IDAHO State Tax Commission

Federal Tax Reform – Idaho Impact

The potential effect of federal tax reform for Idaho
On December 22, 2017, the President signed into law the Tax Cuts and Jobs Act. This legislation includes provisions that will impact Idaho taxpayers in both 2017 and 2018. Those provisions will require careful consideration by the 2018 Idaho Legislature to determine the effect on Idaho taxpayers.

Because Idaho's Income Tax Code uses the Internal Revenue Code (IRC) as a starting point, Idaho's income tax returns begin with the federal adjusted gross income (AGI). Historically, Idaho lawmakers have generally conformed to the IRC on an annual basis except for the Bonus Depreciation and Net Operating Loss provisions.

I. Conformity Overview

1. Idaho Conformity: Because Idaho conforms to the federal calculation of taxable income:
    a. Any changes that affect these calculations will impact the Idaho return and Idaho revenue.
        i. Idaho will study any change and decide whether or not to conform.
    b. Any changes that affect only the federal tax rates or credits will have no impact on the Idaho return or Idaho revenue.
2. No Idaho Impact: The following changes only affect the federal tax rates or credits and will have no impact on the Idaho income tax return or Idaho revenue.
    a. Tax brackets.
    b. Corporate tax rate.
    c. Alternative Minimum Tax.
    d. Any of the federal credits, both business and individual.
    e. Federal Net Operating Loss (NOL)
        i. Idaho doesn't currently conform to federal NOL.
    f. Bonus depreciation rules – immediate expensing.
        i. Idaho doesn't currently conform to federal bonus depreciation.

II. Tax Year 2017 Conformity

1. Retroactive Provisions - Individuals: The implementation date of federal reform affects state tax administration. For individuals, the tax reform areas mainly impact tax year 2018 except for the threshold for itemizing medical expenses. The federal change to itemized medical expense deductions (reduces the threshold for all taxpayers from 10% to 7.5% of federal AGI to claim this deduction) takes effect for tax years after 12/31/16 and sunsets 12/31/18. This will affect the Idaho 2017 and 2018 tax years, and the changes will reset back to 10% for the 2019 tax year and forward.
    a. To prepare for the tax year 2017 filing season that typically begins in January, the following actions have been completed or are currently underway:
        i. Forms are finalized.
            1. If Idaho conforms to the threshold for itemizing medical expenses:
                a. The Idaho State Tax Commission will need to inform taxpayers and tax professionals.
                b. No form changes are required; however, instructions will need to be updated and communicated.

c. Reduces FY2018 and FY2019 Idaho revenue by approximately $6.4 million[1] and $1.8 million[6b] respectively. Calculations are based on Joint Committee on Taxation (JCT) estimates.

2. If Idaho doesn't conform to the threshold for itemizing medical expenses:
    a. The Tax Commission will need to provide outreach, instructions, and a worksheet for taxpayers to calculate a modified Schedule A (schedule for itemizing deductions).
    b. The calculation difference isn't easily identified while processing returns and would be subject to audit to determine appropriate calculations.

ii. Tax year 2017 internal processing requirements have been developed.
    1. Conformity doesn't require internal processing system changes.

iii. Software developers have programmed tax year 2017 requirements to market products to taxpayers by January 2018.
    1. Conformity requires industry software changes.

2. Retroactive Provisions – Business[2]**:** There are some significant and unprecedented changes to the treatment of foreign income of affiliates and dividends received from foreign subsidiaries. Some of these federal changes are retroactive to tax year 2017 and are in place as of the signing of the federal law.
    a. These will have unknown effects on multinational corporations that file Idaho income tax returns. It's difficult to estimate the changes that are likely to occur, since we have a mixture of worldwide and water's edge filers. The tax reform legislation creates some new Internal Revenue Code sections for some of these changes. The actual results will depend on whether our statutes address some of the issues. We're also not able to anticipate taxpayer filing behavior. Large multinational corporations have more choices than typical individuals do in their filing methods.
    b. Responding to federal changes on international activities requires prompt legislative action by the Idaho Legislature because the federal effective date for some provisions is for tax year 2017. Due to the unique nature of multinational taxation, statutory changes would be needed. More research and legislative discussions will need to take place to fully identify the impact on Idaho taxpayers and Idaho revenue.

