New Mexico Federal Funding Stabilization & Affordability Subcommittee

August 3, 2026

Federal Tax Reform
State Conformity and Decoupling

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The Council On State Taxation (COST)

- COST is a nonprofit trade association, whose mission is to preserve and promote fair and equitable taxation. Its members are approximately 450 of the nation’s top multijurisdictional corporations. Since 1969, COST has been actively involved in state tax policy, advocating for non-discriminatory taxes that do not unfairly burden its members.

- COST's advocacy is governed by a broad set of public policy objectives.
  - The Policy Statements fall into Four Categories:
    - State tax administrative issues focused on ease of compliance, fairness, efficiency;
    - Corporate income tax issues focused on constitutional overreach, fairness, efficiency;
    - Sales tax issues – taxation of business inputs, fairness, uniformity; and
    - Other issues – focused on sound tax policy principles concerning property taxes, gross receipts taxes, unclaimed property, and local taxes

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Unless stated any views or opinions expressed in this presentation are my own and not the official position of COST or its members.

Agenda

- Overview of HR1’s Policy Objectives & Federal Tax Changes
- Why States Conform or Decouple
- How States have Responded to HR 1
- Challenges Arising from Variations in Federal and State Tax Policies & Rules
- What’s Next?
- Questions

Overview of HR1's Policy Objectives & Federal Tax Changes

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Federal Tax Policy Objectives and Structural Changes Under HR1

Federal Policy Goals:

- HR1 made permanent several provisions of Tax Cuts & Jobs Act (TCJA)
- The goals of both TCJA and HR 1 were:
  - To influence econmic behavior
  - Boost domestic investment, and
  - Modernize international tax rules by shifting from a worldwide approach to a territorial approach

Key HR 1 Provisions:

- Changes to IRC sections 163(j), 168(k), 168(n), 174A, and 951A
- Resulting in changes to:
  - Interest expense limits
  - Accelerated depreciation and full expensing of capital investments
  - R&E expenses, and
  - Global Intangible Low Tax Income (GILTI) regime

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Federal Tax Policy Objectives and Structural Changes Under HR1

State vs. Federal Challenges:

- States face revenue volatility
- Conflicting priorities due to differences in tax base conformity; and
- Budget constraints

Federal Tax Policy vs. State Tax Policy

- Federal policy-based approach to tax reform contrasts with the states' need for
  - Revenue stability,
  - Revenue predictability; and
  - Feasible enforcement

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Inconsistent Federal and State Tax Concepts Example: Taxation of Foreign Source Income

Federal vs. State Tax Rules

- Federal tax policies: inclusion of foreign source income in the tax base
    - Offset by foreign tax credits and deductions
- States' constitutional limitations when taxing foreign source income

Variations in State Tax Treatment

- States' approaches differ on inclusion of foreign source income in the tax base
    - GILTI, NCTI, Subpart F and foreign dividends
        - Policy considerations vs. revenue needs
        - Lack of foreign tax credits and inconsistent I.R.C. § 250 deductions
        - Impact on state tax apportionment

Why States Conform or Decouple

State Considerations
Decouple vs. Conform to HR1

Decoupling Decision Factors

- Economic goals
- Revenue impact
- Statutory requirements
- Competitiveness with neighboring states
- Impact of retroactive changes on state policy objectives and budgets

Administrative Challenges

- Legislation requirements
- Tax form and instruction revisions
- Developing guidance
- Tight time frames

Strategic Approaches

- May use to manage fiscal impact and compliance burdens
    - Selective or gradual decoupling
    - Prospective decoupling

Political and Fiscal Balance

- State autonomy
- Fiscal stability
- Administrative simplicity
- Political perceptions

States' Response to HR 1

States’ Response to HR1

- Most states have addressed at least some changes:
  - Approximately, 25 states have fully addressed ’s corporate income tax provisions
- States have used traditional and creative approaches:
  - Legislation
  - Regulations
  - Budgetary decoupling
  - Executive orders
  - Memos
  - Notices
- Less binding guidance is being replaced
  - States that initially issued executive orders, memos and notice addressing HR1 conformity are now passing legislation

