PRELIMINARY REPORT ON THE EFFECTS ON MAINE TAXES OF THE FEDERAL TAX CUTS AND JOBS ACT

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Office of Tax Policy

Maine Revenue Services

Department of Administrative and Financial Services

EXECUTIVE SUMMARY

The Tax Cut and Jobs Act (TCJA) is the most significant overhaul of the federal tax Code since the Tax Reform Act of 1986. The new law has wide-ranging implications on individual and business taxation, including a new international tax regime. Furthermore, the TCJA has a broad effect on the states, many of whom—Maine among them—have historically sought to "conform" to the federal tax Code, or "the Code." For context, following the 1986 reform, 39 of 40 states with an income tax conformed in 1987; the last one followed suit in 1988.[i] As a result of prior conformity efforts—and direct linkages between Maine's tax law and the federal tax Code—changes to the federal system stand to affect significantly the state taxes that Mainers pay and revenues flowing to our state.

TCJA Effect on Federal Tax Burden in Maine

Beginning with a broader view of the federal reform bill's effect on our state, it is helpful to view the law's component parts. Even absent conformity actions to recouple Maine's tax law to the federal Code, the TCJA has a broad impact on Maine households, small businesses and corporations. According to estimates by the Institute of Taxation and Economic Policy (ITEP), the new law provides an overall economic benefit to Mainers of approximately $1 billion in 2019.[ii] $563 million of that would be in the form of federal income tax cuts for Maine individual income taxpayers, which aligns with MRS estimates.[iii] Maine pass-through businesses would receive another $198 million in federal tax cuts, and there would be a corporate benefit of $293 million.

By contrast, it is important to note that the change to the state and local tax deduction has the opposite effect on certain Maine taxpayers. In limiting the state and local tax deduction to $10,000, the new law effectively increases the state tax burden on Mainers who pay significant state and local taxes.

TCJA Effect on State Individual Tax Burden in Maine

In terms of the TCJA's effect on state tax burden in Maine, that will be dependent on the degree to which policymakers determine to conform Maine's tax law to the new federal Code—or to take the necessary steps to formally decouple it. Full conformity, for example, would result in a tax increase of approximately $250 million annually for Maine individuals and businesses. The large majority of that increase—$233 million—would result from repealing Maine's personal exemption to align with the now-eliminated personal exemption in the Code. Lower- and middle-income families would generally face the steepest relative tax increase as a result.

Decile Analysis of TCJA Effects: Personal Exemption Repeal

Income		Tax Families	Percent Tax Change	Average Tax Change	Increase in Taxable Families	Number of Families	Change in Tax Liability ($ millions)	Average Tax Change
		All Families				Families With a Tax Increase		
$ -	$ 9,630	69,427	20.0%	$ -	15	32	$ -	$ 308
$ 9,631	$ 17,321	69,427	1560.0%	22	8,751	10,680	1.6	146
$ 17,322	$ 27,142	69,426	124.8%	109	9,793	33,201	7.6	229
$ 27,143	$ 35,813	69,426	71.3%	191	14,713	47,768	13.3	278
$ 35,814	$ 45,484	69,427	55.8%	256	10,042	53,887	17.8	330
$ 45,485	$ 57,383	69,427	39.5%	328	6,426	58,313	22.8	391
$ 57,384	$ 71,996	69,427	32.1%	402	6,000	62,394	27.9	447
$ 71,997	$ 95,598	69,427	27.1%	543	2,398	66,634	37.7	566
$ 95,599	$ 137,694	69,426	18.9%	670	407	68,731	46.5	677
$ 137,695	plus	69,419	5.6%	710	105	64,536	49.3	764
Totals		**694,259**	**15.4%**	**$ 323**	**58,648**	**466,176**	**$ 224.3**	**$ 481**

Note: Maine resident families only

For summary purposes, it is important to understand that the repeal of the federal personal exemption is coupled with a near-doubling of the federal standard deduction—to $12,000 for individual filers and $24,000 for joint filers—and doubling to $2,000 of the federal child tax credit and the creation of a $500 dependent tax credit. The latter provisions compensate most taxpayers at the federal level for the loss of personal exemptions.

For state tax purposes, however, Maine increased its standard deduction in 2016 to nearly the new federal level. For tax year 2018, Maine's standard deduction is already scheduled to be $11,800. Therefore, conforming to the latter provision of the new federal Code would provide only small tax relief to Maine taxpayers. As the Tax Policy Center—a joint venture of the Urban Institute and Brookings Institution—noted in a recent report on federal tax reform,

> *"Maine, which links to federal personal exemptions but not federal standard deductions, faces the opposite issue if it maintains conformity: lowering its personal exemption amount from $4,150 to $0 would raise taxable income and lead to a large tax increase on residents…"*[iv]

By contrast, maintaining our state's personal exemption—and administering it without federal resources—would come at significant administrative burden, cost and liability to revenue collections. This report will further explore the personal exemption dynamic in detail.

