



## AICPA Backgrounder on State Tax Conformity and Conformity Variances

### Background

With the passage in recent years of numerous significant federal tax legislation, there has been significant discussions among state tax practitioners about how federal tax changes affect or could affect taxpayers from a state income tax perspective. These federal changes include the Tax Cuts and Jobs Act of 2017 (“TCJA”), and the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act, the Inflation Reduction Act of 2022 (“IRA”). Still more potential federal tax changes are on the horizon.

The first question for the analysis of the state impact of a federal income tax change is whether the individual states will *conform* to (or follow) the federal provisions under review.

### State Tax Conformity

In general, state income tax regimes are affected by federal tax law and regulatory changes because they “piggy-back” off of, or conform to, the Internal Revenue Code (IRC) for purposes of administrative ease by either using federal taxable income as the starting point, or by incorporating the IRC in whole or in part. States that incorporate the IRC either:

- Conform to the IRC as of a specific date, commonly referred to as “static” conformity; or
- Automatically follow the version of the IRC in effect for the current tax year, commonly referred to as “rolling” conformity.

When analyzing the state impact of federal tax legislation, taxpayers must be mindful of each particular state’s level of conformity, e.g., static v. rolling, to the IRC because the manner and timing for a state’s reference to an IRC-derived starting point may result in differences between the federal and state income tax treatment of new or amended federal income tax provisions.

In states with “static” conformity, a different state tax result relative to the federal result may be triggered in any instance where an IRC provision was added or amended *after* the state’s conformity date. For example, California generally conforms to the IRC as of January 1, 2015. Absent specific legislation updating California’s IRC conformity date or specifically conforming to the IRC provision added or amended after the IRC conformity date, California generally would not follow federal tax legislation enacted after January 1, 2015. Therefore, due to the lag in conformity date, California generally does not follow the federal tax legislative changes enacted as part of TCJA, which include the Global Intangible Low-Taxed Income (“GILTI”) regime and IRC section 163(j), as the enactment occurred after January 1, 2015.

In states with either rolling conformity or a federal taxable income starting point, the federal-state difference resulting from amendments to the IRC are typically avoided as they automatically follow all federal tax legislative changes upon federal enactment unless specific legislation is enacted by the state to *decouple* from (or not follow) the federal tax legislation.

For example, Massachusetts generally conforms to the IRC as amended and in effect for the taxable year. Therefore, Massachusetts generally follows the federal tax legislative changes enacted as part of TCJA unless specific legislation provides otherwise, such as decoupling provisions related to the deductions provided under IRC sections 245A and 250, which were enacted as part of TCJA.

As illustrated by the example of Massachusetts, practitioners and taxpayers must also be mindful of each state's decoupling or modification provisions, amongst other items, when analyzing the state impact of federal tax legislation. Even when a state adopts the currently effective version of the IRC, states, may decouple from specific federal provisions for fiscal or policy reasons that may result in differences between the federal and state income tax treatment.

### **Common Areas of Federal/State Conformity Variances**

Taxpayers and practitioners should consider questions of states' conformity when analyzing any of the below areas, among others, as federal-state variances may have a significant state tax impact.

- Federal tax legislation, in general
- Research and experimental expenditures under IRC section 174
- Bonus depreciation under IRC section 168(k)
- Interest limitation under IRC section 163(j)
- GILTI provisions under IRC sections 951A and 250
- Foreign-derived intangible income (FDII) under IRC section 250
- Qualified business income under IRC section 199A
- Dividends received deduction under IRC section 245A
- Net operating losses under IRC section 172
- Tax attributes, in general
- Treatment of disregard entities
- Federal consolidated return regulations under Treas. Reg. §1.1502-1 *et. seq.*
- U.S. Constitutional considerations and U.S. Supreme Court developments

### **Other Resources**

For more information on state tax conformity and related issues, see:

- The Tax Adviser article, "[Significant State Conformity Issues for Corporate Taxpayers](#)" (Feb. 1, 2023)
- Journal of Accountancy article, "[States' rolling conformity to the Code and CARES Act](#)" (Feb. 1, 2021)
- State Tax Notes article, "[State Tax Conformity to Key Taxpayer: Favorable Provisions in the CARES Act](#)" (Apr. 20, 2020)
- [NCSL Task Force on State and Local Taxation](#), including:
  - [Federal Tax Reform under the Biden Administration and Its Implications for State Taxation](#) (May 2021)
  - [State Revenues and Tax Policy](#)

- [Tax Foundation](#), including:
  - [Center for State Tax Policy](#) and [Tax Maps](#)
  - [State Conformity to Federal Pandemic-Related Tax Provisions in CARES and ARPA](#) (April 1, 2021)
  - [Biden Administration Changes to GILTI and FDII Will Yield Automatic State Tax Increases](#) (May 25, 2021)
- State [Conformity on Tax Benefits of Opportunity Zones](#)

For more information, see [AICPA State Conformity Map](#).

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