CIT Overview and Federal Impacts: H.R.1

House Committee on Ways and Means

Senate Committee on Finance

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Vermont Corporate Income Tax Overview

How Does Vermont Tax Businesses?

- Vermont – like the Federal government – treats taxes on net income/profit depending on how a business is structured.
- Two Characterizations:
  1. Corporations
     - Subject to the Corporate Tax.
  2. Pass-Through Businesses:
     - These include LLC’s, Partnerships, S-corps, and Sole Proprietorships
     - Profits are divided amongst shareholders depending on shares of business.
     - Owners of the business pay taxes through the Personal Income Tax Code.
     - Adjustments the corporate tax rate would not affect business income owners receive from pass-throughs.

How Does Vermont Tax Businesses?

- Vermont requires unitary combined reporting.
- Combined reporting treats affiliated companies that are part of a unitary group as one entity for tax purposes, so the group only files one return.
- Unitary combined reporting applies to:
  - Multi-state businesses that are part of a unitary group; and
  - The portion of the unitary business that occurs both within and outside the U.S. borders.

IRS 1120 Form

- The IRS 1120 form is the tax form that all C-corps are required to fill out and submit to determine their taxable income.
- Vermont uses the federal definition of taxable income as the starting point on the State return (much like federal AGI is the starting point for State person income tax returns).

IRS Form 1120 – Determining Total Income

Income	1a	Gross receipts or sales	1a		
	b	Returns and allowances	1b		
	c	Balance. Subtract line 1b from line 1a		1c	
	2	Cost of goods sold (attach Form 1125-A)		2	
	3	Gross profit. Subtract line 2 from line 1c		3	
	4	Dividends and inclusions (Schedule C, line 23)		4	
	5	Interest		5	
	6	Gross rents		6	
	7	Gross royalties		7	
	8	Capital gain net income (attach Schedule D (Form 1120))		8	
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)		9	
	10	Other income (see instructions—attach statement)		10	
	11	**Total income.** Add lines 3 through 10		11	

- Total income does not equal taxable income.
- Corporations are eligible to take deductions before determining taxable income as seen on the next slide.

IRS Form 1120 – Determining Taxable Income

Deductions (See instructions for limitations on deductions.)

12	Compensation of officers (see instructions—attach Form 1125-E)	12	
13	Salaries and wages (less employment credits)	13	
14	Repairs and maintenance	14	
15	Bad debts	15	
16	Rents	16	
17	Taxes and licenses	17	
18	Interest (see instructions)	18	
19	Charitable contributions	19	
20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	20	
21	Depletion	21	
22	Advertising	22	
23	Pension, profit-sharing, etc., plans	23	
24	Employee benefit programs	24	
25	Energy efficient commercial buildings deduction (attach Form 7205)	25	
26	Other deductions (attach statement)	26	
27	**Total deductions.** Add lines 12 through 26	27	
28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.	28	
29a	Net operating loss deduction (see instructions)	29a	
b	Special deductions (Schedule C, line 24)	29b	
c	Add lines 29a and 29b	29c	

- Line 28 is the starting point for determining Vermont taxable corporate income.
- All changes made at the federal level that affect lines 1 through 27 do flow through to Vermont, while those further down the form do not.

Key Vermont CIT Provisions

- **Repeal of 80/20 language:** Previously, if a C-corp had a subsidiary whose primary source of sales came from overseas (defined as 80% of total sales or more), it was excluded from the sales of the parent C-corp. Act 148 repealed that language so that any subsidiary operating in Vermont had to be counted as a member of the unitary group's sales for sales apportionment.
- **Joyce to Finnigan Methodology:** VT previously used the Joyce methodology which limited a C-corps nexus in VT to only the subsidiaries that have nexus in VT. Under the current Finnigan methodology, if one subsidiary has nexus, then the entire unitary group has nexus. This change impacted the apportionment formula for corporations.

Key Vermont CIT Provisions

- **Single Sales Factor:** Previously, VT relied on a three-factor apportionment that included a C-corp's payroll, property ,and sales to apportion income for VT CIT. Act 148 shifted this to a single factor that apportions income on the basis of sales alone.