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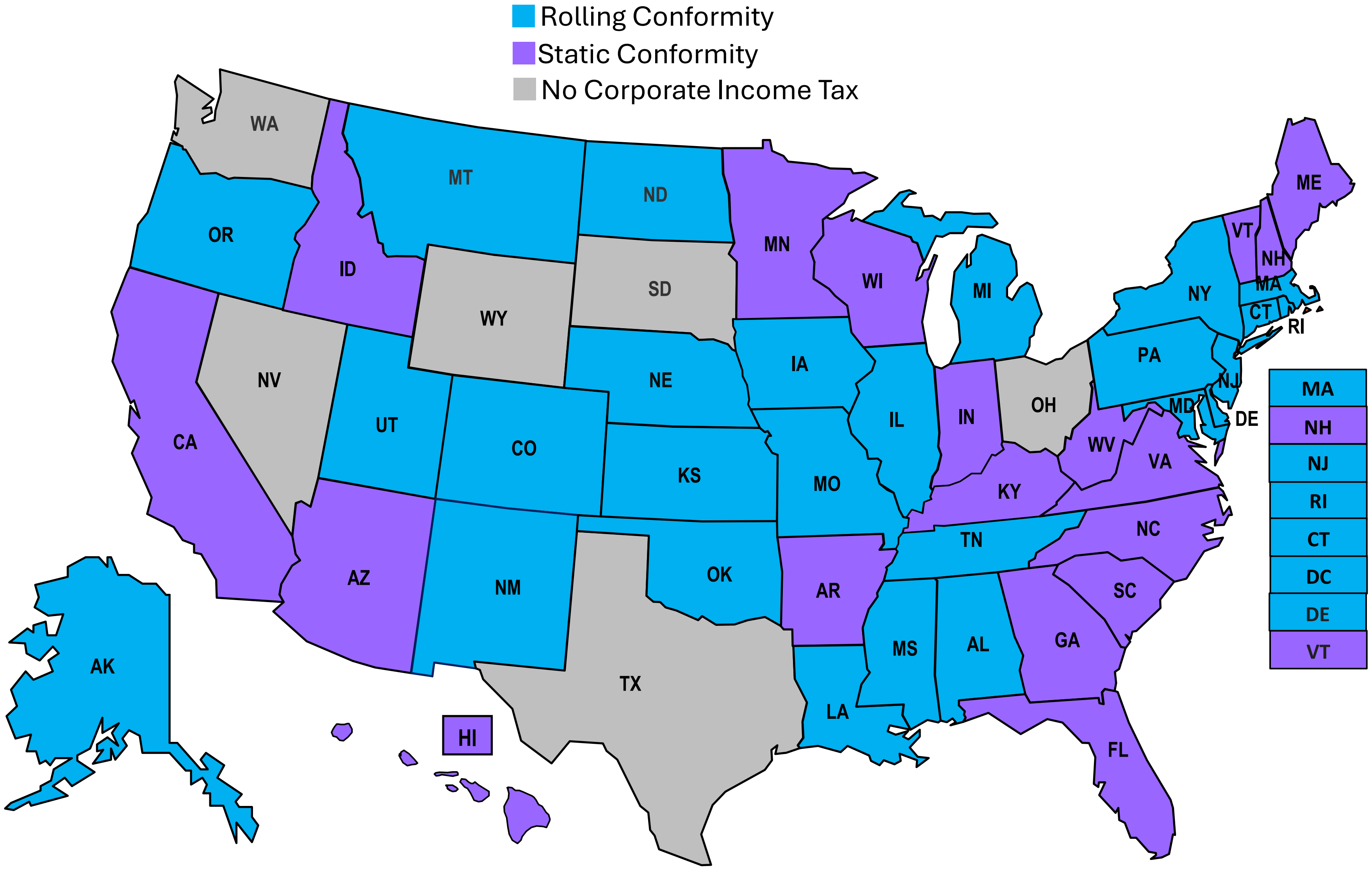
General IRC Conformity for State CITs



Arkansas: State only adopts certain provisions of IRC and IRC dates vary.

Maryland: Maryland automatically decouples from any federal law change that has a state revenue impact in excess of $5 million for the year of IRC enactment and prior years.

Massachusetts: Amendments to the IRC will not apply to any taxable year in which enacted. The exception is amendments that have a revenue impact of less than $ 20 million based on a rolling 3-year average. H.5470 (Laws 2026).

Michigan: Taxpayers can use the IRC as of 1/1/25 or elect to use the IRC in effect for the tax year (H.B. 4961 (2025)).

Oregon: Static conformity for items not related to the computation of taxable income.

Pennsylvania: Status of rolling conformity currently subject to litigation.

Rhode Island: Rhode Island DOR has promulgated rules to preserve tax base, e.g., ADV 2025-18. *See* 280-RICR-20-25-17.

Virginia: Virginia is a static conformity state because it halted its rolling conformity status until 2027. During the 2026 General Assembly Session, the 2026 Amendments to the 2025 Appropriation Act replaced Virginia's rolling conformity to the IRC with a fixed conformity date of December 31, 2025.

Disclaimer: This map generally groups the state CITs as either a rolling or static conformity state; however, many states have nuances on how they couple with certain IRC provisions. This information should be used for general guidance and not relied upon for compliance.

