Worldwide Combined Reporting

House Committee on Ways and Means

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Current Method: Unitary Combined Reporting

U.S. Federal Taxable Income (with adjustments) of unitary group within U.S. X $\frac{\text{VT Sales}}{\text{U.S. Sales}}$ X Tax Rate = Tax

Worldwide Combined Reporting

All net income (subject to definition/adjustments) of unitary group X $\frac{\text{VT Sales}}{\text{All Sales}}$ X Tax Rate = Tax

Will corporations end up paying more or less?

- The relative profitability of a unified group's foreign and domestic subsidiaries largely determine if they would end up paying more.
- Reminder: A corporation's net income that is taxable in Vermont is determined by their sales factor.
- Adding foreign income will increase the net income portion of the equation, but at the same time decrease the sales factor.
  - Whether a firm pays more under WWCR is ultimately determined by the relative profitability of foreign and domestic subsidiaries.
  - However, multinationals that shift income to foreign subsidiaries that hold intellectual property are likely to pay more under WWCR.

Will corporations end up paying more or less?

Same Profitability			
Geography	**Sales**	**Profitability**	**Profits**
Domestic	10,000	10%	1,000
Foreign	10,000	10%	1,000

Reporting Type	Water's Edge	Worldwide
Profits	1,000	2,000
Sales Factor	100%	50%
Taxable Income	1,000	1,000

Will corporations end up paying more or less?

More Profitable Domestically			
Geography	**Sales**	**Profitability**	**Profits**
Domestic	10,000	15%	1,500
Foreign	10,000	5%	500

Reporting Type	**Water's Edge**	**Worldwide**
Profits	1,500	2,000
Sales Factor	100%	50%
Taxable Income	1,500	1,000

Will corporations end up paying more or less?

Less Profitable Domestically			
Geography	**Sales**	**Profitability**	**Profits**
Domestic	10,000	5%	500
Foreign	10,000	15%	1,500

Reporting Type	**Water's Edge**	**Worldwide**
Profits	500	2,000
Sales Factor	100%	50%
Taxable Income	500	1,000

Estimated Revenue Impact of WWCR

- Four important factors need to be taken into account with this bill:
    1. Increase in reported net income after pulling in all foreign income.
    2. Treatment of subpart F income (GILTI and FDII).
    3. Decrease in the sales factor.
    4. Change in taxable income.
- Definitions:
    - GILTI: Global intangible low-taxed income is income earned from “intangible” assets such as copyrights, patents, licenses, trademarks and other intellectual property (IP).
    - FDII: Foreign-derived intangible income are earnings that come from the sales of products related to IP. If a U.S. company holds IP in the U.S. and has sales to foreign customers based on that IP, the profits from those sales face a lower tax rate.

1 - Increase in Reported Net Income

- Bureau of Economic Analysis (BEA) data shows that U.S. parent corporations earn approximately 36.6% of net income from their majority owned foreign affiliates.
  - Currently, with some exceptions, this income is not required to be reported.
- Requiring corporations to report this income would increase total net income reported to Vermont.

All net income (subject to definition/adjustments) of unitary group X $\frac{\text{VT Sales}}{\text{All Sales}}$ X Tax Rate = Tax

2 - Treatment of FDII and GILTI

- Currently, Vermont uses the Federal definition of taxable income which includes:
  - 37.5% deduction for FDII.
  - 50% deduction for GILTI.
- This means that 62.5% of FDII and 50% of GILTI are already flowing through and being reported on Vermont returns.
- The non-deductible amounts of FDII and GILTI have to be removed from the increase in net income because they already flow through as part of federal net income.