Notably, there are other tax policy changes that Maine could make to mitigate a tax increase, and Governor LePage has made clear to the Department of the Administrative and Financial Services that he would not support tax conformity that increases the state income tax burden on Mainers.

TCJA Effect on State Business Tax Burden in Maine

In addition to its changes to individual income tax provisions, the TCJA makes numerous adjustments to business tax provisions to which Maine has historically linked its tax laws. These include limiting interest expensing; providing for immediate full depreciation of capital assets; simplifying accounting for small businesses; and repealing the deduction for employee entertainment expenses. Subsequent sections of this report discuss those and other provisions in detail.

Compared to the individual income tax provisions, conforming to the TCJA's business tax provisions would not have as significant a net revenue impact on our state. Decoupling from them, however, would impose significant administrative burden on tax filers and administrators—effectively requiring two sets of financial books for businesses and new regulatory regimes for MRS.

Individual Income Tax Itemized Deductions

The TCJA does away with numerous individual income tax itemized deductions which this report discusses at length in subsequent sections. Under current law, the Office of Tax Policy estimates that 48,000 Maine resident filers would have state itemized deductions greater than the standard deduction. That number is projected to decline to 37,600 because of the change made by the TCJA to federal itemized deductions.

INTRODUCTION

At the request of Governor Paul R. LePage, the Office of Tax Policy of Maine Revenue Services (MRS), a bureau of the Department of Administrative and Financial Services (DAFS), has prepared a preliminary analysis of the TCJA's impact on Maine households and businesses; the Office's findings are outlined in this report. By way of disclaimer, it is important to acknowledge the breadth and complexity of the federal reforms. MRS professionals continue to review the effects of certain aspects of the new law, in particular international taxation provisions affecting repatriation of international liquid and illiquid assets of U.S.-headquartered firms.

Although certain implications of the TCJA remain under consideration, the Office of Tax Policy has completed its review of a large majority of the law's provisions. That analysis is contained herein. Estimates for the business tax reform provisions should be considered preliminary. The Office of Tax Policy continues to refine its estimates, based on conformity analysis, of the complex interactions and behavioral responses for many of the business provisions.

Maine's income tax system, which the Legislature enacted in 1969, is fundamentally linked to the United States Internal Revenue Code as specified in Title 36 of the Maine Revised Statutes. Maine tax provisions have historically been linked to the Code as of a specific date in order to avoid the prohibition in the Maine Constitution against the delegation of the Legislature's taxing power. The current conformity date is December 31, 2016 (See 36 M.R.S. Section 111(1-A)). Each year, therefore, the Legislature must review amendments to the Code and adopt them in state tax law to the extent that Maine will conform to federal tax changes. This year, those changes are far more extensive than is typically the case, with the recent enactment of U.S. Public Law 115-97, the federal Tax Cuts and Jobs Act of 2017, which became law on December 22, 2017.

This report provides a broad preliminary overview of the TCJA and the impact on Maine law of conforming to the Code as of December 31, 2017, which would update Maine tax law to reflect the changes set forth in the new federal law. Some of the major changes in the TCJA affect Maine tax provisions while others do not. The report is based on the Office of Tax Policy's detailed analysis of the TCJA as it affects Maine tax law, as well as the Office's review of published analysis and commentary and other primary source documents.[v]

The principal TCJA changes fall into four overlapping categories: personal income tax, business income tax, tax treatment of pass-through entity income and international business activity aspects of state taxation. This report discusses each category and includes tables listing changes to key tax provisions. The report then presents a brief discussion of conformity items, concluding with a section covering the known and unknown implications on our state of the TCJA's international provisions.

International Tax Provisions

Maine, like other states, continues to evaluate the new law's international provisions and to seek consensus among states and tax professionals regarding those implications. While the law's "deemed" repatriation provision on foreign-held liquid and illiquid assets of U.S. firms may result in increased revenues for states, the amount and timing of that increase is far from determined. MRS strongly recommends that policymakers proceed cautiously with respect to any expected revenues from deeming. Inasmuch, MRS is in the process of enlisting third-party assistance to review international provisions of the TCJA and will continue to follow and participate in national discussions on this topic. DAFS will issue a supplement to this report when the Office of Tax Policy further determines the impact of those provisions on Maine.

Timing of TCJA Provisions

Finally, readers should note that the TCJA contains numerous timing provisions for the specified tax treatment. For the most part the effective date of the provisions is tax years beginning on or after January 1, 2018; however, there are three provisions that are effective during the 2017 tax year (see MRS Tax Alert, February 2018). In addition, many of the major individual tax relief provisions in the TCJA expire in 2025.

