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September 30, 2020

John J. Ficara, Director  
Alan S. Kline, Counsel to the Director  
New Jersey Division of Taxation

*Via E-Mail*

Re: Clarification of New Jersey's 95% Dividend Received Deduction

New Jersey historically has not taxed foreign dividends. For privilege periods prior to 2017, New Jersey provided a statutory 100% dividends received deduction (DRD) for dividends received from subsidiaries that met an 80% ownership threshold. N.J.S.A. 54:10A-4(k)(5)(A)(i). This position remained until the federal Tax Cuts and Jobs Act's (TCJA) enactment on December 22, 2017, which in part, included a one-time transition tax on the [untaxed foreign earnings](#) of a U.S. company's foreign subsidiaries by treating those earnings as a deemed repatriation under IRC § 965.

One of New Jersey's responses to the TCJA was to reduce its DRD from 100% to 95% for privilege periods beginning in or after 2017. N.J.S.A. 54:10A-4(k)(5)(A)(ii); -(iii). With this change, New Jersey switched from not taxing foreign dividends to taxing 5% of these dividends, after accounting for the 95% DRD. This legislative change allowed New Jersey to tax 5% of the IRC § 965 deemed repatriated dividends (and possibly dividends related to foreign income earned in privilege periods after 2017).

The Division's recent pronouncements, however, have caused significant confusion regarding the 95% DRD application and calculation. Based on the forms and instructions to Schedule R (Dividend Exclusion), of the 2019 CBT-100U return, the Division is having combined filers calculate the DRD on a post-allocation basis. If this method has been adopted simply to allot the full 95% deduction among the members of the combined group based on the member's allocation factor, it is not necessarily inconsistent with the statutory DRD provision. If, however, the method is used to allow a DRD to only the member of the combined group that actually received the dividend (and then, only to the extent of that particular member's allocation factor), then it is inconsistent with the statutory DRD provision.

The Division can remedy this confusion, and affirm that the former is its intent, by clarifying that the purpose of Part III, Schedule R is to divide the full 95% DRD amongst the members of the group (presumably based on their share of the allocation factor), and provide guidance as to how that is done mechanically.

If the Division takes the position that the DRD is limited to the extent of the member's allocation factor, then we believe it would be inconsistent with the statute and raise a series of troubling fairness and constitutional concerns. The Division would be asserting that more than 5% of non-eliminated dividends (*e.g.*, dividends from non-unitary subsidiaries, IRC § 965 deemed repatriated dividends and future foreign dividends) are subject to taxation in New Jersey. This confusion could extend to dividends relating to: (1) deemed repatriated amounts in 2017 received by non-nexus taxpayers that did not file in New Jersey in 2017 or 2018, but begin filing in New Jersey in 2019; and (2) future dividends from foreign income earned in 2018 and beyond, whether received by nexus or non-nexus taxpayers.

Moreover, it could potentially lead to taxation of close to **150% of foreign source income earned in privilege periods beginning in 2018**. The reason for this is that in 2018 New Jersey began to tax 50% of global intangible low-tax income (GILTI). If a New Jersey taxpayer earns foreign source income in 2018 (or later years) and then makes a cash dividend of that income in 2019 (or later years), a New Jersey filer is potentially subject to tax on both the 50% of foreign income represented by GILTI (in the year earned) and the foreign dividend (in the year received). If New Jersey takes the position that it is taxing not just 5% of the foreign dividend (after the 95% DRD is taken), but most or all of the foreign dividend (if the DRD is restricted to the taxpayer that received it based on its New Jersey allocation factor), then the taxpayer is potentially subject to New Jersey tax on up to 150% of its foreign source income. **And this is not an isolated situation.** If the average New Jersey allocation factor of an out-of-state New Jersey taxpayer is 5% or less, then most New Jersey taxpayers with foreign source income would be in this position. **This is obviously unfair, irrational, and unconstitutional.**

### **New Jersey's Statutory Inclusion and Allocation of Foreign Dividends**

Although the starting point for the entire net income computation is line 28 of the federal corporate income tax return, N.J.S.A. 54:10A-4(k)(2)(B) adds back “[a]ny part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in paragraph (5) of subsection (k) of this section.” This provision includes certain foreign dividends in a taxpayer's “entire net income” beginning with the 2017 privilege period, subject to the State's 95% DRD (100% for privilege periods before 2017) as provided under N.J.S.A. 54:10A-4(k)(5)(A)(i)-(iii).

Although the DRD's percentage changes from the period prior to and after the TCJA (from a 100% DRD to a 95% DRD), the basis of the DRD remains the same—“[95% of ] dividends which were included in computing such taxable income for federal income tax purposes” must be excluded from entire net income. *See* N.J.S.A. 54:10A-4(k)(5)(A)(i)-(iii). Given the fact that these above-mentioned dividends all are “included in computing such taxable income for federal income tax purposes,” even if they are not federally taxed in tax years after 2017, these dividends qualify for the State's DRD.

[Special Adoption Regulation § 18:7-5.20](#) modifies this DRD exclusion, primarily by providing a special allocation method and protection against double taxation—relating to the receipt of both deemed dividends and actual dividends—for taxpayers that filed in New Jersey in privilege periods 2017 and 2018. The Special Adoption Regulation does not change the statutory provisions relating to the 95% DRD for other taxpayers filing as part of a combined group for privilege periods starting in 2019.