2 - Treatment of FDII and GILTI

- Using IRS SOI data on the Section 250 allowable deductions for subpart F income and applying that to the available BEA foreign affiliate income brings the net increase in net income to 47.7%.
  - This is down from the 57.7% increase seen before accounting for subpart F income.

$$\text{All net income (subject to definition/adjustments) of unitary group} \times \frac{\text{VT Sales}}{\text{All Sales}} \times \text{Tax Rate} = \text{Tax}$$

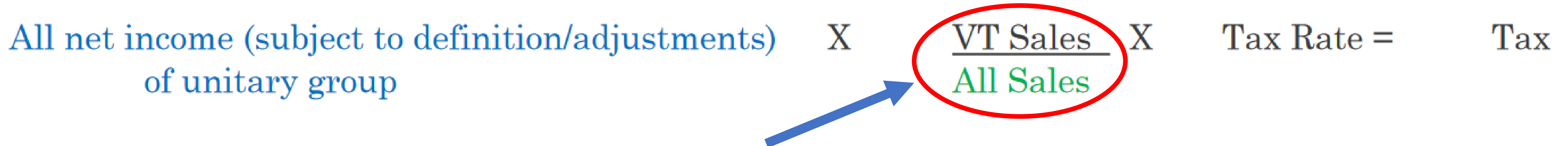
3 - Decrease in Sales Factor

- BEA data shows that approximately 31.1% of U.S. parent corporations' sales are made by majority owned foreign affiliates.
  - Currently, with a few exceptions income from these sales are not required to be reported.
- Requiring corporations to report this income would increase reported sales by approximately 45.2%.

$$\text{All net income (subject to definition/adjustments) of unitary group} \times \frac{\text{VT Sales}}{\text{All Sales}} \times \text{Tax Rate} = \text{Tax}$$

3 - Decrease in Sales Factor

- The simulated Vermont-wide single sales factor averaged between 2021 and 2022 returns was 0.064%, which includes only domestic sales.
- After including foreign sales, Vermont's sales factor would be estimated to decrease to 0.044%.



This equation is for the sales factor. Under WWCR the denominator would increase while the numerator would remain unchanged, thus decreasing the sales factor.

4 - Change in Taxable Income

- After accounting for the change in net income, treatment of subpart F income, and the change in the sales factor JFO estimates a 1.2% increase in Vermont taxable corporate income.
- If this were applied to the FY 2025 corporate income estimate that would increase revenue by approximately **$2.8 million**.
  - Note: There is a lot of uncertainty in this estimate.

All net income (subject to definition/adjustments) of unitary group X VT Sales / All Sales X Tax Rate = Tax

Increase

Decrease

Change in Taxable Income – Important Note

- Barring new federal legislation, starting in tax year 2026 the federal government will reduce the deductions for subpart F income:
  - The deduction for FDII will decrease from 37.5% to 21.875%.
  - The deduction for GILTI will decrease from 50% to 37.5%.
- Using same-year dollars, JFO estimates that this change would decrease the net change in revenue from **$2.8 million to -$1.1 million** annually.
  - Note: There is a lot of uncertainty in these estimates.
  - Also note: the decrease in the federal deductions will increase VT corporate income tax revenue irrespective of any changes to State law.

Considerations

- The estimated revenue increase does not account for any compliance or administrative costs the Tax Department may incur.
  - If reporting is voluntary this could erode potential revenue generated.
- Starting in tax year 2026 changes in the federal tax code will reduce subpart F income which will decrease expected net new revenue.
- There is considerable uncertainty in these estimates specifically related to the scale of the increase in net income and decrease in the apportionment factor.