State Tax Conformity

Due to the TCJA's broad scope, states across the nation are in the process of conducting detailed analysis of changes to the Code and considering degrees to which they will conform their respective tax laws. In general, the more closely a state income tax conforms to the federal income tax, the simpler the preparation of that state return becomes. Furthermore, conformity simplifies administration of state tax laws and makes the latter far more efficient, in effect enabling conforming states to utilize broad federal tax resources that would be otherwise unavailable. As the Tax Policy Center makes clear,

> *"When states link to the federal code, it benefits both their residents and their government's tax administrators. Using federal rules and definitions simplifies state returns for taxpayers, who only need one set of documents and calculations for both their federal and state returns. Different states using the same federal laws also helps residents who earn income in multiple states. On the administrative side, states that use the federal code can rely on the IRS, Treasury Department, and federal courts for regulation, guidance, liability determinations, and compliance. With an intricate and complex system already established, states have "an almost irresistible incentive" to levy income taxes that draw on the federal system (Stark 2010)."*[vi]

KPMG concurs in their recent analysis of the new federal law: "Nearly every state corporate and personal income tax conforms in some manner to the federal Code. Conformity between state and federal taxes simplifies compliance for taxpayers and, at the same time, reduces the administrative burden facing state tax authorities."[vii]

Ongoing conformity of Maine’s income and estate tax laws to the federal tax regime enables our state to raise revenues efficiently and economically. By conforming to the basic definitions of taxable income and estates, Maine benefits from the administrative resources of the federal government, including federal audit activity, revenue rulings, and administrative and court decisions.

For context, the Maine sales tax regime does not have the benefit of piggybacking on a federal tax. Accordingly, Maine has full responsibility for compliance efforts, and MRS has 27 field auditors as a result. By contrast, MRS has no dedicated individual income tax auditors. Without continued conformity to the federal tax base, these significant benefits to the state would be jeopardized.

One area of significant complexity is determining individuals who qualify as a personal exemption. Historically, Maine has relied on federal personal exemption determinations for purposes of the Maine personal exemption. Because the federal personal exemption is zero for tax years beginning after 2017 and before 2026, it is believed that the IRS will no longer make the necessary determinations that Maine would need for its personal exemption. The complexity in making such determinations is illustrated by the seven criteria the IRS has used in determining who qualifies as a dependent exemption.

Individual Income Tax

The TCJA makes numerous changes to the calculation of federal individual income tax, some of which have important linkage implications for Maine.

Summary of Individual Tax Provisions and Conformity Linkage

Individual Tax Provision	Conformity Implications
Changes tax rates and brackets	No
Eliminates deduction for personal exemptions	Yes
Nearly doubles the standard deduction	Some; Maine does not conform to basic standard deduction, but does conform to additional deductions for age and blindness
Doubles the child tax credit; increases credit phase-out	No
Increases the AMT exemption amounts and phase-out thresholds	No
Limits deduction for state and local taxes to $10,000	Yes
Limits mortgage interest deduction to $750,000 ($375,000 for married-separate)	Yes
Medical expenses deductible for costs exceeding 7.5% of AGI	Yes
Increases deduction for charitable contributions to 60% of AGI	Yes
Suspends overall limitation of federal itemized deductions	Yes
Increases estate tax exclusion amount	Yes
Reduces ACA Individual Shared Responsibility Payment amount to zero	No
Adds alternative inflation measure	Yes
Repeals exclusion for employer-provided bicycle commuter fringe benefit	Yes
Repeals exclusion for employer-provided qualified moving expense reimbursements (other than members of the Armed Forces)	Yes
Repeals deduction for moving expenses (other than members of the Armed Forces)	Yes
Repeals special rule permitting recharacterization of Roth conversions	Yes
Extends and expands ABLE accounts	Yes
Grants combat zone tax benefits to the Sinai Peninsula of Egypt	Yes
Excludes from gross income certain student loans discharged on account of death or disability	Yes
Allows 529 plan withdrawals up to $10,000 for primary and secondary education	Yes
Adds relief for Retirement plan and casualty losses in any designated disaster area	Yes
Repeals deduction for alimony payments and generally corresponding inclusion in income	Yes

Personal Exemption. Maine tax law currently provides that the personal exemption is equal to the federal personal exemption amount allowed under the Code, Section 151. For 2017, the deduction amount for federal and Maine tax purposes is $4,050 per personal exemption, rising to $4,150 in 2018. Under the TCJA, the federal personal exemption deduction is zero for tax years beginning after 2017 and before 2026.

State and Federal Personal Exemption Comparison

	2017		2018	
	Maine	Federal	Maine	Federal
Per person/dependent	$4,050	$4,050	$4,150	$0

If Maine were to conform to that provision of the new federal Code, the Maine personal exemption deduction for the same period would be zero, as well. As noted earlier, that would result in a $234 million tax increase for Maine tax filers. Rather than conforming, Maine could maintain its personal exemption. Doing so, however, would require that Maine Revenue Services establish a method for validating personal exemptions. Since our state currently relies on the federal government's validation of these exemptions, this would require a significant upgrade in audit capabilities.

