DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. Patron A. Benton Chafin, Jr.

2. Bill Number SB 1698

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee Senate Finance

4. Title Corporate Income Tax Subtraction; Global Intangible Low-Taxed Income.

5. Summary/Purpose:

The bill would expand Virginia's existing corporate income tax subtraction for subpart F income so that it also applies to global intangible low-taxed income ("GILTI"). As a result, global intangible low-taxed income would be permitted to be subtracted for Virginia corporate income tax purposes to the extent it is included in a taxpayer's federal taxable income.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

6. Budget amendment necessary: Yes.
Item(s): Page 1, Revenue Estimates

7. Fiscal Impact Estimates are: Available. (See Line 8.)

8. 7b. Revenue Impact:

Fiscal Year	*Dollars*	*Fund*
2018-19	($7.1 million)	GF
2019-20	($5.4 million)	GF
2020-21	($5.5 million)	GF
2021-22	($5.8 million)	GF
2022-23	($6.0 million)	GF
2023-24	($6.3 million)	GF
2024-25	($6.5 million)	GF

8. Fiscal implications:

Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have an estimated negative General Fund revenue impact of $7.1 million in Fiscal Year 2019; $5.4 million in Fiscal Year 2020; $5.5 million in Fiscal Year 2021; $5.8 million in Fiscal Year 2022; $6.0 million in Fiscal Year 2023; $6.3 million in Fiscal Year 2024; and $6.5 million in Fiscal Year 2025. If this bill is enacted, the budget would need to be adjusted to reduce the revenue estimate by $7.1 million in Fiscal Year 2019 and $5.4 million in Fiscal Year 2020.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes. In order to clarify that the taxable years to which this bill applies, the following technical amendment is suggested:

Page 6, Line 359, end of line
Insert: 2. That the provisions of this act shall apply to taxable years beginning on and after January 1, 2018.

11. Other comments:

Global Intangible Low-Taxed Income

The federal Tax Cuts and Jobs Act ("TCJA") made significant changes to the federal taxation of U.S. corporations and individuals that own stock in foreign corporations. Prior to the TCJA, domestic corporations as well as U.S. citizens and U.S. residents were required to report and pay tax on their worldwide income, which includes both their domestic and foreign income. Therefore, the U.S. tax system prior to the TCJA was referred to as a "worldwide system." Despite the apparent far-reaching nature of a worldwide system, some U.S. taxpayers were able to avoid U.S. tax on their foreign income by forming foreign corporations in the countries where they do business. Because foreign corporations are not considered U.S. corporations even if wholly owned by a U.S. parent, their foreign profits were not generally subject to U.S. taxation so long as they kept the profits abroad and did not distribute them to their domestic parent corporation.

The TCJA replaced the worldwide system for certain domestic corporations with what is referred to as a "territorial system." In this system, domestic corporations generally pay U.S. tax only on their domestic income and are exempt from U.S. tax on their foreign income. To prevent multinational firms from shifting their profits to low-tax countries, the TCJA included a provision that requires U.S. corporations and other U.S. shareholders that own stock in specified foreign corporations to pay federal income tax at reduced rates on certain abnormally high overseas profits, referred to as global intangible low-taxed income or "GILTI."

U.S. individuals and domestic corporations that are 10 percent-or-more owners that collectively own more than 50 percent of a foreign corporation, referred to as a "controlled foreign corporation" or "CFC," are required to pay tax on their GILTI. The GILTI inclusion is the taxpayer’s aggregate net income from CFCs that exceeds a 10 percent return on the CFCs' tangible assets. Net income means the CFCs gross income less deductions, exclusive of income already taxed or exempted from U.S. tax in the current year. This may include, but is not limited to, Subpart F income, income effectively connected with a U.S. trade or business, and income subject to a high foreign effective tax rate. The 10 percent return on tangible assets is not counted for any CFC with a net loss.

Corporations are allowed a foreign tax credit on their federal income tax returns for foreign taxes allocable to their GILTI inclusion. Therefore, the GILTI inclusion is grossed up for the related foreign taxes. For corporations only, the GILTI inclusion plus the gross-up is reduced by 50 percent for Taxable Years 2018 through 2025 and by 37.5 percent for Taxable Years 2026 and after. The 50 percent or 37.5 percent reduction applies after net operating losses. Any unused excess reduction is lost and may not be carried forward.

Individuals are taxed on the full GILTI inclusion. However, such taxpayers may make an election to be taxed on the deemed income at corporate rates, including credits, which gives temporary relief until the earnings are actually repatriated.

Virginia Income Tax Incentives for Foreign Income

For corporate income tax purposes, Virginia generally exempts income from other countries. This is accomplished by allowing subtractions on the Virginia corporate income tax return for foreign source income and for subpart F income to the extent such income is included in and not otherwise subtracted from federal taxable income. However, GILTI does not currently qualify for either of these corporate income tax subtractions.

Proposed Legislation

The bill would expand Virginia's existing corporate income tax subtraction for subpart F income so that it also applies to GILTI. As a result, GILTI would be permitted to be subtracted for Virginia corporate income tax purposes to the extent it is included in a taxpayer's federal taxable income.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

Similar Legislation

House Bill 2700 is identical to this bill.

Senate Bill 1443 and **Senate Bill 1631** would expand Virginia's existing corporate income tax subtraction for subpart F income so that it also applies to GILTI, and would make several additional tax policy changes.

cc : Secretary of Finance

Date: 1/19/2019 JJS
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