Oregon Should Conform to the Federal International Provisions under the Tax Cut and Jobs Act

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Chairman Barnhart, Vice Chairs Smith and Smith Warner, and Members of the Committee:

My name is Nicole Kaeding, and I’m an economist and the Director of Special Projects at the Tax Foundation. For those unfamiliar with us, we are a nonpartisan, nonprofit research organization that has monitored fiscal policy at all levels of government since 1937. We have produced the Facts & Figures handbook since 1941, we calculate Tax Freedom Day each year, we produce the State Business Tax Climate Index, and we have a wealth of other data, rankings, and information at our website, www.TaxFoundation.org.

I’m pleased to submit written testimony on Senate Bill 1529, which updates Oregon’s conformity to the Internal Revenue Code (IRC). The bill updates Oregon’s conformity to the IRC on a number of topics, with the largest changes related to the taxation of income earned by multinational corporations. While I take no position on either bill, I do believe that Oregon bill SB1529 is the right approach to conformity on the international tax conformity.

Tax Conformity is Important

The enactment of federal tax reform has far-reaching implications on state tax codes. States such as Oregon rely heavily on the Internal Revenue Code, through a process known as conformity or coupling.

Conformity dramatically reduces the compliance costs of state tax collections. Taxpayers can use their federal 1040 as the basis of their state returns. While all states made modifications to federal adjusted gross income and federal tax income, taxpayers are saved time and energy by not duplicating initial calculations. Conformity also reduces the administrative costs for the state itself. It can define terms based on federal statute and use Internal Revenue Service guidance and publications to help interpret the state’s code. Conformity also makes state tax codes more uniform. Definitions, provisions, and tax treatments are similar across states, reducing compliance burdens for multistate filers, such as corporations.
For these reasons, conformity should be the goal of all states. No two states conform in the same way, but greater conformity should always guide state conversations.¹

**The Taxation of International Income under the Tax Cuts and Jobs Act**

The Tax Cuts and Jobs Act included a complete overhaul of the United States’ rules on the taxation of international income. Previously, the United States operated under a worldwide taxation system, meaning that U.S. firms paid income taxes in the country where the income was earned, but also paid taxes on the rate differential when the money was repatriated to the U.S. Given that the U.S. had the highest income tax rate in the industrialized world, this was a large deterrent to income back to the U.S. More than $2 trillion in profits were deferred overseas, prior to the Tax Cut and Jobs Act.²

The Tax Cuts and Jobs Act corrected this issue. The U.S. now has moved towards a territorial taxation system, where income is only taxed in the country where it is earned.

However, the law also included several other provisions to limit base erosion, preventing abuse of the new system. The first, the Base Erosion and Anti-Abuse Tax (BEAT), is a functional alternative minimum tax of 10 percent on taxable income, limiting the ability of firms to profit shift out of the United States. The second, the Global Intangibles Low Tax Income (GILTI), creates a tax on foreign affiliates on income in excess of 10 percent of a company’s tangible overseas capital income. This limits the ability of U.S. firms to shift their intellectual property to low-tax jurisdictions to avoid domestic taxation. Finally, the Tax Cuts and Jobs Act created a that encourages U.S. firms to locate their intellectual property in the U.S., rather than overseas. (This provision is known as foreign-derived intangible income (FDII).) These three provisions, the BEAT, the GILTI, and the FDII, work together to limit base erosion and profit shifting to lower-tax jurisdictions.

The Tax Cuts and Jobs Act added an additional one-time deemed repatriation of overseas profits. Deferred profits are taxed at 15.5 percent for cash and liquid assets and 8 percent for illiquid assets. Firms have eight years to pay their deemed repatriation payments.

**The Impact on Oregon from these International Changes**

Oregon, like many other states, conforms to the federal definition of taxable income for C corporations. Because of this connection, the state is impacted by the overhaul of the international tax system contained in the Tax Cuts and Jobs Act. As noted previously, Oregon should work to maintain conformity to the definition of federal taxable income to limit compliance costs for both the state and its taxpayers.

SB1529’s approach of clarifying the interaction between the state’s dividends received deduction and its broader conformity of federal taxable income to ensure that multinational companies are


not receiving a double deduction, resulting in negative income in Oregon, is a proper step. Updating conformity is important, and states should clarify that the conformity does not create inappropriate interactions with their state code.

Similarly, with the inclusion of the BEAT, GILTI, and FDII, Oregon’s tax haven law is unnecessary. These three provisions at the federal level work to limit base erosion and profit shifting among multinational companies and their affiliates. Oregon’s tax haven law duplicates the new federal provisions.

Finally, Oregon’s approach of dedicating any revenue from deemed repatriation to the rainy-day fund is a fantastic step that other states should copy. SB1529 directs the Oregon Department of Revenue to transfer the additional tax revenue to the state’s rainy-day fund. The state should be applauded for using this one-time money wisely; adding one-time money to a state budget is always a tempting choice, but it simply forces more difficult decisions in the future.

**Conclusion**

The federal Tax Cuts and Jobs Act has shifted the tax debate from Washington, D.C., to all fifty state capitals. States such as Oregon are trying to determine how best to conform to the litany of federal tax changes. Oregon’s SB1529 makes important changes to Oregon’s tax structure to properly conform with updated IRC, while maintaining appropriate protections such as dedicating any new tax revenue to the state’s rainy-day fund.

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