Standard Deduction. The standard deduction allows taxpayers who opt not to itemize their deductions to take a deduction against their taxable income. The TCJA nearly doubles the federal standard deduction amounts for tax years beginning after 2017 and before 2026 (from $6,350 to $12,000 for single filers). The additional amounts for age and blindness continue to be available.

Maine's basic standard deduction amount is a specified amount and is not linked to the Code. For 2017, the Maine standard deduction amounts are $11,600 for single taxpayers and married individuals filing separately, $23,200 for married individuals filing jointly and $17,400 for individuals filing head-of household. The Maine standard deduction begins to phase-out for single filers with Maine AGI of more than $70,000 ($105,000 for head of household filers and $140,000 for married individuals filing jointly), adjusted annually for inflation, and is completely phased-out by $145,000 for single filers ($217,500 for head of household filers and $290,000 for married individuals filing jointly). In comparison, the 2017 federal standard deduction amounts are $6,350, $12,700 and $9,350, respectively. The Maine standard deduction amounts may be increased by an additional standard deduction amount for age and blindness, which is linked, equaling the additional amounts allowed for federal income tax purposes.

State and Federal Standard Deduction Comparison

	2017		2018	
	Maine	Federal	Maine	Federal
Single	$11,600	$6,350	$11,800	$12,000
Head of Household	$17,400	$9,350	$17,700	$18,000
Married Filing Jointly	$23,200	$12,700	$23,600	$24,000

Because Maine has decoupled from the federal standard deduction, the changes in the federal standard deduction amounts would have no impact on the Maine basic standard deduction amounts, unless we choose to relink our state's tax law to the federal Code. Given that Maine's current standard deduction is nearly equal to the new federal standard deduction, the fiscal implications of conforming to this provision are limited.

Itemized Deductions. Maine tax law currently provides that Maine itemized deductions are equal to federal itemized deductions with some specified modifications, such as reducing the deduction by the amounts claimed for state and local income taxes. Additionally, Maine limits the total amount of itemized deductions that taxpayers can take. For 2017—with the exception of itemized deductions for medical expenses—the limit of deductions is $28,600. The Maine itemized deduction amount is subject to the same phase-out applicable to the Maine standard deduction.

For tax years beginning after 2017 and before 2026, the TCJA makes several changes to federal itemized deductions, including the following:

- The deduction for state and local taxes is, for non-business purposes, limited to a maximum of $10,000 ($5,000 for married filing separately taxpayers).

- The mortgage interest deduction is limited to interest paid on the acquisition indebtedness up to $750,000 ($375,000 for married filing separately taxpayers). No deduction is allowed with respect to interest paid on home equity debt.

- Medical expenses are deductible to the extent exceeding 7.5 percent of federal AGI, except that this change applies to tax years beginning after 2016 and that end before January 1, 2019. Note that this tax change applies to tax year 2017.

- The limitation on the deduction for charitable contributions is increased from 50 percent of federal AGI to 60 percent of federal AGI.

- Miscellaneous itemized deductions subject to the two percent floor are suspended. Under current law, individuals may claim itemized deductions for certain expenses to the extent the expenses, in aggregate, exceed two percent of AGI. These expenses include unreimbursed employee expenses, tax preparation fees, and certain other expenses related to the production or collection of income, the management of property held to produce income, or a claim for a refund of any tax.

- The overall limitation on federal itemized deductions is suspended. Under prior law, the total amount of allowable itemized deductions (with the exception of medical expenses, investment interest, and casualty, theft or gambling losses) is reduced by three percent of the amount by which the taxpayer's AGI exceeds a threshold amount (referred to as the "Pease limitation"). The threshold amount was $261,500 for single filers ($287,650 for head of household filers and $313,800 for married individuals filing jointly).

If Maine were to conform to the new federal Code, each of the aforementioned changes would flow through to Maine tax laws, with the exception of the deduction for state and local taxes. Our state does not allow a deduction for state taxes; however, it does allow for deduction of local property taxes. Therefore, if Maine were to conform, the Maine tax deduction for local property taxes would be limited by the federal cap.

Estate, Gift and Generation-Skipping Transfer Tax. Maine is one of 18 states that maintain either an estate or an inheritance tax. For 2017, Maine conforms with the federal Code. The TCJA doubles the estate and gift tax exemption for estates of decedents dying, and gifts made, after December 31, 2017, and before January 1, 2026. This is accomplished by increasing the basic exclusion amount provided in Section 2010(c)(3) of the Code from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011 and is projected to be $11.2 million in 2018. Maine tax law currently provides that the Maine exclusion amount is equal to the federal basic exclusion amount. Therefore, if Maine were to conform, this change would flow through to the state, doubling the Maine exclusion.

