

## Idaho Conformity and Tax Reform

### The 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 impact Idaho taxpayers in both 2017 and 2018.

On February 9, 2018, the President signed into law the federal budget reconciliation that also impacted Idaho taxpayers for their 2017 taxes.

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. The following changes included in the Tax Cuts & Jobs Act affect only the federal tax rates or credits and have no impact on the Idaho income tax return or Idaho revenue.
  - a. Individual 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 – House Bill 355 (signed by Governor Otter on Feb. 9, 2018)

1. *Retroactive Provisions - Individuals:* 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 threshold will reset back to 10% for the 2019 tax year and forward.
2. *Retroactive Provisions – Business:* There were 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. The provision requires taxpayers to report and pay tax on previously unreported overseas earnings.
  - a. Taxpayers who file on a water's-edge basis should attach their IRC 965 Transition Tax Statement to their Idaho return. Add the total amount of gross income from 965 dividends on line 17 of Idaho Form 41 "other additions."

**III. Tax Year 2017 Conformity – House Bill 624** (signed by Governor Otter on March 20, 2018)

1. This trailer bill conformed Idaho to some of the federal tax breaks that Congress extended as part of the federal budget reconciliation on February 9, 2018. The Idaho law extends the sunset date of the following 11 deductions that Idaho normally conforms to:

<u>IRC</u>	<u>Description</u>
108	Exclusion from gross income of principal residence debt relief (If you lose your principal residence due to foreclosure, you don't have to include any forgiven debt in your taxable income.)
163	Mortgage insurance premium deduction for premiums treated as qualified insurance
222	Qualified tuition and related expenses deduction (On Form 40, it's included in the federal adjusted gross income. On Form 43, report on line 22.)
168(e)	3-year depreciation of certain racehorses
168(i)	7-year recovery for motorsports complexes
179E	Mine safety expense deduction
199	Puerto Rico production deductions
168(e)	5-year cost recovery for energy property
179D	Energy efficient commercial building expenses
181	Film, television, and theater production cost deductions
451	State energy restructuring

**IV. Tax Year 2018 Conformity – House Bill 463** (signed by Governor Otter on March 12, 2018)

1. The Idaho income tax code is based on using the federal taxable income as a starting point for both business and individual income tax returns. The fiscal effect of the Tax Cuts & Jobs Act generated a revenue increase of an estimated \$97 million causing a tax increase for many Idaho taxpayers. In reaction to the potential effect on Idaho taxpayers, the Governor recommended and the Idaho Legislature passed legislation to offset the fiscal hit to taxpayers and create additional tax breaks. This bill conformed the Idaho income tax code to changes made to the Internal Revenue Code (IRC) that affect the 2018 taxable year, including but not limited to:
  - a. Increasing the standard deductions
    - Single = \$12,000
    - Head of Household = \$18,000
    - Married Filing Jointly = \$24,000
  - b. Eliminating the personal exemptions

- c. Eliminating dependent exemptions
  - d. Eliminating or capping most itemized deductions
  - e. Changing the definitions for qualified expenses from a 529 Education Savings account to include K-12 and private schools
  - f. Adopting miscellaneous business income tax changes (see page 4)
2. This bill also created a nonrefundable Idaho child tax credit of \$130 per qualifying child.
  3. Additionally it reduced the personal income tax rate by 0.475% in all brackets and reduced the corporate income tax rate by 0.475%. The corporate rate and the top rate for individuals are now 6.925%.

**V. Tax Year 2018 Conformity – House Bill 675** (signed by Governor Otter March 28, 2018)

1. This legislation raised the child tax credit from \$130 to \$205.

The final 2018 Idaho income tax reform bill became law on March 28. As a result, some taxpayers will see a decrease in the tax they owe for 2018, and others will see an increase. Guidance is available online at [tax.idaho.gov/taxreform](http://tax.idaho.gov/taxreform). Taxpayers can email specific tax questions to [taxrep@tax.idaho.gov](mailto:taxrep@tax.idaho.gov).

### Individuals

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 required immediate statutory guidance for Idaho taxpayers. The guidance will help ensure taxpayers are prepared for filing their tax year 2018 Idaho income tax returns.

1. Prior to tax reform, Idaho withholding calculations used the federal Form W-4, which collected the employee's filing status and number of exemptions. Idaho's 2018 withholding table calculations use the filing status, number of qualifying children, and tax bracket information.
  - a. The IRS published a new W-4 in January with implementation in February
  - b. Using the federal allowance entry reported on the new W-4 could cause miscalculations of Idaho withholding
  - c. The Tax Commission will use the federal W-4 for tax year 2018 and will require a state-specific entry on line 5
    - i. In addition to the number of federal allowances, taxpayers will determine the number of qualifying children and insert that number on line 5 of the federal W-4 after the federal number
    - ii. The state entry reports only the number of qualifying children
      - This is different from the federal calculation
      - To ensure proper withholding, the state entry is important for the employer to collect
  - d. The Tax Commission updated the Idaho withholding tables and guide in April
  - e. The Tax Commission will consider a state specific W-4 for the 2019 tax year
    - i. Decision to be made by September 2018
  - f. If taxpayers need to adjust their Idaho estimated payments:
    - i. The new tax rate tables will be posted on our website as soon as they're updated for the new law

## Business

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 required immediate statutory guidance for Idaho business taxpayers. The guidance will help ensure business taxpayers are prepared for filing their tax year 2018 Idaho income tax returns.

1. Increase of IRC Section 179 expense limit to \$1 million.
  - a. The section 179 is an immediate expensing or accelerated depreciation election. The new law raises the expense limit from \$500K to \$1 million.
  - b. Bonus depreciation (section 168(k)) is a separate issue and Idaho doesn't conform to that section.
2. Simplified accounting for small business.
  - 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 assets until used.
3. Interest expense limited to 30%.
  - a. Interest expense deductions for a business are being limited to 30% of the sum of adjusted taxable income and taxable interest income.
4. 1031 exchanges limited to real estate.
  - 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 airplanes or art.
5. S corporation to C corporation conversion rules.
  - a. The S corporation to C corporation conversion will allow some post-conversion distributions.
6. Inclusion of income (more choices).
  - a. The inclusion of income provision requires businesses to report taxable income no later than when it's reported on their financial statement.
7. Repeal Section 199, the domestic production deduction.
  - a. The deduction's original intent was to encourage investment in domestic facilities. With the new federal territorial tax regime established with the Tax Cuts and Jobs Act, this provision isn't necessary.
8. Repeal employee entertainment expense.
  - a. Employee recreational memberships aren't allowed. Professional memberships for business are allowed.
9. Repeal employee transportation and parking reimbursement.
  - a. Employee commuting and parking expenses are no longer allowed.
10. Section 199A — Reduce most pass-through income by 20% on the owner's income tax return.
11. Section 461(l)(2) — Disallow active pass-through losses in excess of \$500,000 for joint filers, \$250,000 for all others.