3. Tax Year 2017 Conformity: The first conformity bill to be considered in the Idaho 2018 legislative session will be the conformity for tax year 2017, including the retroactive provisions.

III. Tax Year 2018 Conformity – Individuals

1. Even though the Idaho legislature would normally address tax year 2018 conformity during the 2019 legislative session, there are several dramatic changes in the Tax Cuts and Jobs Act that may require immediate statutory guidance for Idaho taxpayers. The guidance would help ensure taxpayers are prepared for filing their tax year 2018 Idaho income tax returns.
    a. In addition to the taxpayer guidance, the 2018 Idaho Legislature may want to consider statutory changes to address Idaho revenue changes resulting from the federal tax reform.

   b. Changes made for tax year 2018 will require timely communication to taxpayers:
      i. How the 2018 tax code affects them.
      ii. How the 2018 tax code affects payroll withholding.
      iii. If adjustments need to be made for their Idaho estimated payments:
         1. Individual estimated payments – tax year 2015 = 4,800 taxpayers
         2. Business estimated payments – tax year 2015 = 9,300 taxpayers
2. Federal tax rate changes—No direct effect on Idaho.
3. Standard deduction increased—Reduces Idaho revenue by $340.5 million[3].
   a. Calculating the standard deduction based on historical taxpayer filing status.
   b. *Estimate based on multiplying the estimated number of Idaho 2018 returns by the 2018 marginal increase for the standard deduction. This total was reduced by 5% to account for the estimated percentage of Idaho filers that will still itemize.*
4. Eliminating the personal exemption—Increases Idaho revenue by $272.3 million[4].
   a. Counting one exemption for Single or Head of Household & two for Married Filing Joint.
   b. *Estimate based on multiplying the estimated number of Idaho 2018 personal exemptions by the 2018 exemption amount.*
5. Eliminating dependent exemptions—Increases Idaho revenue by $139.5 million[5].
   a. *Estimate based on multiplying the estimated number of Idaho 2018 dependent exemptions by the 2018 exemption amount.*
6. Eliminating or capping most itemized deductions—Increases Idaho revenue by $55.3 million[6a].
   a. *Estimate based on using a portion of the federal estimate made by the Joint Committee on Taxation, December 18, 2017, times the Idaho effective tax rate. This total was reduced by 25% to account for the lower property taxes in Idaho.*
7. Changing the definitions for qualified expenses from a 529 Education Savings account — Reduces Idaho revenue by approximately $6 million[7].
   a. *To calculate the estimated expenses, we multiplied 14,138 (Idaho students enrolled in private schools) by $6,382 (estimated expense per student).*
      i. The average tuition amounts of $5,069 for K-8 and $6,757 for high school are now allowed.
      ii. The cap is at $10,000 per year of expenses. We used $6,382 per student as an estimate.
8. Current estimate of the effect to Idaho revenue if all current individual provisions of the bill are adopted by Idaho is +$118.8 million.
9. Idaho withholding calculations use the federal Form W-4, which currently collects the employee's filing status and number of exemptions. Idaho's 2018 withholding table calculations use the filing status, exemptions, and tax bracket information.
   a. The IRS has announced that it will temporarily design and implement changes to work with the existing Forms W-4 that employees have already filed.
      i. IRS intends to publish changes in January for implementation in February.
   b. Once the Idaho Legislature decides on Idaho's direction, the Tax Commission will be able to communicate and provide guidance to employers and employees.