BUSINESS INCOME TAX: DOMESTIC TAXATION

The TCJA makes numerous changes to the calculation of federal AGI and other aspects of personal income tax as well as federal taxable income and other aspects of corporate income tax.

Summary of Business Tax Provisions and Conformity Linkage

Business Tax Provision	Conformity Implications
Reduces corporate tax rate (lowering the top rate from 35% to 21%)	No
Allows owners of certain "pass-through" entities, such as partnerships and limited liability companies, or LLCs, to take a 20% income tax deduction with respect to that income	No
Doubles, extends and expands bonus depreciation, from 50% to 100%, phasing out starting after 2022	Yes; partial (as modified, via MCIC)
Increases Section 179 expensing to $1 million with a phase-out range beginning at $2.5 million and expands definition of qualified property	Yes
Limits net interest deductions to 30% of adjusted taxable income, carryforward of denied deduction	Yes
Modifies treatment of net operating loss and other loss deductions • Elimination of the 2-year carryback of NOLs and limiting NOL deductions to 80% of adjusted taxable income • Disallowance of certain pass-through entity losses in excess of $500,000 for joint filers ($250,000 for all others)	Partial
Repeals Alternative Minimum Tax on corporations	Yes
Modifies certain contributions to capital	Yes

Pass-Through Entity Income: Special Deduction. The TCJA allows a 20 percent deduction for certain qualified business income from a partnership, S-corporation, or sole proprietorship; but the law specifies that this deduction is not to be considered in the calculation of federal AGI. Therefore, this special deduction is not linked to Maine's tax provisions. The commonly understood reason for this special federal deduction was federal policymakers' desire to provide tax relief to pass-through entity businesses commensurate to the reduction of corporate taxes through the lower corporate rate. Because this deduction does not affect federal AGI, there would be no conformity effect for Maine.

Section 179 Expensing and Section 168(k) Bonus Depreciation Business Expense Deduction. Business purchases of qualifying assets are eligible for special depreciation deduction treatment under the Code. Purchases of such business assets may be eligible for accelerated bonus depreciation under Section 168(k), while others may be deducted completely as a first-year expense under Section 179. Because these two deductions are part of the calculation of FTI/AGI, they would be incorporated by Maine conformity absent Title 36 modification.

Section 179 previously allowed businesses and pass-through business owners to expense up to $500,000 of the cost of an asset purchased during the tax year. The deduction phased-out for assets that exceeded a cost of $2 million. The TCJA increases the deduction to $1 million and increases the phase-out threshold to $2.5 million

Section 168(k) previously allowed for bonus depreciation during the first year the asset was placed into service. The bonus depreciation deduction was equal to 50 percent of the cost of the asset. The TCJA doubles the federal bonus depreciation to 100 percent, or full expensing, in the year the of expense for qualified assets placed in service after September 27, 2017. Beginning in 2023, bonus depreciation generally phases out by 20 percent each year and reaches zero percent for most assets placed in service after 2026 (although certain assets qualify for an extended phase out period). Notably, the TCJA expands bonus depreciation to include purchases of used equipment. Note that this tax change applies to tax year 2017.

Over the years, Maine law has provided various levels of conformity to the federal Section 179 expense and bonus depreciation laws. For the former, Maine law has been in full conformity for since the 2011 tax year. For the latter, Maine has adopted a modified conformity approach to the federal bonus depreciation deduction. Maine tax provisions decouple from federal bonus depreciation—allowing modified standard depreciation treatment—but then provide tax incentive similar to conformity for eligible property placed in service in Maine through a credit based on a percentage of federal bonus depreciation for such property.

Therefore, under current Maine law, property placed in service in Maine between 2015 and 2017 qualifies for a credit based on the federal deduction for 50 percent bonus depreciation, falling to 40 percent for 2018 and 30 percent in 2019 and then is repealed for property placed in service after 2019 due to the previous phase-out.

Were Maine to conform, our state could remain decoupled from bonus depreciation, as the Maine Capital Investment Credit allowed under Section 5219-NN would be based on the increased and expanded federal deduction of 100 percent for qualified assets placed in service in 2023, generally phasing out by 20 percent every year thereafter.

Net Operating Loss Deduction (Section 172). If a business sustains a net operating loss (NOL) in a taxable year, that loss may be applied as a deduction in the computation of federal taxable income in prior or subsequent years. The business' ability to apply the NOL against future earnings was limited by the Code to carrying back two years or carrying forward up to 20 years.

The TCJA eliminates NOL carrybacks but allows carryforwards indefinitely. However, any carryforward is limited to 80 percent of the year's pre-NOL taxable income. The new carryback and carryforward provisions impact new NOLs created in fiscal years ending after March 31, 2018. Existing NOLs are grandfathered and treated under the previous 2/20 rules.

