were enacted to simplify and reform small business accounting.

Business Related Deductions

- The deduction for domestic production activities provided under section 199 is repealed.
- The bill provides a limitation of deduction by employers of expenses for entertainment and certain fringe benefits.

International Tax Reform

- The new law shifts the taxation of multinational businesses into a more territorial regime. A 100 percent deduction is allowed for the foreign-source portion of dividends received by U.S. shareholders; foreign corporations are subject to tax on U.S. source income.

Repatriation Transition Tax

- In order to ensure that income that has been earned by a controlled foreign corporation will not escape taxation, a one-time tax on foreign earnings is imposed – the repatriation transition tax (RTT).
- The RTT also has a specific federal deduction in order to lower the effective rate.
- The RTT is to be included in the CNIT income base
- Taxpayers may also recognize the Repatriation Deduction
- Because the repatriated income is treated as dividend income for Pennsylvania tax purposes, it will be excluded from the sales factor
- PA DOR published Corporation Tax Bulletin 2018-01 to explain the treatment of RTT in the CNIT base.

Repatriation Transition Tax

Corporation has \$1M of RTT income and is eligible for a \$557K RTT deduction
Corporation can take 80% DRD for PA purposes

RTT Income	1,000,000
RTT Deduction	557,143
Net RTT	442,857
PA DRD	(354,286)
CNIT Tax Base	88,571

Global Intangible Low-Taxed Income (GILTI)

- The new code section 951A would require a U.S. shareholder of a Controlled Foreign Corporation to include “global intangible low-taxed income” (“GILTI”) in a manner similar to subpart F income. There is also a deduction for corporate shareholders equal to 50% of GILTI, which would be reduced to 37.5% starting in 2026. GILTI is the excess of a shareholder’s CFCs’ net income over a routine or ordinary return.
- DOR is creating guidance on how to treat the GILTI in the CNIT base. The IRS released guidance on GILTI on September 13th.

Effect on PA Tax Credits

- In TCJA, the state and local tax (SALT) deduction limitation was set at \$10,000. States responded by proposing work-arounds to allow their residents to continue to use unlimited deductions.
- In response, the IRS published Notice 2018-54, which stated that the Treasury Department intended to publish regulations that addressed the federal treatment of these transfers.
- While the regulations will limit the deductibility of these transfers as a charitable deduction, it is unclear what effect this may also have on tax credits that had existed prior to the SALT deduction limitation.
- In Pennsylvania, there are educational tax credits that may have their federal deductibility impacted. These credits are utilized at about \$160 million per year.
- Pennsylvania DOR will continue to administer the tax credit program, which allows for a 90% tax credit for donations to scholarship organizations or educational improvement organizations.