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5 Key Takeaways | State Taxation of Foreign Income after OBBBA

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Kilpatrick partner **Jeff Reed** presented on “State Taxation of Foreign Income after OBBBA” on a BarBri/Strafford webinar on July 7th. Jeff discussed state taxation of foreign income.

Below are five key takeaways from the presentation:

1. NCTI Broadens the Foreign Income Tax Base
The transition from GILTI to NCTI (Net CFC Tested Income) under OBBBA expands the state tax base by eliminating the Qualified Business Asset Investment Exclusion and reducing the Section 250 deduction from 50% to 40%, raising the effective tax rate on foreign operations to approximately 12.6%. Taxpayers must now determine whether states follow GILTI or NCTI, which can turn on whether a state adopts rolling or static conformity to the IRC, and whether existing deductions or exclusions (e.g. state DRDs) apply to reduce the income in the tax base.

2. State Conformity Methods Create Significant Complexity
States conform to the IRC in different ways—rolling, fixed-date (static), or rolling selective conformity—and each approach creates distinct compliance challenges. Critically, conformity is only the starting point; even rolling-conformity states may decouple from specific international tax provisions like GILTI, FDII, or Section 965, meaning conformity alone rarely determines the final state tax treatment of foreign income.

3. Foreign Corporations May Have State Tax Obligations Despite No Federal Liability
A foreign corporation can have no effectively connected income (ECI), no permanent establishment, and no federal income tax liability, yet still face state filing and tax obligations. States are generally not parties to federal income tax treaties, and P.L. 86-272protects only interstate—not foreign—commerce, leaving foreign corporations potentially exposed to state-level taxation based on independent state nexus standards.

4. California's Unique CFC and PTI Regime Demands Careful Tracking
California does not conform to federal Subpart F inclusion rules and instead uses its own CFC inclusion mechanism (Form 2416) based on the ratio of Subpart F income to current E&P. This creates a separate California PTI tracking system that differs from federal PTI, requiring detailed E&P analysis for dividend distributions and generates common audit issues.

5. Constitutional Principles Shape—But Do Not Eliminate—State Authority Over Foreign Income
United States Supreme Court case law (including C*ontainer Corp., Barclays, Kraft,* and *Allied-Signal/Meadwestvaco*) supports broad state taxing power over unitary foreign income while imposing limits on

non-unitary income and prohibiting discriminatory treatment of foreign income. GILTI and foreign-income controversies at the state level frequently turn on whether income qualifies as unitary, and whether it is treated differently from domestic income.

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