SALT Alert! 2018-06: Indiana: Comprehensive Conformity Legislation Enacted

After a one-day special session on May 14, 2018, House Bill 1316 was passed and signed by Governor Holcomb that very evening. Importantly, this legislation updates Indiana's conformity to the Internal Revenue Code in light of federal tax reform. In general, the bill revises the definition of "Internal Revenue Code" to mean the Internal Revenue Code of 1986 as amended and in effect on February 11, 2018.

That said, Indiana does not adopt many of the changes enacted as part of the Tax Cuts and Jobs Act or P.L. 115-97. However, rather than simply decoupling from the federal Code section incorporating the tax reform change, House Bill 1316 decouples from the federal changes largely by revising the provisions of Indiana law that make modifications to federal taxable income in computing Indiana tax liability, notably Indiana Code § 6-3-1-3.5(b), which governs the computation of "taxable income" for corporations. Similar adjustments are required in computing the income of individuals, insurance companies, financial institutions, and trusts and estates. All these provisions are effective for tax years beginning after December 31, 2017 unless an earlier effective date is provided.

Specifically, the revisions to Indiana Code § 6-3-1-3.5(b), which addresses the Indiana taxable income of corporations, include the following:

- The provision requiring an add back for any amount deducted under IRC section 199 is eliminated. This makes sense given that the IRC section 199 deduction is repealed under the Tax Cuts and Jobs Act.

- An addback is required for any directly related interest expenses (as defined in Ind. Code. § 6-3-2-20) that reduced the corporation's adjusted gross income (determined without regard to the modifications statute). The amount of interest that is considered to have reduced the corporation's adjusted gross income equals: (i) the directly related interest expense that reduced the taxpayer's federal taxable income; plus (ii) any directly related interest expenses for which a subtraction is allowable under the state's related party addback rules; minus (iii) any directly related interest expenses required to be added back under those rules because an exception does not apply. This is not a new addback requirement, but the mechanism for making the addback is modified and separated from the addback required for intangible expenses.

- For taxable years beginning after December 25, 2016, corporations (other than a REIT) must add an amount equal to the amount reported by the taxpayer on IRC 965

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Transition Tax Statement, line 1. This is the total amount required to be included in income by reason of IRC section 965(a), which is the amount of mandatory repatriation before the participation exemption. REITs do not report repatriation on the IRC 965 Transition Tax Statement; such amounts are included in a REIT's federal taxable income. Thus, REITs must add an amount equal to the deduction for deferred foreign income that was claimed by the taxpayer for the taxable year under IRC section 965(c), but only to the extent that the taxpayer included income pursuant to IRC section 965 in its taxable income for federal income tax purposes or was required to add back dividends paid to a captive REIT (as required under Indiana law).

- Corporations must add an amount equal to the deduction that was claimed by the taxpayer for the taxable year under IRC section 250(a)(1)(B) (attributable to global intangible low-taxed income or GILTI). This is the special deduction that reduces the effective rate of tax imposed on GILTI. The taxpayer must separately specify the amount of the reduction under IRC section 250(a)(1)(B)(i), which is the total amount of GILTI included in income under section 951A, and under IRC section 250(a)(1)(B)(ii), which is the amount treated as a dividend under IRC section 78.

- A subtraction is allowed for any interest expense paid or accrued in the current taxable year, but not deducted as a result of the limitation imposed under IRC section 163(j)(1). There is no guidance on how the amount not allowed at the federal level should be determined if the federal and Indiana filers differ. However, this addback means that Indiana does not conform to the limitations imposed on the deductibility of interest at the federal level. To capture any federal disallowed interest expense subsequently carried forward and deducted for federal purposes, taxpayers must add any interest expense paid or accrued in a previous taxable year, but allowed as a deduction under IRC section 163 in the current taxable year. Thus, taxpayers will need to know when doing Indiana compliance whether any portion of the federal interest deduction for a particular year is a carryforward of previously disallowed interest.

