

A Potential Wild Card in the Forecast: Corporate Revenues from Repatriation

One of the most important provisions in the 2017 Federal Tax Cut and Jobs Act (TCJA) also introduces considerable complexity and uncertainty in terms of revenue impacts: repatriation of potentially \$3 trillion or more in accumulated U.S. corporate offshore earnings. These profits, sheltered from U.S. taxation in a wide array of global tax havens, have allowed corporations to avoid U.S. and related state income taxes for many years. The Tax Act fundamentally changes the rules of international taxation and provides for repatriation of this accumulated income at a fraction of the prior tax rate (35%), at either 15.5% (for cash) or 8% (for more illiquid holdings), over an eight year period.

It is currently the opinion of both the Vermont Tax Department and Legislative Council that this repatriated income is also subject to state income taxation. Although currently impossible to verify with complete certainty, we estimate that approximately \$15 million in FY2018 State Corporate receipts and more than \$1 million in FY19 to date have been received in connection with repatriated earnings.

In conjunction with the Tax Department, we have developed a list of 322 corporations with large potential repatriation liabilities based on publicly available information, who collectively have an estimated \$2.7 trillion in offshore earnings. We have applied the relevant Vermont apportionment factors to each affected company from Tax filings and estimated potential state Corporate receipts at both the 8% and 15.5% tax rates. Based on this, the State could ultimately receive \$100-\$200 million, however, the timing and exact liability is still highly uncertain at this time. Some even contest the ability of states to tax this income – and the same legal and accounting firms that set up these and other tax avoidance mechanisms are hard at work to minimize tax payments under the new law. Thus, final receipt of these amounts could be subject to lengthy legal proceedings and even clawback from firms who have already paid.

In recognition of this, we have only included \$15-\$20 million in expected FY2019 Corporate revenues from repatriation and smaller amounts (\$1 to \$5 million per year) thereafter. The Tax Department is planning on publishing guidance to Corporate taxpayers on this issue within the next few months, and eventually, forms to specifically identify tax payments connected to repatriated earnings. With this information, and federal tax returns, we will be in a better position to identify payments linked to this liability and establish a more accurate sense of both potential liabilities and tax payment timing.

The Wall Street Journal currently estimates that only about 10% of all corporate repatriation has been effected to date, due to the eight year Federal payment window. At the State level, however, Vermont considers the entire liability to be due with tax year 2017 payments.

We will be tracking this closely in FY2019 and beyond, since it could contribute to enormous revenue variances - up or down - in selected revenue forecast periods.

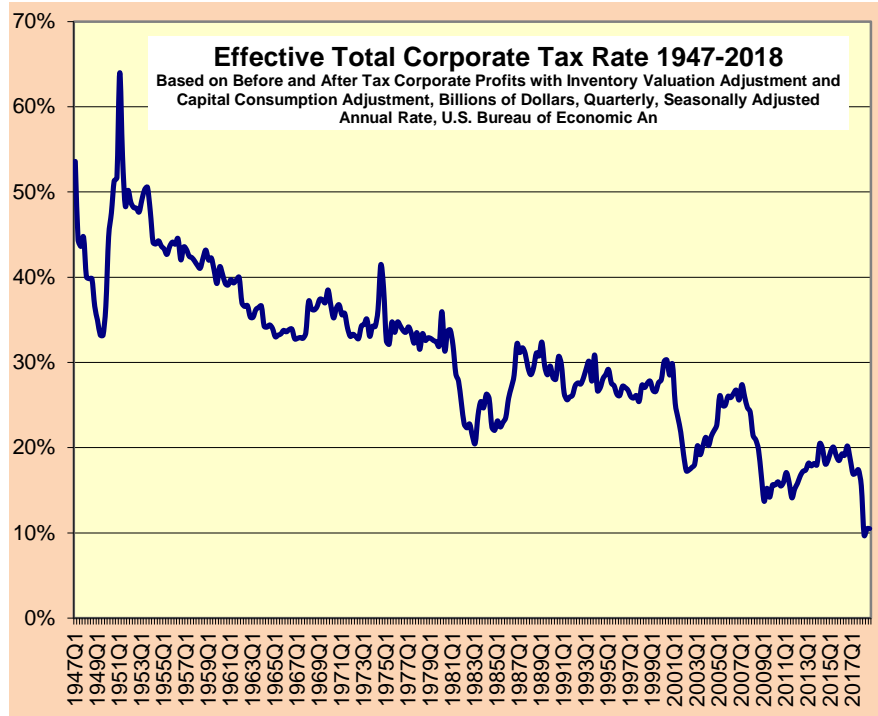


Repatriation Redux: Still the Biggest Wild Card in the Revenue Forecast

Although outlined in the prior July Revenue Forecast, one of the most important provisions in the 2017 Federal Tax Cut and Jobs Act (TCJA) remains as relevant and uncertain 6 months hence: repatriation of potentially \$1-\$3+ trillion in accumulated U.S. corporate offshore earnings. These profits, sheltered from U.S. taxation in a wide array of global tax havens, have allowed corporations to avoid U.S. and related state income taxes for many years. The Tax Act fundamentally changes the rules of international taxation and provides for repatriation of this accumulated income at a fraction of the prior tax rate (35%), at either 15.5% (for cash) or 8% (for more illiquid holdings), over an eight year period.

It is still the opinion of both the Vermont Tax Department and Legislative Council that this repatriated income is also subject to state income taxation, although despite payments by some firms, others have questioned this liability. Although currently impossible to verify with complete certainty, we estimate that as much as \$15 million in FY2018 and \$24 million in FY19 to date in Corporate tax revenues may have been received in connection with repatriated earnings – about 30% of all corporate revenues collected during calendar year 2018.

We are working closely with the Tax Department to identify possible payments associated with repatriation and as formal returns are filed, will be evaluating these so as to inform and refine further estimates. From public information in 10K and 10Q corporate filings reviewed to date, two things are clear: 1) There is a great deal of confusion over application of the law; and 2) Many firms are electing to repatriate earnings over time, despite Vermont law requiring immediate payment of the entire liability. The complexity of the law, absence of final IRS guidance in many areas, and the technical and legal resources available to the affected firms, may mean some payments and Vermont liabilities could be litigated for many years. The IRS has promised to complete final guidance and rulemaking by June 2019, however personnel assigned to this work have been sidelined by the recent government shutdown.



From what we now know, we expect revenue flows to be slightly larger over the balance of FY19 and FY20 and a more extended tail of contested revenues that could be large and random in their resolution. Although refunding could occur if a legal challenge to states' claim to this revenue is successful, until such a challenge is credibly posed, we do not currently have any provision for this in the current revenue forecasts.

We will continue to track this at the individual firm level in FY19 and beyond, since it is likely to contribute to enormous revenue variation - up or down - over an extended period of time.