**January 15, 2008, Interested Parties Meeting Request**
**Expanded Economic Impact (Additions In Red)**

Tax Revenue Estimate

Based on data and assumptions discussed below, this proposal would result in the following net revenue impact.

| Estimated Revenue Impact of LP 08-03<br>Effective for Taxable Years BOA 1/1/08<br>***Enactment Assumed After 6/30/08*** | | |
|---|---|---|
| 2008-09 | 2009-10 | 2010-11 |
| <-$500,000 | <-$500,000 | <-$500,000 |

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

## Tax Revenue Discussion

The revenue impact of the proposal would depend on the difference in amounts of net CFC income included in the water's-edge group tax filing under current state law (partial inclusion of subpart F income and unitary factors) versus conforming to federal law's Subpart F provisions (Subpart F income treated as a deemed dividend).

The estimate was derived in the following steps:

1. Selected a statistically representative sample of water's-edge filers reporting CFC income or a foreign dividend deduction (Forms 100W-Water's Edge Filers for the 2004 taxable year);
2. Calculated the change in tax (increase or decrease) if each filer reported Subpart F income according to the proposal. This was accomplished as follows:
   - Reversed the amount of CFC income reported on line 7a of Form 100W.
   - Added Subpart F income as reported on the federal Form 5471.
   - Excluded the amount of the CFC's property, payroll, and sales reported in the denominator of the apportionment factors.
   - Added the amount of the CFC's Subpart F income (100%) in the taxpayer's denominator of the sales factor.
3. Multiplied the calculated tax change for each corporation by its respective weight and summed the results: a revenue gain of $21.4 million;

4. Assumed the approximate revenue offset for the taxpayer favorable transitional rules, interest offset, and intercompany transactions: a revenue loss of $3 million;
5. Calculated a dividends-received deduction that would result in a roughly revenue neutral tax impact for the proposal: 27% dividend deduction. The dividends-received deduction reduces the amount of CFC income and the amount included in the sales factor denominator.

At the 2004 level, conforming to the federal Subpart F rules and including 100% of Subpart F income results in a revenue gain of $21.4 million. This revenue gain would be reduced somewhat by proposed transition rules: (1) income previously taxed as Subpart F income before this proposal is effective would be considered previously taxed income for state purposes, and (2) federal adjustments to the stock basis of a CFC before this proposal is effective would become the new stock basis for the CFC for state purposes. For purposes of an estimate, it is assumed the revenue reduction is approximately $3 million annually. This assumption is based on discussions with knowledgeable audit and legal department staff. This impact could drop in future years beyond those for which estimates are developed here. At the 2004 level, allowing a 27% dividends-received deduction for Subpart F income would result in a net revenue loss.

For each component of the estimate, except for the $ 3 million impact discussed in item 4 above, the tax effect is grown by the forecast in corporate profits as projected by the Department of Finance. At the 2009 level, allowing the 27% dividends-received deduction results in a minor net revenue loss of less than $500,000 for the proposal. The 2009 taxable year results are presented in the table below, as this is the first year that both calendar year and fiscal year filers would be represented.

| Estimated Revenue Effects Projected to the 2009 Taxable Year Level ($ in Millions) | |
|---|---|
| Conformity with federal rules | +$34.1 |
| Transitional rules | -$ 3.0 |
| Dividends-received deduction | -$31.6 |
| Net Impact for 2009 | -$ 0.5 |

Although the net tax effect for the proposal is roughly revenue neutral, most corporations in the sample experienced a tax decrease. Specifically, 44% had a tax decrease, 25% a tax increase, and 31% had no tax effect.