Taxing Subpart F Income

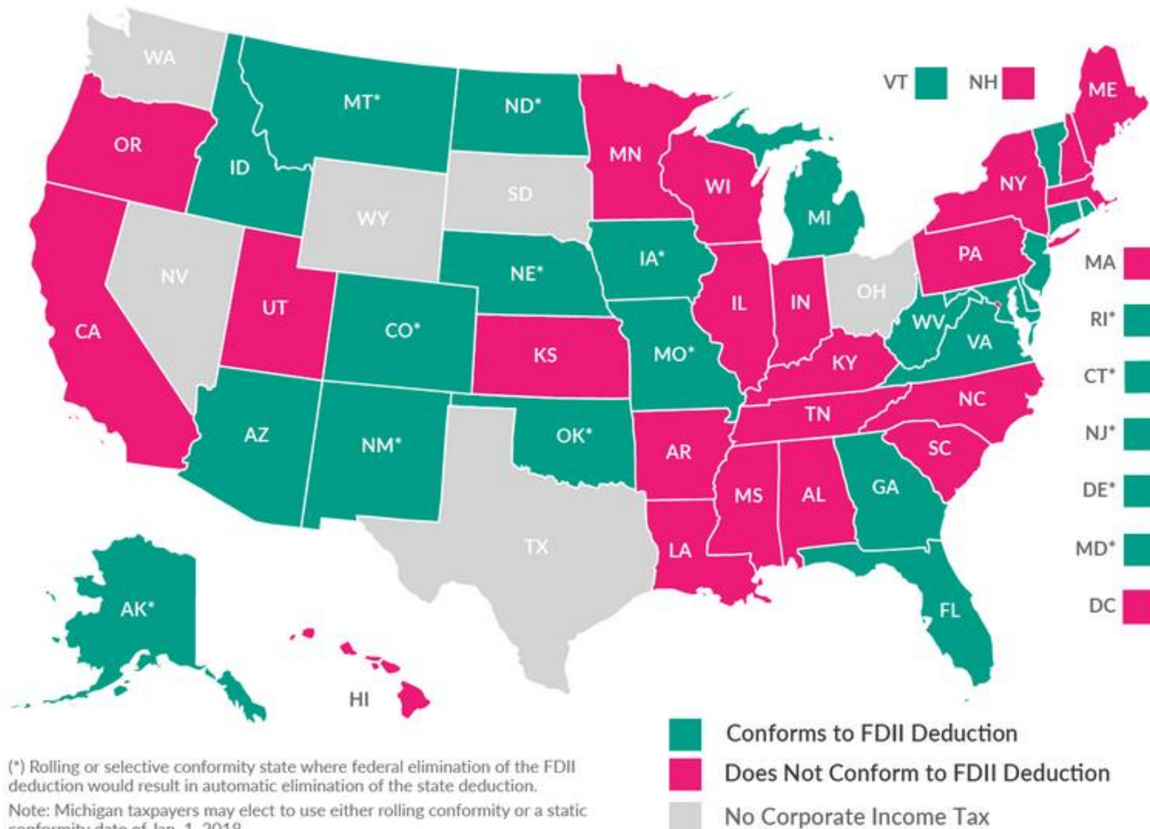
GILTI Deductions

WA
OR 20%
ID 15%
MT 20%
ND 30%
SD
WY
NV
CA
UT 50%
CO* 50%
NE 50%
KS
MN
IA
WI
MI
IL
IN
OH
PA
MO
OK
AZ
NM
TX
AR
LA
MS
AL
GA
SC
NC
VA
WV* 50%
KY
TN 5%
FL
AK* 20%
HI
ME 50%
NY 5%
VT 50%
NH 50%
MA 5%
RI 50%
CT 5%
NJ 50%
DE* 50%
MD 50%
DC* 50%

Currently Taxes GILTI
Does Not Tax GILTI
No Corporate Income Tax

- Currently 20 states tax GILTI.
  - MN now taxes 50% of GILTI
- VT taxes GILTI because we are coupled with the federal definition of net income.

FDII Deductions



- Currently 22 states conform with the federal deduction of FDII.
- Of the states that tax GILTI, 10 also do not conform with the federal FDII deduction.
  - This includes MA, ME, NH and NY among VT's geographic neighbors.

Considerations

- Taxation of GILTI reduces the incentive for U.S. companies to offshore intangible property into low-tax countries.
- Conversely, the FDII deduction is meant to provide an incentive for situating IP in the U.S.
  - Remember FDII are earnings that come from the sales of products related to IP. If a U.S. company holds IP in the U.S. and has sales to foreign customers based on that IP, a portion of those profits are deductible from net income on the federal level.

GILTI and FDII Deductions

- As noted, Vermont uses the federal definition for net income when calculating taxable income, which includes deductions for FDII and GILTI.
  - Removing (or adding back) these deductions would increase Vermont taxable income without affecting the sales factor.
- JFO estimates adding back deductible FDII and GILTI income would increase revenue by approximately **$13.0 million**.
  - $2.9 million from FDII and $10.1 million from GILTI.
- Using same-year dollars, starting in tax year 2026 this would decrease to approximately **$9.3 million** in additional revenue when the subpart F income deduction rates change on the federal level.
  - $1.7 million from FDII and $7.6 million from GILTI.