Source: Council On State Taxation (COST) – As of July 10, 2026

HR 1 State Decoupling: Key Provisions

- States most commonly decouple from these federal tax law changes:
  - Section 163(j): Business interest expense limitation
  - Section 168(n): Special depreciation for qualified production property
  - Section 168(k): Bonus depreciation (modified)
  - Section 174A: Domestic R&E expenditure full expensing

Note: Key consideration when enacting legislation penalty and interest relief for underpayments attributable to retroactive changes

HR1 Changes to Interest Expense Limitations IRC Section 163(j)

- Restoration of EBITDA-Based Adjusted Taxable Income Calculation (Effective for Tax Years Beginning After 12/31/2024)
  - Restoration of the add-back for:
    - Depreciation
    - Amortization
    - Depletion
- Expansion of Floor Plan Financing Rules (Effective After 12/31/2024)
  - HR 1 broadened the definition of vehicles eligible for the floor plan financing exception
- New Anti-Abuse Rule for Capitalized Interest (Effective for Tax Years Beginning After 12/31/2025)
  - The new rule generally requires the §163(j) limitation to be applied without regard to whether the interest would otherwise be capitalized
- Changes Affecting Controlled Foreign Corporations
  - HR. 1 modifies the ATI computation by excluding specified CFC-related income inclusions and related deductions, including amounts under:
  - §951(a) (Subpart F)
  - §951A(a) (GILTI/NCTI)
  - §78 gross-up

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State Conformity with HR 1 – Sec. 163(j)

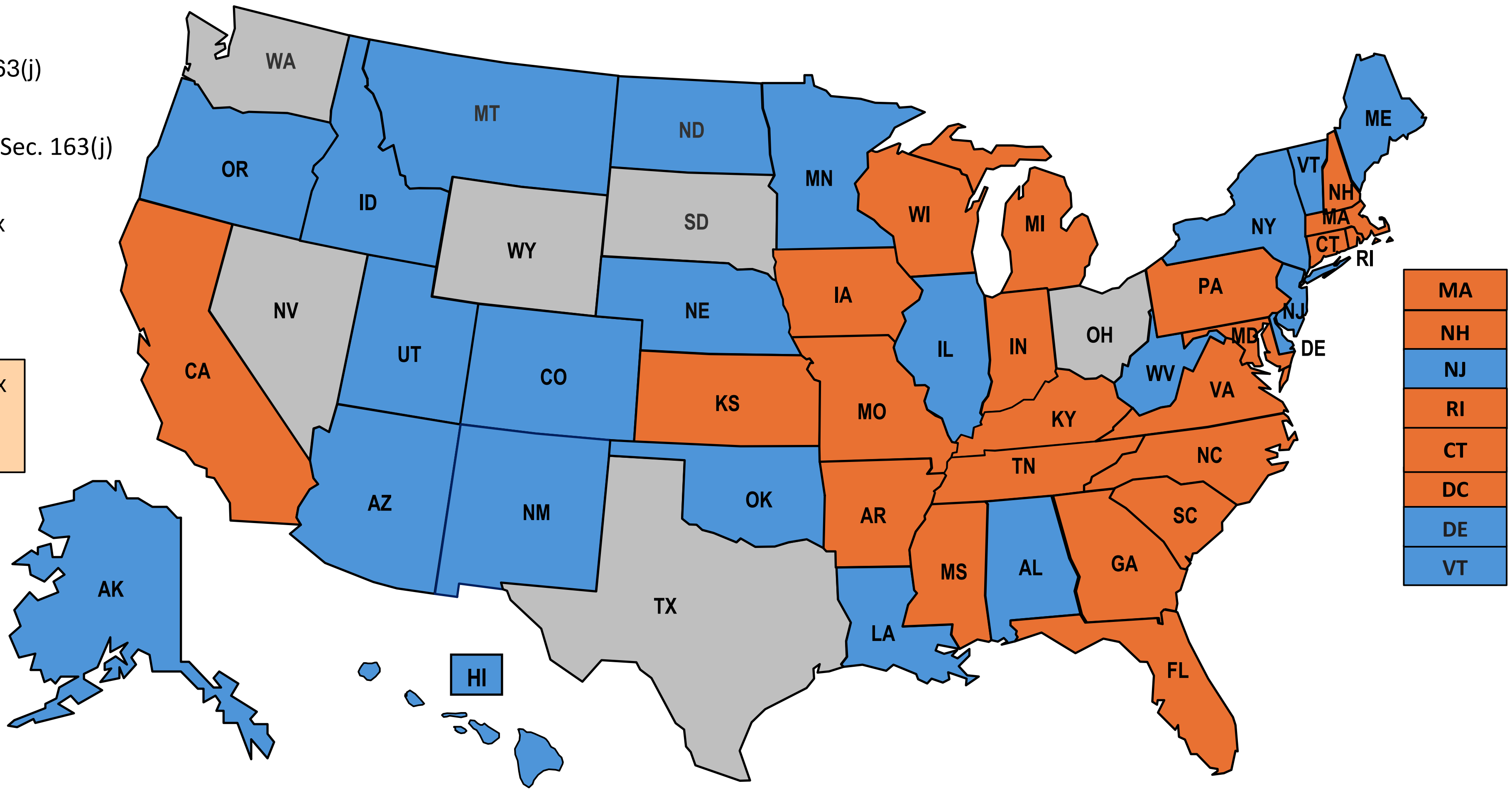
(Interest Expense Limitations)