Over the years, Maine has been in various stages of conformity with the federal loss carryback and carryforward rules. Currently, Maine law does not allow any loss carryback but does permit loss carryforward. Federal NOL carryforward changes would apply through Maine conformity.

Net Interest Expense. Businesses are allowed to deduct interest payments against their taxable earnings. The TCJA limits the deductibility of net interest expense to no more than 30 percent of earnings before interest, taxes, depreciation and amortization (EBITDA) for four years. Businesses are then limited to 30 percent of their earnings before interest and taxes (EBIT). Certain businesses are excluded from this limit, including taxpayers with an average of $25 million or less in gross receipts over the prior three years and regulated public utilities. Previously, there was no limit to the deductibility of interest expense. Any disallowed interest deductions will be allowed to be carried forward into subsequent tax years

This limitation is often viewed as a counterpart to 100 percent expensing, discussed above. If Maine conforms, this limitation would flow through to Maine.

Corporate Alternative Minimum Tax (Section 55). Corporations were previously subject to Section 55, which created an Alternative Minimum Tax for corporations. Under the Corporate AMT, businesses were required to add back a host of deductions and credits to create an alternative minimum taxable income (AMTI), which was taxed at a 20 percent rate.

The TCJA repeals the corporate AMT effective at the end of the 2017 tax year. Maine's corporate AMT is linked to the Code, through the definition of federal AMTI. Therefore, conforming to this provision of the new federal Code would effectively repeal Maine's corporate AMT.

Contributions to Capital. The TCJA requires a corporation to include in federal gross income contributions to capital from civic groups and by governmental entities, likely including contributions made by the State of Maine and its municipalities to induce a corporation to locate its business in a community or to enable a corporation to expand its operating facilities. If Maine conforms, this income would flow through to Maine. The treatment of certain contributions made by our state is still under review.

BUSINESS INCOME TAX: INTERNATIONAL TAXATION

The TCJA makes numerous changes to the calculation of federal AGI and other aspects of personal income tax as well as federal taxable income and other aspects of corporate income tax.

Summary of International Business Tax Provisions and Conformity Linkage

International Business Tax Provision	Conformity Implications
Base Erosion and Anti-Abuse Tax (BEAT)	None
Changes to a territorial income tax system	Yes
Mandatory deeming of cash and non-cash assets held abroad by U.S. corporate entities	Yes
Tax on Global Intangible Low Tax Income (GILTI)	Yes
Deduction for Foreign-Derived Intangible Income (FDII)	Yes

The new federal law makes numerous significant changes to the way in which foreign income of multinational businesses is taxed. Prior to this law, the federal Code taxed U.S. corporations on any worldwide income (FTI) repatriated to the United States. Under this model—which was unique among industrialized nations—income earned by a foreign subsidiary of a U.S. firm was not taxable under the federal Code until that firm distributed those foreign earnings to its domestic corporation. The TCJA, then, moves from a worldwide basis system of taxation to a territorial system, and it creates both one-time and ongoing tax provisions effectuating this transition.

Both before and after the law, certain income earned by a controlled foreign corporation (CFC) of a domestic corporation is deemed to have been paid to the domestic affiliate, even if the corporation does not repatriate that foreign income (Subpart F income). A CFC is defined as a foreign corporation that is more than 50 percent owned by one or more U.S. persons, each of which owns at least ten percent of the foreign subsidiary.

Subpart F income and dividends paid by foreign affiliates to U.S. corporations are generally taxed in Maine; however, such dividends often qualify for a 50 percent dividends received subtraction modification.

Territorial Income Tax System. At the federal level, U.S. corporations will be allowed to deduct 100 percent of the foreign-source portion of dividends received from certain foreign corporations of which they own at least ten percent. However, certain dividends will instead be treated as Subpart F income of the U.S. corporation. Dividends treated as Subpart F income are not subject to the deduction and remain taxable at the federal level.

If Maine conforms, this deduction would flow through to Maine removing these foreign-sourced dividends from Maine's tax base. The portion of the dividends included in Subpart F income at the federal level would remain within Maine's tax base, subject to Maine's 50 percent dividend received subtraction in certain instances.

Mandatory Repatriation. The new law requires U.S. shareholders owning at least ten percent of a foreign subsidiary to include as Subpart F income the shareholder's pro rata share of accumulated earnings and profits of its foreign subsidiary. The shareholder is allowed a separate deduction for a portion of the foreign earnings and profits. This income recognition is a one-time event, but taxpayers have the option to pay the net tax liability over eight years.

If Maine conforms, these earnings and profits would flow through to the Maine tax base as would the foreign earnings deduction. This income would be further subject to Maine's 50 percent dividend received subtraction in certain instances. Unlike the federal tax, the state liability would be due all at once, instead of spread over eight years. Note that this tax change applies to tax year 2017.

