COST
COUNCIL ON STATE TAXATION

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Louisiana House of Representatives
Ways and Means Committee

Louisiana State Senate
Revenue and Fiscal Affairs Committee

Re: Louisiana Application of Federal Corporate Tax Reform

Dear Chairman Abramson, Chairman Morrell, and Committee Members:

On behalf of the Council On State Taxation (COST),[1] I am submitting testimony concerning the impact of federal tax reform on Louisiana corporate taxpayers that should be considered by the Louisiana State Legislature this year.

Earlier this year, COST and its research affiliate, the State Tax Research Institute (STRI), published a study conducted by Ernst & Young LLP on the state corporate tax impact of federal tax reform enacted under the Tax Cuts and Jobs Act of 2017.[2] This study showed a potential corporate tax base expansion resulting from federal conformity averaging 12% nationwide, including in Louisiana. Unfortunately, this corporate base expansion often works at the state level at cross purposes to the intended effects at the federal level (*e.g.*, to incentivize domestic investment and make U.S. businesses more competitive globally). Existing Louisiana corporate tax law in some instances exacerbates this policy disconnect, further disadvantaging Louisiana's job creators.

Louisiana, as a "rolling conformity" state, automatically adopts these changes, and therefore it is critical that the Louisiana State Legislature make appropriate adjustments this year to avoid the potential negative (and inadvertent) results. Below are some of the major issues facing Louisiana due to its rolling conformity to the federal corporate tax changes:

- **Corporate Tax "Repatriation" under I.R.C. Sec. 965.** Louisiana has temporarily limited dividend deductibility to 72% of the amount of dividends that otherwise would be included in gross income. If the limitation is extended beyond its current sunset date, this could have the effect of limiting the deductibility of "Subpart F" income representing accumulated foreign

[1] 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.
[2] The study is available on the COST website at: http://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/cost-federal-tax-reform-3-1-2018-cost-v2.pdf.

earnings back to 1986 under the federal tax reform. However, the Louisiana dividend limitation only went into effect during 2015, meaning that for prior years domestic dividends could receive a 100% deduction, while foreign earnings for years between 1986 and 2015 might be limited to a 72% deduction. This likely unconstitutional result should be remedied by the Legislature by providing a 100% dividend deduction for "repatriated" earnings under I.R.C. Sec. 965.

- **Territorial Taxation under I.R.C. Sec. 245A.** The Louisiana dividend deduction limitation also works at cross purposes to the I.R.C. Sec. 245A deduction for 100% of foreign dividends received. Louisiana should provide for a 100% dividend deduction for both domestic and foreign dividends to align with the I.R.C. Sec. 245A effective date of taxable years ending after December 31, 2017.[3]

- **Taxation of Certain Foreign Income under I.R.C. Sec. 951A.** The federal tax reform provides for taxation of certain "global intangible low-taxed income," or GILTI, under I.R.C. Sec. 951A. This income represents a portion of active foreign earnings of U.S. multinational corporations and, for state tax purposes, disproportionately impacts in-state companies. Further, state taxation of such income reaches beyond the "water's edge," distorts income attributable Louisiana, and is likely unconstitutional for Louisiana to tax. Because of the anticompetitive effects of taxing this income and the uncertainty regarding its implementation, several states including Georgia have already decoupled from these provisions.[4]

- **Immediate Expensing under I.R.C. Sec. 168(k) and Interest Deductibility Limitations under I.R.C. Sec. 163(j).** Federal tax reform provides for an extension of "bonus depreciation" under I.R.C. Sec. 168(k) to provide for immediate expensing of certain business investments. Louisiana conforms to these provisions, which are intended to help businesses invest in and grow their U.S. operations. However, a proposal in the current special session would repeal this conformity (H.B. 22). This proposal would not only harm Louisiana investment, it is particularly unfair given Louisiana's "rolling conformity" and its resulting adoption of interest deductibility limitations under I.R.C. Sec. 163(j).

  Louisiana instead should decouple from I.R.C. Sec. 163(j), which represents the largest (and continuing) element of the estimated state corporate base increase resulting from conformity to federal tax reform. The interest deductibility limitation applies to both intercompany and third-party borrowing, and thus impacts all borrowing by Louisiana taxpayers for both business operations and investment/expansion. Louisiana recently adopted an "addback" law applicable to certain intercompany borrowing that explicitly allows the deduction of these interest expenses where they are not to avoid Louisiana tax

[3] For more on the policy grounds for allowing full deductibility of dividends in Louisiana, please see COST's prior written testimony to the Legislature, available at: http://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-comments-and-testimony/testimony-re--deduction-for-dividend-income.pdf.
[4] COST's letter to the Georgia General Assembly outlining policy concerns with these provisions is available here: http://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-comments-and-testimony/03062018-ga-letter-to-gen-assembly-re.-foreign-income-taxation.pdf.

or are attributable to third-party borrowing. Louisiana should allow its addback law to work and avoid the complexity and anticompetitive effect of coupling to I.R.C. Sec. 163(j). Multiple states, including Mississippi (already decoupled due to prior law), Tennessee, and Georgia, have decoupled from this provision, and more states in the southeast are considering like action.

- **Limitation of Net Operating Loss Deductions.** Louisiana limits net operating loss deductions to 72% of the amount of net Louisiana loss incurred in a preceding year. Federal tax reform instead includes a limitation of 80% of taxable income, with an unlimited carryforward period. At a minimum, Louisiana should conform to the new federal limitation and carryforward rules to reduce complexity and disincentives to Louisiana investment. Likewise, Louisiana should take this opportunity to repeal its Louisiana-specific ordering rules for the deduction of losses, which also result in complexity and distortion.

Thank you for the opportunity to share COST's research on the issue of federal tax reform conformity and specific issues facing Louisiana. Please contact me with any questions regarding this testimony or COST's research.

Respectfully,

Ferdinand Hogroian

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