Conforms to HR 1 Sec. 163(j)

Does not conform to HR 1 Sec. 163(j)

No Corporate Income Tax

New Mexico: Effective for tax year 1/1/27 decoupled. SB 151



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Most States Decouple from Bonus Depreciation Changes

- HR 1 amended §168(k) and added §168(n)
  - Reinstated 100% bonus depreciation
  - § 168(n) Created a new qualified property type: *qualified production property*

- Major change at federal level but not at state level
  - Majority of states previously deviated from federal depreciation rules

- States may treat §§ 168(k) & (n) differently
  - Treatment is likely based on differences in property type
  - Differential treatment may be based on economic development concerns

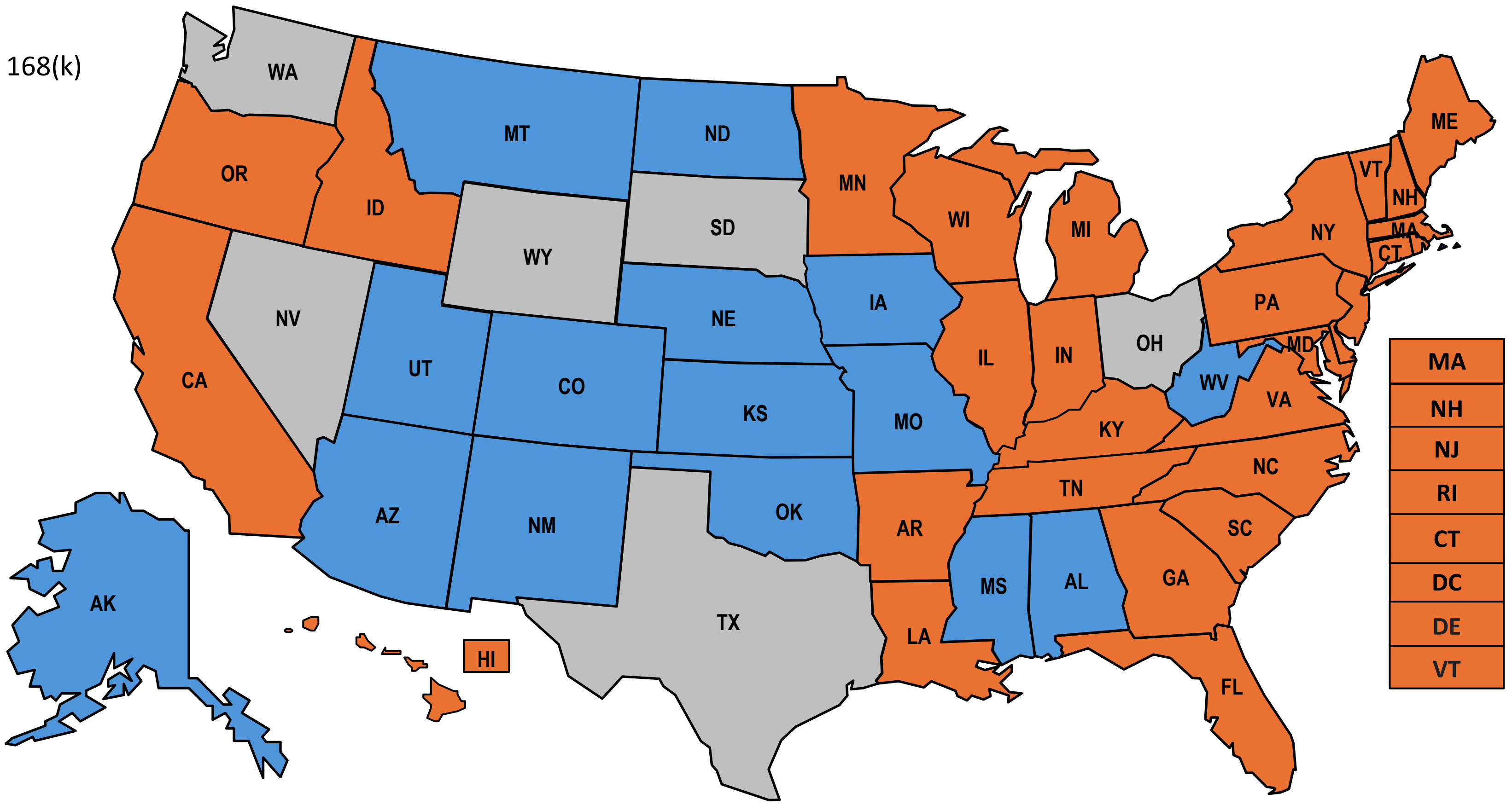
State Conformity with HR 1 – Sec. 168(k)