Tax on Global Intangible Low Tax Income. U.S. shareholders of CFCs must include their pro rata share of a CFC's global low taxed intangible income (GILTI) in gross income, even if such amount is not actually distributed to the U.S. shareholder. This provision is generally intended to curtail tax avoidance achieved by locating income-producing intangible assets in low-tax jurisdictions. The shareholders are allowed a deduction for a portion of the GILTI income (as well as foreign derived intangible income).

If Maine conforms, the income and deduction would flow through to Maine. At this point in our analysis, it is unclear whether GILTI would be subject to Maine's 50 percent dividends received subtraction income modification.

Deduction for Foreign-Derived Intangible Income. The new law provides a lower effective tax rate on excess returns earned directly by a U.S. corporation from foreign sales. Specifically, the new law allows a U.S. corporation to deduct a portion of its "foreign-derived intangible income" (FDII). At a high level, a U.S. corporation's FDII is the amount of its "deemed intangible income" that is attributable to sales of property (including licenses and leases) to foreign persons for use outside the United States or the performance of services for foreign persons or with respect to property outside the United States. This provision is generally intended to encourage locating income-producing intangible assets in the U.S.

If Maine conforms, this deduction would flow through to Maine.

Base Erosion and Anti-Abuse Tax. The Base Erosion and Anti-Abuse Tax **(**BEAT) is an alternative tax which does not alter federal taxable income or federal AGI. As such, it does not flow through to Maine. Nevertheless, because it is an important feature of the transition to a territorial-based tax system, brief comment is warranted. The new law establishes a base erosion minimum tax to prevent companies from stripping earnings out of the U.S. through payments to foreign affiliates that are deductible for U.S. tax purposes. The tax is structured as an alternative minimum tax that applies when a multinational company reduces its regular U.S. tax liability to less than a specified percentage of its taxable income. The tax applies to deductible payments to foreign affiliates from domestic corporations, as well as on foreign corporations engaged in a U.S. trade or business.

CONCLUSION

The Office of Tax Policy continues its review of Maine tax law conformity issues presented by the recent significant changes in federal tax law. While MRS has a long history of analyzing and estimating the impact of large federal tax changes, the TCJA is far and away the most comprehensive and complex federal tax law enacted since the 1986 reform. It is likely that Maine and other states will not fully understand certain effects of the new federal law in the near future, meaning that Maine should be cautious in the development of certain fiscal impacts of conforming to the TCJA. In particular, the effect of the international tax components will require vigilant monitoring in the months and years to come.

The projected and actual behavioral responses to the TCJA have already had an impact on the Maine economy and revenues flowing to our state. The Consensus Economic Forecasting Commission, in its February 1, 2018, report increased its forecasts of Maine personal income and wage and salary growth for 2018 and 2019 primarily based on expected stimulus from the TCJA. December 2017 final individual income tax estimated payments increased 50 percent over the prior year, as Maine taxpayers rushed to increase their 2017 state income tax payments before the $10,000 state and local itemized deduction cap became effective on January 1, 2018. The Office of Tax Policy expects that taxpayers and businesses will continue evaluating the impact of the TCJA and will alter their behavior, as necessary, to minimize their future state and federal tax liabilities. To that end, the Office of Tax Policy will keep the Administration and the Legislature abreast of effects—clearly discernable and otherwise inferred—on how the TCJA is affecting state revenues.

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[i] *The Tax Debate Moves to the States: The Tax Cuts and Jobs Act Creates Many Questions for States that Link to Federal Income Tax Rules,* Tax Policy Center, Urban Institute and Brookings Institution (R. Auxier and F. Sammartino) (January 2018)

[ii] *The Final Trump-GOP Tax Bill: National & 50-State Analysis,* Institute on Taxation and Economic Policy (December 2017)

[iii] Maine Revenue Service analysis

[iv] *The Tax Debate Moves to the States: The Tax Cuts and Jobs Act Creates Many Questions for States that Link to Federal Income Tax Rules,* Tax Policy Center

[v] Commentary significantly consulted:

1. *Reshaping the Code: Understanding the new tax reform law,* Deloitte (2018)
2. *Don't Forget the SALT: State and Local Tax Implications of Federal Tax Reform,* KPMG (H. Duncan, D. De Jong, M. Evans, and S. McGahan) (2018)
3. *The Tax Debate Moves to the States: The Tax Cuts and Jobs Act Creates Many Questions for States that Link to Federal Income Tax Rules,* Tax Policy Center, Urban Institute & Brookings Institution (R. Auxier and F. Sammartino) (January 23, 2018)
4. *Preliminary Report on the Federal Tax Cuts and Jobs Act,* New York State Department of Taxation (January 2018)
5. *Preliminary Estimates Report*, State of Minnesota, Department of Revenue, Tax Research Division (January 9, 2018)
6. *The 60-Day Report Effects of Federal Tax Law Revisions on the State of Maryland,* Maryland Bureau of Revenue Estimates (January 2018)
7. *State Revenue Estimates of Federal Tax Legislation Conformity,* State of Arizona (2018)
8. *Conference Report to Accompany H.R. 1*, H.R. Rep. No. 115-466 (2017)
9. *Conference Agreement for H.R. 1, Tax Cuts and Jobs Act – Initial Observations,* KPMG (December 18, 2017)