Key Vermont CIT Provisions

- Vermont uses the U.S. definition for taxable income for unitary groups within the U.S.
- C-Corps’ taxable income is then apportioned to Vermont using a single sales factor.
- Single sales factor is agnostic about where a c-corp is located. The only determining factor in apportionment is the extent to which c-corps sell into the Vermont market.

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

Line 28 from 1120 form

Vermont Corporate Income Taxation

Example 1

C-Corp A

Federal Taxable Income		VT Sales / U.S. Sales		Vermont Taxable Income
1,000	x	$\frac{0}{5{,}000}$	=	0

Example 2

C-Corp B

Federal Taxable Income		VT Sales / U.S. Sales		Vermont Taxable Income
1,000	x	$\frac{5{,}000}{5{,}000}$	=	1,000

Example 3

C-Corp C

Federal Taxable Income		VT Sales / U.S. Sales		Vermont Taxable Income
1,000	x	$\frac{2{,}500}{5{,}000}$	=	500

- These calculations are the same regardless of whether a corporation is based in Vermont or any other state.

Corporate Income Taxes

Marginal Tax Rates		
Income Allocable to Vermont		**Tax Rate**
$0	$10,000	6.0%
$10,000	$25,000	7.0%
$25,000	and up	8.5%

Minimum Annual Tax		
Vermont Gross Receipts		**Minimum Tax**
$0	$500,000	$100
$500,000	$1,000,000	$500
$1,000,000	$5,000,000	$2,000
$5,000,000	$300,000,000	$6,000
$300,000,000	and up	$100,000

H.R.1 Changes Corporate Income Taxes

H.R.1 Changes to Business and Corporate Taxes

- There were many changes made to business and corporate income taxes that are considered “above the line” which are expected to flow through to Vermont.
- These include changes to:
  - The deduction for domestic research and development expenses,
  - limitation on business interest deduction,
  - exceptions from limitations on business meals deductions,
  - limitation on expensing for depreciable business assets,
  - special depreciation allowance for qualified production property,
  - foreign derived intangible income and global intangible low-taxed income,
  - changes to pro rata share rules,
  - renewal and expansion of opportunity zones,
  - charitable deduction for corporations,
  - accounting changes for certain residential construction, and
  - expanded exclusion of gains from qualified small business stock.

The Deduction for Domestic Research and Development Expenses

- H.R.1 changes how corporations calculate their R&D deduction amount.
- Starting in 2022 (TCJA), these expenses were required to be amortized over five years, which meant the benefit from the deduction was realized incrementally over that period.
- Prior to TCJA, incurred R&D expenses could be deducted immediately. The H.R.1 changes revert back to pre-TCJA treatment.
- H.R.1 also makes this change retroactively to include any R&D expenses that have not been already deducted since 2022.
- This will likely front-load the cost of the deduction for R&D expenses.
- **This change is expected to reduce State revenues by approximately $2.3 million in FY 2026 and 2027, but the impact is expected to decrease over time.**

Amended Limitation on Business Interest Deduction

- H.R.1 expanded the limit to which corporations can deduct interest paid on loans for a business purpose.
- The limit on business interest deductions is limited by the sum of its business interest *income*, floor plan financing interest, and 30% of their adjusted taxable income.
- H.R.1 expanded the amount of business interest paid that can be deducted from 30% to 50%.
- Because Vermont is coupled to this provision this expansion will flow through to the State.
- **This change is estimated to reduce State revenue by approximately $1 million annually starting in FY 2026.**

Exceptions from Limitation the Business Meals Deductions

- In 2022, TCJA eliminated a general deduction on business entertainment expenses, but still kept a more limited deduction for food and beverages provided by employers to employees.
- H.R.1 kept these restrictions but created a few new exceptions to the deduction limitation including when employees pay the same price for the meal as the general public, meals provided to crews on commercial vessels and oil platforms, and meals provided on certain fishing vessels and facilities.
- This expansion of exceptions from TCJA will flow through to Vermont, but is expected to have a de minimis impact.