(100% Equipment Bonus Depreciation)

- Conforms to HR 1 Sec. 168(k)
- Does not conform to HR 1 Sec. 168(k)
- No Corporate Income Tax

Alaska: Decouples from IRC Section 168(k) and 168(n) for oil and gas companies.

New Mexico: Effective for tax year 1/1/27 decoupled. SB 151



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Source: Council On State Taxation (COST) – As of July 10, 2026

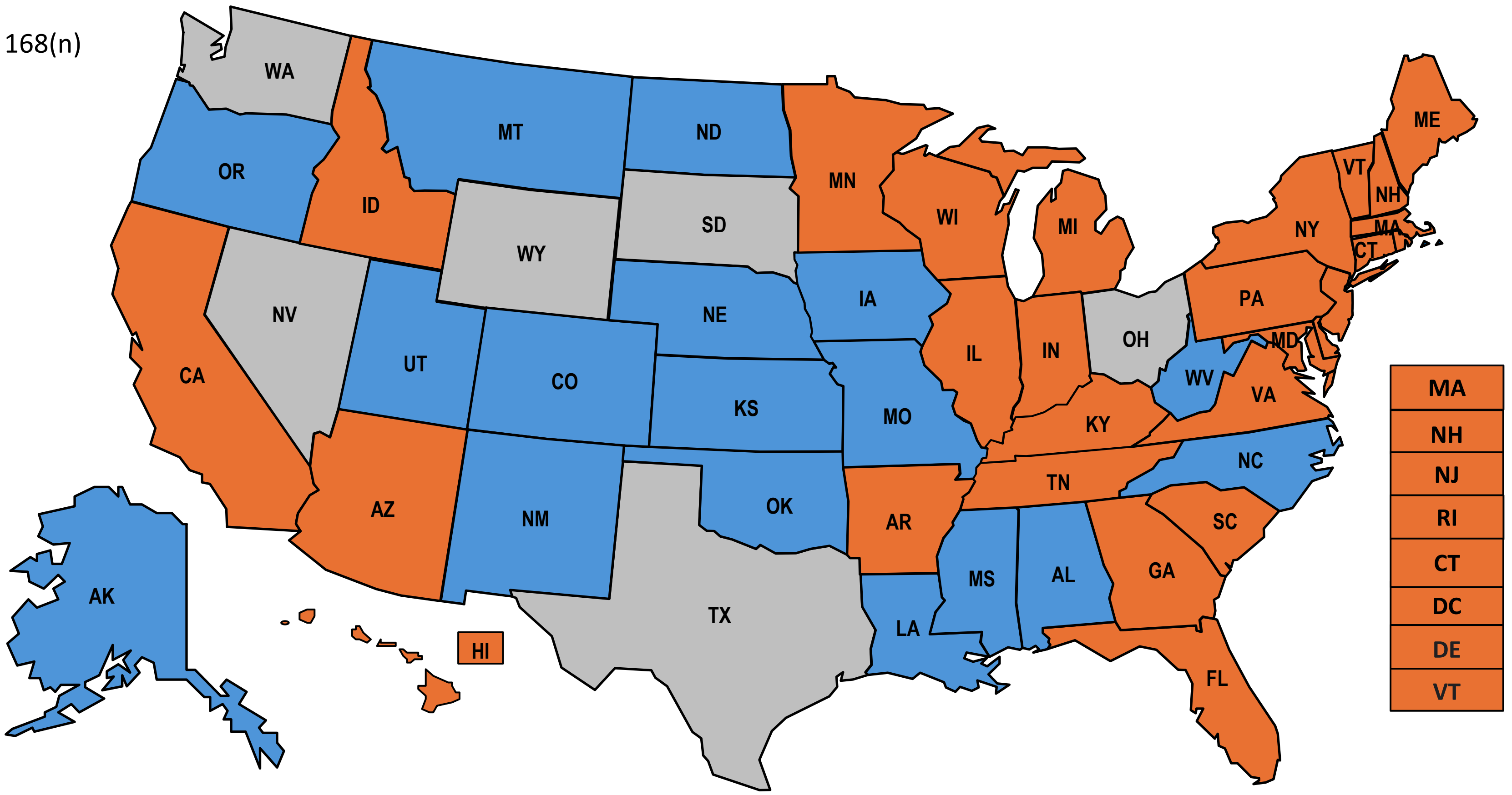
State Conformity with HR 1 – Sec. 168(n)