10. Thomson Reuters CHECKPOINT (online): *Complete Analysis of the Tax Cuts and Jobs Act*.
11. See also, *The Tax Cuts and Jobs Act (TCJA); Federal Tax Reform and the Effects on States*, National Conference of State Legislatures (January 12,2018)

[vi] *The Tax Debate Moves to the States: The Tax Cuts and Jobs Act Creates Many Questions for States that Link to Federal Income Tax Rules,* Tax Policy Center

[vii] *Don't Forget the SALT: State and Local Tax Implications of Federal Tax Reform,* KPMG (H. Duncan, D. De Jong, M. Evans, and S. McGahan) (2018)

Conformity to The Tax Cuts and Jobs Act (Effective January 1, 2018)

($ millions)

Individual Tax Reform	FY2018	FY2019	FY2020	FY2021
Lower Medical Expense Deduction AGI Threshold to 7.5% (Tax Year 2017)	$ (1.2)	$ -	$ -	$ -
Repeal of Deduction for Personal Exemptions	23.4	307.7	246.5	255.9
Other Individual Income Tax Changes (1)	0.6	10.7	9.3	9.3
Double Estate Tax Exemption Amount	-	(4.2)	(5.6)	(5.8)
Total (Individual Tax Reform)	**$ 22.9**	**$ 314.2**	**$ 250.1**	**$ 259.5**

Business Tax Reform	FY2018	FY2019	FY2020	FY2021
Corporate AMT Repeal	$ -	$ (1.5)	$ (1.2)	$ (1.2)
Small Business Reforms (2)				
Corporate	-	(4.4)	(2.0)	(1.2)
Individual	-	(9.6)	(3.3)	(1.9)
Cost Recovery				
Bonus Depreciation (Tax Year 2017) (2)				
Corporate	(0.7)	(0.8)	-	0.0
Individual	(1.3)	0.0	0.3	0.3
Bonus Depreciation (Tax Years 2018-2026) (3)				
Corporate	-	(7.8)	(9.6)	(12.5)
Individual	-	(11.3)	(7.2)	(6.5)
Limit Net Interest Deduction				
Corporate	-	13.2	11.0	11.5
Individual	-	3.0	3.0	3.0
Modification of NOL Deduction				
Corporate	-	6.5	6.0	5.5
Individual	-	1.5	1.5	1.5
Other Cost Recovery Provisions				
Corporate	-	0.4	0.3	0.5
Individual	-	0.3	0.3	0.3
Business-Related Deductions				
Corporate	-	4.8	3.3	3.3
Individual	-	0.3	0.3	0.3
Accounting Methods				
Corporate	-	1.9	1.6	1.7
Individual	-	0.4	0.4	0.4
Compensation				
Corporate	-	0.3	0.7	0.7
Partnerships				
Individual	-	0.4	0.5	0.5
Tax-Exempt Organization				
Corporate	-	0.3	0.3	0.3
Other Provisions				
Corporate	-	0.4	0.3	0.5
Individual	-	0.1	0.1	0.2
Total - Business Tax Reform				
Corporate	$ (0.7)	$ 13.3	$ 10.7	$ 9.1
Individual	$ (1.3)	$ (14.9)	$ (4.0)	$ (1.9)
Total (Business Tax Reform)	**$ (2.0)**	**$ (1.6)**	**$ 6.7**	**$ 7.2**

Total Conformity to TCJA				
Corporate	**$ (0.7)**	**$ 13.3**	**$ 10.7**	**$ 9.1**
Individual	**$ 21.6**	**$ 299.3**	**$ 246.1**	**$ 257.6**
Total	**20.8**	**312.6**	**256.8**	**266.7**

1/ Estimate assumes full conformity with the major individual income tax reform provisions in the TCJA. This includes; itemized deduction changes, repeal of deduction for moving expenses, and alternative inflation adjustments. Includes the provision to disallow active pass-through losses in excess of $500,000 for joint filers, $250,000 for all others.

2/ Includes the increase in Section 179 expensing to $1 million with a phase-out range beginning at $2.5 million, and simplified accounting for small businesses.

3/ Estimates the additional cost of the Maine Capital Investment Credit because of the increase in bonus depreciation from 50% to 100% for property acquired and placed into service after September 27, 2017 and before January 1, 2018.

4/ Assumes increase in Maine Captital Investment Credit from conformity to the expansion and phase down of bonus depreciation after December 31, 2017