- Indiana does not adopt the federal change that requires certain state and local tax incentives to be included in taxable income. As such, taxpayers must subtract the amount included in the taxpayer's gross income under IRC section 118(b)(2) for taxable years ending after December 22, 2017.

Revised Definition of Foreign Source Dividend

Based on a reading of the revised Indiana modifications statute, it would appear that the state would include certain foreign income—specifically, mandatory repatriation amounts and GILTI—in the tax base. However, the definition of a foreign source dividend is expanded to provide exclusions for both mandatory repatriation and GILTI. Under Indiana Code § 6-3-2-12, a corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction. The definition of "foreign source dividend" has been amended to include any amount that a taxpayer is required to include in its gross income for a taxable year under IRC sections 951 and 951A, and for taxable years beginning after December 25, 2016, any amounts required to be included in adjusted gross income after application of the addback for amounts included in income from line 1 of the IRC Section 965 Transition tax Statement. This clarifies that mandatory repatriation and GILTI will be eligible for a foreign source dividend deduction. Under Indiana law, the subtraction allowed is equal to:

- 100 percent of foreign source dividend received from 80 percent-or-more-owned foreign corporations;

- 85 percent of foreign source dividend received from less-than-80 percent but more-than-50 percent-owned foreign corporations; and

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- 50 percent of foreign source dividend received from less-than-50 percent owned foreign corporations.

Effect of Tax Reform Changes on Apportionment

Senate Bill 11 also revises Indiana Code § 6-3-2-2, which addresses how to determine adjusted gross income derived from sources within Indiana for corporations and nonresident persons. For taxable years beginning after December 25, 2016, if a taxpayer is required to include amounts in federal taxable income, or on IRC 965 Transition Tax Statement, line 1, as a result of IRC section 965, the following apply:

- For an entity that is not eligible to claim a deduction under Indiana Code § 6-3-2-12 (the deduction allowed corporations for a foreign source dividends) these amounts will not be receipts in any taxable year for the entity.

- For an entity that is eligible to claim a foreign source dividend deduction, these amounts will be receipts, but only to the extent of the amount added back from the IRC section 965 Transition Tax Statement, minus the foreign source dividends deduction. This applies regardless of the taxable year in which the money or property was actually received.

If a taxpayer is required to include amounts in the taxpayer's federal adjusted gross income or federal taxable income as a result of IRC section 951A, the following applies:

- For an entity that is not eligible to claim a foreign source dividend deduction under Indiana Code § 6-3-2-12, the receipts that generated the income will not be included as a receipt in any taxable year.

- For an entity that is eligible to claim a deduction for foreign source dividends, the amounts included in federal gross income as a result of IRC section 951A, reduced by the deduction allowable for foreign source dividends with regard to that income, will be considered a receipt in the year in which the amounts are includible in federal taxable income.

Receipts will not include receipts derived from sources outside the United States to the extent the taxpayer is allowed a deduction or exclusion in determining both the taxpayer's federal taxable income as a result of the federal Tax Cuts and Jobs Act of 2017 and the taxpayer's adjusted gross income under Indiana law. If any portion of the federal taxable income derived from these receipts is deductible under Indiana Code § 6-3-2-12, the receipts must be reduced by the proportion of the deduction allowable under Indiana Code § 6-3-2-12 with regard to that federal taxable income.

Receipts includible in a taxable year will be considered dividends from investments for apportionment purposes. Under Indiana Code § 6-3-2-2.2, which addresses interest income, discounts, and receipts attributable to Indiana, receipts in the form of dividends from investments are attributable to Indiana if the taxpayer’s commercial domicile is in Indiana.

Net Operating Losses

Indiana requires taxpayers to compute their own Indiana NOL, but previously conformed to the federal NOL carryforward period. House Bill 1316 provides that an Indiana NOL may not be carried over for more than 20 taxable years after the taxable year of the loss. Under the Tax Cuts and Jobs Act, NOLs can be carried forward indefinitely for federal purposes. Indiana does not adopt the limitation on the use of losses that now applies at the federal level.

Contacts

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Please contact Marc Caito at 317-951-2434 with questions on Indiana's conformity bill.

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