(Production/Factory Expensing)

- Conforms to HR 1 Sec. 168(n)
- Does not conform to HR 1 Sec. 168(n)
- No Corporate Income Tax

Alaska: Decouples from IRC Section 168(k) and 168(n) for oil and gas companies.

New Mexico: Effective for tax year 1/1/27 decoupled. SB 151



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States Divided on Adoption of Immediate Expensing Under § 174A

- HR1 distinguishes between domestic and foreign research & experimental (R&E) expenditures
  - Foreign: Amortization of foreign expenditures
  - Domestic: Immediate expensing of domestic expenditures
- Immediate expensing of domestic R&E expenditures problematic for states:
  - Budgetary concerns have led several states to decouple from § 174A while remaining conformed to § 174
  - Differential treatment of foreign v. domestic R&E may have Foreign Commerce Clause implications

State Approaches to R&E Expenditure Treatment

- Full Decoupling:
  - Pre HR1 rules: Adopt Section 174 as of pre-HR1 date; disallow Section 174A
- Amortization deductions begin with economic benefits:
  - R&E expenditures amortized over 60 months, as if Section 174A(c) election was made
- Addback with amortization:
  - Require addback; permit subtraction over specified years
- Phase-in conformity:
  - Increase Federal taxable income by applicable percentage of Section 174A deduction, declining over time
- Eligible taxpayer exception:
  - Eligible taxpayers (generally, small businesses) may deduct remaining unamortized R&E; others use pre-HR1 rules
- Temporary decoupling:
  - Decoupling limited to specified transition period

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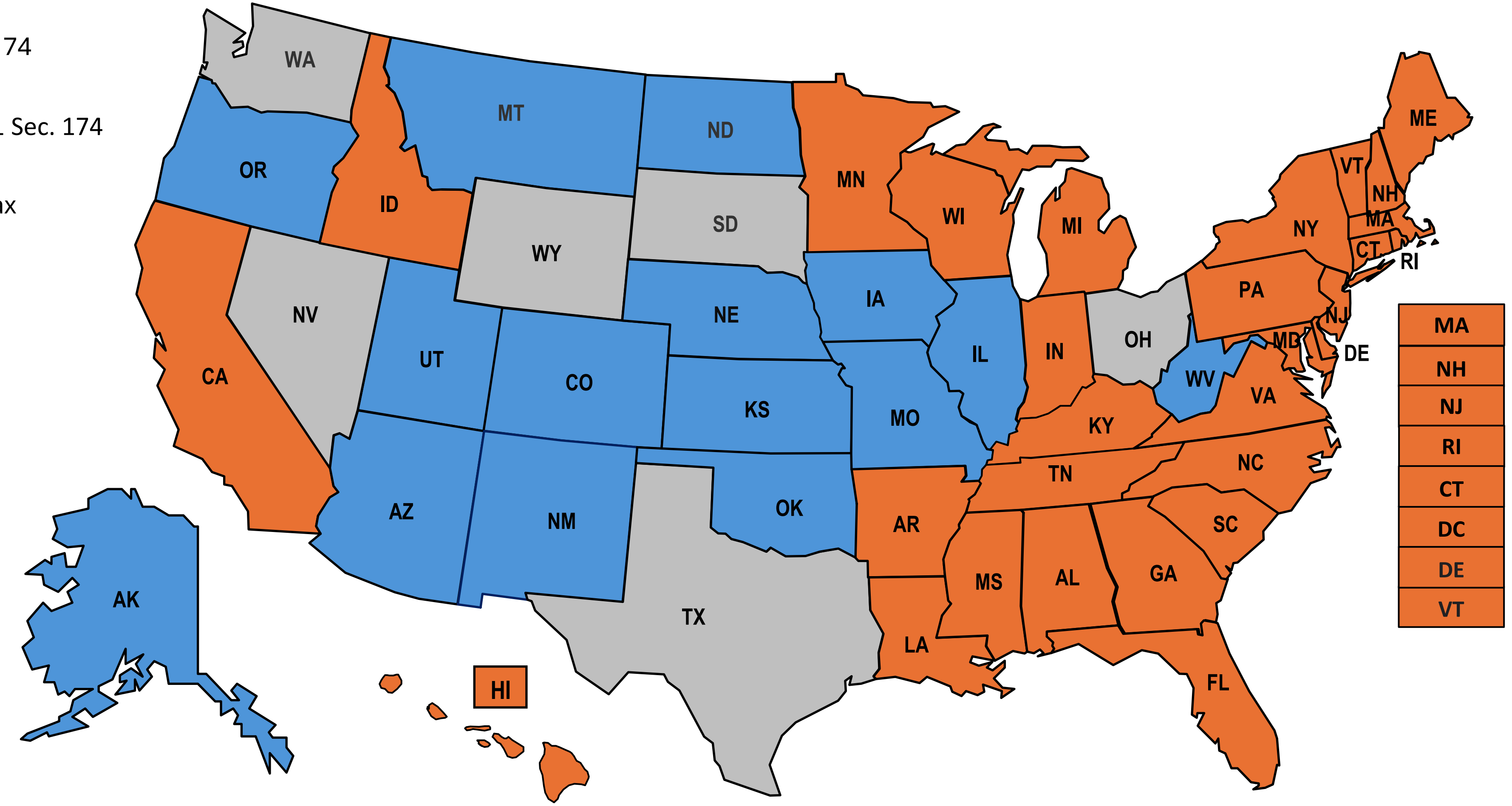
State Conformity with HR 1 – Sec. 174*

