March 14, 2019

Chair Mark Hass
Senate Finance & Revenue Committee
900 Court Street NE
Salem, OR 97301

RE: Proposed addback of federal GILTI deductions to state taxable income

Dear Chair Hass and Members of the Committee,

Thank you for the opportunity to submit these written comments on the behalf of the Smart Growth Coalition regarding the contents of SB 851.

About the Smart Growth Coalition

The Smart Growth Coalition is a consortium of tax professionals representing multistate and multinational taxpayers located in Oregon. Our coalition was formed in 1999 to add technical expertise to state legislative proceedings regarding proposed reforms to state tax law affecting businesses. Our members are unified in their commitment to sound tax policies that encourage local investment and provide technical simplicity and clarity to the state tax code.

Global Intangible Low-Taxed Income (GILTI)

In 2017, Congress enacted and the president signed the most significant overhaul of the federal tax code in more than a generation. The reforms include a lowering of the federal corporate income tax rate and a substantial broadening of the corporate income tax base to help pay for those lower rates. Among the many provisions related to the corporate income tax base was a substantial change in the tax treatment of multinational income, effectively moving the U.S. from a worldwide tax system to a hybrid-territorial tax system.

Under the 2017 tax law, Congress effectively eliminated the tax on the foreign-source portion of dividends returned to the U.S. and created guardrails intended to prevent tax planning around the new system. Among those guardrails is a new category of income designed to prevent tax planning strategies in low-tax jurisdictions. This guardrail is included in IRC §951A, known as global intangible low-taxed income (GILTI), and is an inclusion of foreign operating income exceeding an expected rate of return. As part of the GILTI computation, new IRC §250 allows a 50 percent deduction (effectively imposing a tax rate of 10.5 percent on the income) and tax credits to offset tax payments to foreign governments, limited to 80 percent of GILTI.

State income tax laws, including those in Oregon, are not designed around the inclusion of foreign operating income in the state tax base. In fact, almost all the states limit their tax base to income sourced within the water's edge (income earned in the U.S.) and have had no need for foreign tax credits to offset tax payments associated with the foreign income. If a state decided to include GILTI in its tax base without recognizing the tax circumstances of the inclusion, the amount included in the state tax base would far exceed the amount included in the federal tax base. More notably, simply including GILTI in the state tax base would include income reported in low **<u>and high-tax</u>** countries, and would be a major deviation from the federal strategy to prevent tax planning around the new system.

Application of GILTI Inclusion in Oregon

As taxpayers adjust to the new tax law, both at the federal and state level, much attention is being placed in the state tax treatment of GILTI. In addition to the issues outlined above, there is considerable uncertainty for taxpayers regarding the application of GILTI to Oregon taxable income.

Oregon is aligned with most other states in limiting the corporate income tax base to the water's edge. However, the rolling connection to federal taxable income means the reach of the tax base could span outside the water's edge by virtue of a GILTI inclusion. The coordination of these two policies seem to be counterintuitive of one another. Additionally, there are many questions regarding the method for including GILTI into the state tax base. For example, the Joint Committee on Taxation's "Blue Book" states that "GILTI inclusions are generally treated as Subpart F inclusions."[1] The Oregon Department of Revenue has provided the Oregon Dividends Received Deduction

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[1] Joint Committee on Taxation, General Explanation of Public Law 115-97 at 370 (December 20, 2018).

(DRD) applies to Subpart F income in part to recognize the absence of a state foreign tax credit regime. However, the department has not made a declaration on GILTI and the statutory language for the Oregon DRD (ORS 317.267) does not currently contain any reference to GILTI. Ultimately, issues such as these are bound to induce audits and appeals in the absence of clear legislative guidance around the tax treatment of GILTI.

Comments on SB 851

Our understanding of SB 851 is it is an attempt to clarify the tax treatment of GILTI for Oregon taxpayers. The Smart Growth Coalition appreciates the attention to some of the irregularities of this very technical tax issue. However, there continues to be questions raised regarding the tax treatment of GILTI under the original bill language.

SB 851 requires an addback of the federal GILTI deduction to state taxable income. However, there is no specific language in ORS 317.267(2) applying the Oregon DRD to the inclusion of GILTI in the state tax base. Our understanding, based on discussions with staff, is the bill is intended to apply the deduction allowed in subsection (2) to the GILTI inclusion. If so, the language should be amended to specify the deduction in subsection (2) be applied against the amount attributable to IRC §951A.

Moreover, the position of the Smart Growth Coalition is that Oregon should not conform to GILTI because it is a deviation from the water's edge approach. With that said, if the policy decision of the legislature is to include GILTI in the state tax base, the importance of providing clarity to taxpayers cannot be understated.

Thank you for allowing us to submit these comments to the official record.

Sincerely,

Jeff Newgard
Executive Director