IV. Tax Year 2018 Conformity - Business

Current estimate of the effect to Idaho revenue if all current business provisions of the bill are adopted by Idaho is approximately -$21.4 million. *Estimates based on historic estimating calculations using the Joint Committee on Taxation analysis.*

1. Federal tax rate changes—No direct effect on Idaho.
2. Increase of IRC Section 179 expense limit to $1 million – Reduces Idaho revenue by $6.0 million[8].
    a. The section 179 is an immediate expensing or accelerated depreciation election. The new law raises the expense limit from $500K to $1 million. The phase-out is increased from $1 million to $2.5 million.
    b. Bonus depreciation (section 168(k)) is a separate issue and Idaho doesn't conform to that section.
3. Simplified accounting for small business – Reduces Idaho revenue by $12.8 million[9].
    a. Simplified accounting increases the threshold for a business to be required to use accrual basis accounting from $5 million in gross receipts to $25 million. For example, a business will be able to take a deduction for some additional items that it previously would have kept as an asset until it was used.
4. Interest expense limited to 30% – Increases Idaho revenue by $14.2 million[10].
    a. Interest expense deductions for a business are being limited to 30% of the sum of adjusted taxable income and taxable interest income. The excess will be carried forward in the federal NOL, which Idaho doesn't conform to. Idaho would have to address this to allow businesses to carry the excess over so they don't lose that in Idaho.
5. 1031 exchanges limited to real estate – Increases Idaho revenue by $0.8 million[11].
    a. The section 1031 exchange allows deferring reporting any gain on the exchange of property except for cash received, until ultimately sold. This provision limits exchanges of like-kind property to real property.
        i. No longer allows like-kind exchanges for other investment property such as buildings or art.
6. S corporation to C corporation conversion rules – Reduces Idaho revenue by $0.8 million[12].
    a. The S corporation to C corporation conversion will allow some post conversion distributions.
7. Inclusion of income (more choices) – Increases Idaho revenue by $2.0 million[13].
    a. The inclusion of income provision requires businesses to report taxable income no later than when it is reported on their financial statement.
8. Repeal Section 199, the domestic production deduction – Increases Idaho revenue by $7.3 million[14].
    a. The original intent was to encourage investment in domestic facilities. With the new federal territorial tax regime established with the Tax Cuts and Jobs Act, Congress didn't think this provision was still necessary.
9. Repeal employee entertainment expense – Increases Idaho revenue by $2.7 million[15].
    a. Part of the justification for lowering the corporate rate was to eliminate some of the deductions. Employee recreational memberships are not allowed. Professional memberships for business are allowed.

10. Repeal employee transportation and parking reimbursement – Increases Idaho revenue by $2.0 million[16].
    a. Employee commuting and parking expenses are no longer allowed.
11. Section 199A—reduce most pass-through income by 20% on the owner's income tax return – Reduces Idaho revenue by $30.8 million[17].
    a. The intent of this provision is to balance the tax rates between pass-through entities and C corporations. Because Idaho's top tax rate for individuals and the tax rate for corporations are the same, the federal justification doesn't exist for Idaho.
    b. As the federal legislation is written, Idaho's conformity would pick up this provision. The Idaho Legislature would need to take specific action in a separate bill to not conform to this provision.

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Federal Tax Reform – Idaho Impact Detail Summary

2017 CONFORMITY	
RETROACTIVE PROVISIONS	
	In Millions $
1. Medical threshold	($6.4)
2. International	Positive unknown

2018 CONFORMITY	
INDIVIDUAL	
	In Millions $
3. Standard deduction increase	($340.5)
4. Personal exemption	$272.3
5. Dependent exemption	$139.5
6a. Itemized deductions	$55.3
6b. Residual medical threshold from 2017	($1.8)
7. Education expenses	($6.0)
Total Individual	118.8
BUSINESS	
8. Section 179	($6.0)
9. Simplified accounting	($12.8)
10. Interest expense	$14.2
11. 1031 exchanges	$0.8
12. S corp. to C corp. conversion	($0.8)
13. Inclusion of income	$2.0
14. Repeal Section 199	$7.3
15. Repeal entertainment expense	$2.7
16. Repeal employee transportation	$2.0
17. Section 199A--pass-through	($30.8)
Total Business	(21.4)
Total Effect 2018 Conformity	$97.4