(Research & Experimental Expenditures)

Conforms to HR 1 Sec. 174

Does not conform to HR 1 Sec. 174

No Corporate Income Tax



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Source: Council On State Taxation (COST) – As of July 10, 2026
* This map incorporated IRC Section 174A

State Approaches to Taxation of Foreign Source Income

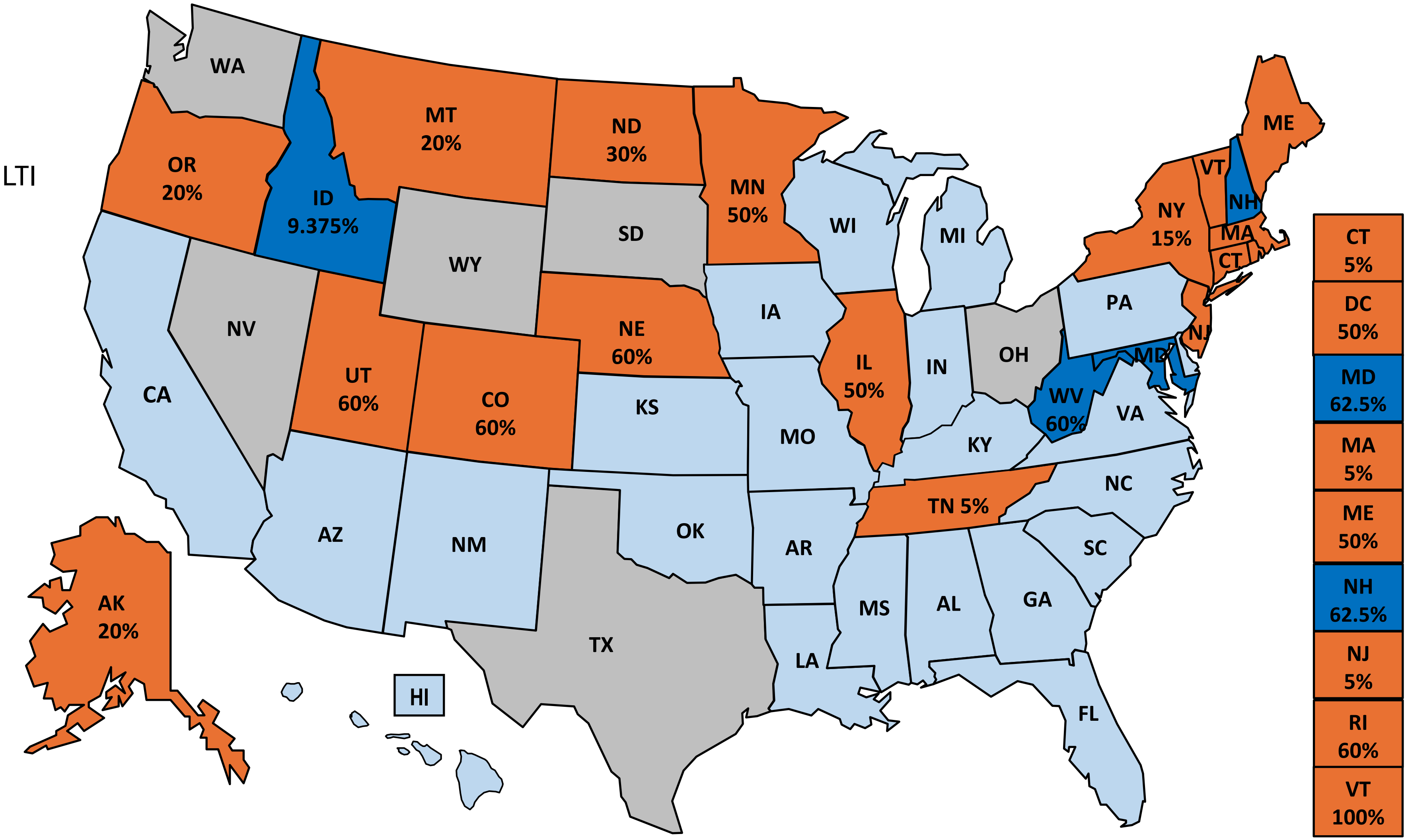
- Federal tax policy – inclusion of foreign source income in the tax base
  - HR1 modified the TCJA international tax regime (GILTI):
    - HR1 revised the GILTI computation and eliminated the Qualified Business Asset Investment (QBAI) adjustment. The result is net CFC tested income (NCTI)
    - Offset NCTI by foreign tax credits (90%) and an IRC § 250 deduction of 40%
- Federal vs. State Tax Rules:
  - States have constitutional limitations when taxing foreign source income