Limitation on Expensing For Depreciable Business Assets

- H.R.1 increases the maximum amount that a taxpayer may expense for the cost of a qualifying depreciable business asset in lieu of recovering the costs through depreciation.
- The maximum amount that can be expensed increased from $1 million to $2.5 million and will be indexed for inflation annually.
- Vermont is coupled to the federal treatment of this deduction so it *does* flow through to the State.
- **This change is estimated to decrease State revenues by approximately $250,000 in FY 2026 and potentially grow to an approximately $600,000 reduction in future years.**

Special Depreciation Allowance for Qualified Business Assets

- H.R.1 now allows a deduction for qualified production property of 100% of its adjusted cost basis.
- This 100% bonus depreciation can be used for qualified nonresidential property used in manufacturing or production of tangible personal products. Further, this is largely limited to agricultural and chemical production.
- These properties are typically depreciated over 39 years, but this change would allow that amount to be fully claimed up front.
- This change applies to properties built or bought after January 19, 2025 and before January 1, 2029.
- **This is estimated to reduce State revenue by approximately $250,000 in FY 2026, but rise significantly to approximately $3.5 million in FY 2027 and $5.2 million in FY 2028.**

Foreign Derived Intangible Income and Global Intangible Low-Taxed Income

- H.R.1 increased the base used to calculate foreign derived intangible income (FDII) while also increasing the percentage of this income that can be deducted, effectively lowering the effective tax rate.
- The bill also eliminated a deduction of 10% of the tax basis of qualified tangible assets in other countries (QBAI) used to calculate global intangible low-taxed income (GILTI), which increases the base amount of this income.
- FDII was renamed foreign-derived deduction eligible income and GILTI was renamed net controlled foreign corporation tested income.
- Vermont is coupled to the federal treatment of this kind of income so this change *does* flow through to the State.
- **These changes are estimated to *increase* revenue to the State by approximately $2.5 million in FY 2026 and increase to about approximately $3.2 million in future fiscal years.**

Changes to Pro Rata Share Rules

- H.R.1 changes the treatment of controlled foreign corporation (CFC)
  - A foreign corporation is a CFC if at least 50% of voting power or value of the stock are held by U.S. shareholders.
- Each U.S. shareholder must include in their gross income their pro rata share of the CFC’s passive income in that tax year.
- Taxpayers that hold stock in CFC’s will have to report more gross income than they would have previously, and this *does* flow through to Vermont.
- **This change is not expected to change State revenue in FY 2026, but is estimated to increase revenue by approximately $100,000 in FY 2027 and increase to approximately $240,000 in FY 2028 and grow gradually thereafter.**

Renewal and Expansion of Opportunity Zones

- H.R.1 makes permanent the creation of opportunity zones created by TCJA.
  - Opportunity zones encourage investment in a Qualified Opportunity Fund to support real estate development in opportunity zones.
  - Investors can elect to defer gains from these investments as long as they hold them, so the longer they hold them the greater the tax benefit.
  - Vermont currently has 25 opportunity zones.
- H.R.1 also created Qualified Rural Opportunity Funds, which provide larger tax benefits for investing in these newly created zones.
- **These changes flow through to Vermont, but the implementation date is delayed until 2027.**

Charitable Deductions for Corporations

- Previously, corporations could deduct charitable contributions equal to up to 10% of their taxable income.
- H.R.1 makes a change so that only contributions made in excess of 1% and up to 10% of taxable income can be deducted.
- This changes reduces the amount that can be claimed by 1%, thus reducing the maximum deductible amount.
- **This is not expected to change State revenues in FY 2026 but is estimated to increase revenue by approximately $140,000 in FY 2027 and increase gradually on an annual basis in future years.**

Summary

Net Estimated Changes to State Revenue

H.R.1 Changes that will flow through if Vermont "Links Up"	**FY26** *(Millions)*	**FY27** *(Millions)*
Child and Dependent Care Tax Credit expansion	0.00	-1.00
Full Expensing of Domestic Research and Experimental Procedures	-2.30	-2.30
Amended Limitation on Business Interest Deduction	-1.00	-1.00
Increased Limitation on Expensing of Depreciable Business Assets	-0.25	-0.60
Special Depreciation Allowance for Qualified Production Property	-0.25	-3.50
International Tax Provisions	2.50	3.20
Pro Rata Share Rules	0.00	0.10
Charitable Deductions for Corporations	0.00	0.14
Misc other business and corporate income provisions	0.00	0.10
Total	**-1.30**	**-4.86**

Questions?