STATE TAXES AFTER REFORM
PARTNERSHIP

Talking Points
South Carolina H. 5341

Summary of Key Issue Recommendations

- ***Repatriation*:** Existing law decouples from IRC section 965. *Support* this bill's lack of change concerning this issue.
- ***GILTI:*** Existing law decouples from IRC section 951A. *Support* this bill's lack of change concerning this issue.
- ***Interest Expense Limitation:*** This bill would decouple from IRC section 163(j). *Support* this bill's decoupling from IRC section 163(j).
- ***Capital Contributions*:** The bill would decouple from IRC section 118, as amended by federal tax reform. *Support* this bill's decoupling from the amended version of IRC section 118.
- ***FDIC Premiums:*** The bill would decouple from IRC section 162(r). *Support* this bill's decoupling from IRC section 162(r).

Detailed Policy Recommendations

- ***Repatriation:*** Support decoupling from repatriation provisions (IRC section 965). This is consistent with historic policy. Generally, states do not include world-wide income in tax base. Inclusion of deemed repatriated foreign earnings would be contrary to this policy because it would be taxation of income earned in a foreign trade or business. Decoupling from IRC section 965 avoids significant apportionment complexity and potential disputes.
- ***GILTI:*** Support decoupling from GILTI (IRC section 951A). Generally, states do not include world-wide income in tax base. Inclusion of foreign earnings would be contrary to this policy because it would be taxation of income earned in a foreign trade or business. At the federal level, taxation of GILTI is supposed to reach only that income that is attributable to "low-tax" foreign jurisdictions; this is accomplished by use of foreign tax credits. South Carolina does not apply foreign tax credits, so conformity would result in taxing much more than income earned in low-tax jurisdictions. Decoupling from IRC section 951A avoids significant apportionment complexity and potential disputes.

Recommendations as of May 23, 2018. About Us: The STAR (State Taxes After Reform) Partnership was formed to help the business community navigate the state legislative, executive, and regulatory reaction to federal tax reform. Please visit our website for more information about the STAR Partnership and our work (www.star-partners.org).

MULTISTATE McDermott Will & Emery

- ***Interest Expense Limitation:*** Support this bill's decoupling from IRC section 163(j). South Carolina should decouple from the interest expense limitation of IRC section 163(j). First, the limitation provides no material benefit to the state because South Carolina already has provisions in place to address improper interest deductions, such as the related-party add back provisions and the potential application of transfer pricing principles. Furthermore, the interest expense limitation has been added at the federal level as a companion to the expensing provisions; the interest expense limitations ensure that taxpayers do not get a double benefit by purchasing certain assets that are eligible for expensing by means of excessive borrowings that would result in an interest expense deduction. Therefore, since South Carolina does decouple from the expensing provisions, it is both logical and fair that it should also decouple from the interest expense limitation.

  Additionally, it would be extremely complex to apply the federal interest expense deduction limitations of 163(j) in South Carolina. For example, because South Carolina is a separate return state, separate computations would be needed for each separate return filed in the state. Furthermore, due to the different South Carolina computations, it is very likely that taxpayers will have interest expense limitations imposed in South Carolina even though those taxpayers do not have any interest expense limitations at the federal level. Finally, the South Carolina Legislature or Department of Revenue will need to spend a significant amount of time drafting rules concerning a myriad of issues, including: whether carried-forward interest expense will be based on the taxpayer's apportionment in the year the interest expense is paid or in the year the interest expense is used; how to coordinate the carried-forward interest expense and the add back for certain interest expense paid to related parties; how to account for the carried-forward interest expense when there is a change of ownership in the taxpayer; and whether to address the likely double taxation when intercompany interest income is taxed and the interest expense is subject to the limitation disallowance. This can all be avoided by decoupling from IRC section 163(j).

- ***Capital Contributions:*** Support this bill's decoupling from IRC section 118, as amended by the Tax Cuts and Jobs Act. South Carolina should conform to IRC section 118 as it was in effect prior to the Tax Cuts and Jobs Act. Conforming to the current IRC section 118 would tax corporations on contributions by governmental entities and civic groups such that state governmental and local governmental incentives to attract and retain businesses would be taxable to the corporation. If a state wants to use incentives to attract and retain businesses, imposing tax on such incentives reduces the effectiveness of such policy.

- ***FDIC Premiums:*** Support this bill's decoupling from IRC section 162(r). South Carolina should decouple from IRC section 162(r). This federal provision disallowing a deduction for FDIC fees was included purely as a means of raising revenue to offset other provisions that reduced the overall amount of corporate federal income taxes that will be paid to the federal government. Because taxpayers are not benefitting from an overall tax reduction in South Carolina, there is no rationale for limiting the deductibility of FDIC fees. Furthermore, this provision negatively impacts institutions with a significant presence in South Carolina.