State Approaches to Taxation of Foreign Source Income

- Variations in State Tax Treatment:
  - States’ approaches differ with respect to the inclusion of foreign source income in the tax base
    - GILTI, NCTI, Subpart F and foreign dividends
    - Lack of foreign tax credits and inconsistent IRC Section 250 deductions
    - States require inclusion of varying percentages of NCTI
  - Inconsistent apportionment policies raising:
    - Constitutional issues
    - Fair representation of income earned in the state
    - Computational issues
- Policy considerations vs. revenue requirements

TY2026: Taxation of IRC Sec. 951A (NCTI/GILTI)

- State taxes GILTI
- State taxes NCTI
- State does not tax NCTI/GILTI
- No corporate income tax



Colorado: No, if the §951A income is derived from a listed tax haven country (such income is included in tax base). Includes 60% of NCTI after deduction for foreign taxes paid.

Minnesota: For tax years after 12/31/2025, there is a deduction for QBAI and decouples from the CFC look-through provisions.

Montana: Includes 20% of NCTI if a water's-edge filer.

New Mexico: Taxes 100% of NCTI January 1, 2027. SB 151.

***Disclaimer**: This map does not constitute legal advice, and the information should be used for general guidance and not relied upon for compliance.*

***Source**:* Council On State Taxation (COST). As of July 10, 2026

Challenges Arising from Variations in Federal and State Tax Policies & Rules

Conformity Complexity Leads to Administrative Challenges – Tax Administrator

- Inconsistent state approaches resulting from decoupling lead to increased compliance efforts, straining both public and private sector resources over time.
- Tax Administrator Perspective:
  - Revenue forecasting
  - Providing transition guidance
  - Changing forms and instructions
  - Promulgating regulatory updates
  - Audit procedures
  - Resource strain and inconsistency

Conformity Complexity Leads to Administrative Challenges – Taxpayer

- Monitoring developments across multiple jurisdictions:
  - Require the development of schedules to track the adjustments by state;
  - Require the development of procedures to obtain necessary supporting documentation;
  - Taxpayers face complex reserve challenges assessing state tax position sustainability amid evolving policies and federal uncertainties.
- Retaining historical data to support pre-decoupling adjustments
- Complex return filing : Differences between federal and state tax rules create difficulties:
  - In preparing returns,
  - Calculating estimate payments,
  - Return extensions, and
  - Result in potential penalties and interest
- Increased Audit and Litigation Risks:
  - Inconsistent tax conformity and decoupling raise audit and litigation risks, especially where laws are ambiguous or guidance is delayed

What’s Next

What’s Next

Legislation

- Approximately 12 states still haven’t formally addressed HR1
- States to watch: Arkansas, California, Mississippi, New Hampshire, South Carolina
- Will rolling conformity states which have taken no action now act
    - Decoupling because of actual revenue impact

Tax Department Updates

- Regulatory projects
- Update federal & state forms and instructions
- Administrative Guidance
- Revenue Estimates with hindsight

Litigation Risk

- Disputes on TCJA R&E adjustments?
- Potential areas for future litigation
    - GILTI vs. NCTI
    - HR1 R&E expensing
    - Administrative issues
    - Penalties
    - Retroactive applications

Thank you

Questions are welcome