Thus, the relevant statutory and regulatory provisions provide for the utilization of the full 95% DRD on a pre-allocation basis by members of a combined group. Alternatively, if the Division requires the calculation of the 95% DRD on a post-allocation basis, it must do so in a manner that does not deprive the combined group of full use of the 95% DRD.

### **An Example of the DRD Provision's Misapplication**

We are hopeful that the Division's interpretation of the 95% DRD statutory provision is consistent with our analysis above. However, if the Division takes a different approach, and utilizes the post-allocation calculation of the DRD to limit the DRD benefits to only members of the combined group that received the dividend, and only to the extent of the member's allocation factor, then there are fairness, statutory, and constitutional concerns associated with such an approach.

The following example<sup>1</sup>, in Scenario 2, highlights the distortion and discrimination that occurs if the Division limits a member with a 0% allocation factor and another member with a 10% allocation factor, that had not previously filed in New Jersey, but do so in 2019 as part of a combined filing, to calculating the 95% DRD only by taking into account the member's own New Jersey allocation percentage (*e.g.*, 0% or 10%), and thus effectively denying the member all or most of the 95% DRD.

- **In the 2017 privilege period, a separate reporting year** in New Jersey, Company A, Company B, Company C, and Company D each have a federal deemed repatriation dividend. The federal deemed repatriation dividend is “included in computing such taxable income for federal income tax purposes” and is taxed at the federal level.
  - Company A and Company B file a New Jersey separate corporate business tax return and their deemed repatriation dividends are taxed by New Jersey with a 95% DRD.
  - Company C and Company D do not file a New Jersey separate corporate business tax return.
  
- **In the 2019 privilege period, a combined reporting year** in New Jersey, Company A, Company B, Company C, and Company D each receive an actual dividend federally treated as previously taxed income/previously taxed earnings and profits (PTI/PTEP) (PTI/PTEP Dividend). The PTI/PTEP Dividend is “included in computing such taxable income for federal income tax purposes,” but since it was previously taxed at the federal level it is not taxed again.
  - All four companies are included in the same New Jersey combined corporate business tax return.
  - Each company's PTI/PTEP Dividend would not be included in New Jersey's Line 28 starting point.
  - We assume for purposes of this example that:

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<sup>1</sup> See NJ - Hypothetical Example of Disparate Impact of NJ Dividends Inclusion/Exclusion Provisions, Scenario 2 (This example deals with the arbitrariness of the DRD calculation, but does not address duplicity.).

- 1) Company A and Company B exclude their PTI/PTEP Dividends from entire net income. Special Adoption Regulation § 18:7-5.20.
  - 2) All of Company C and Company D's PTI/PTEP Dividends are added back and included in the group's entire net income because there was no prior taxation of the dividend by New Jersey.
    - In our example, the combined group does not receive the full 95% DRD for the PTI/PTEP Dividends received by Company C and Company D because their DRDs are determined on a post-allocation basis. This distortion is underscored by the separate member's allocation factor. If Company C had a 0% allocation factor, then it would not receive any DRD benefit. But if Company D had a 10% allocation factor, then it would only receive 10% of the DRD benefit. No company would receive all the 95% DRD unless its allocation factor is 100% in New Jersey.
    - None of the other members of the combined group, Company A and Company B receive the benefit from any of the 95% DRD in 2019.
- Had Company C and Company D filed in New Jersey in 2017, they would have been entitled to a 95% DRD in 2017 and the PTI/PTEP Dividends would have been entitled to an exclusion in 2019.

### **Fairness, Statutory, and Constitutional Concerns**

There are several potential fairness, statutory, and constitutional concerns if the Division takes a position that we believe is contrary to the relevant statute and Special Adoption Regulation. These include:

- New Jersey is potentially taxing up to 100% of foreign dividends, contrary to the statutory intent to tax only 5% of the dividends.
- Taxpayers included in the same combined return are taxed differently on IRC § 965 cash repatriation based on prior year filing positions.
- Taxpayers with nexus in New Jersey are treated differently than taxpayers without nexus, raising Commerce Clause concerns.
- Taxpayers with income from foreign subsidiaries are treated differently than taxpayers with income from domestic subsidiaries, raising foreign Commerce Clause concerns.
- New Jersey is potentially taxing up to 100% of foreign dividends without allowing any foreign factor representation, raising foreign Commerce Clause concerns.
- There is no provision that prohibits double taxation as applied to a taxpayer that is taxed on a foreign dividend and GILTI arising from foreign income earned in the same taxable year. Thus, a taxpayer is potentially taxed on 150% of its foreign income in privilege periods beginning in 2018 (depending on the size of its QBAI), if the taxpayer is taxed on 50% of GILTI (in the year earned) and 100% of a foreign dividend (in the year received) if no DRD is allowed. Again, this is not an aberration, as many, if not most, New Jersey taxpayers with foreign source income may be in this position.

### **Immediate Guidance Is Needed**

In light of the confusion regarding the DRD application, the Division should issue guidance clarifying how taxpayers should calculate the DRD. Specifically, the Division should affirm that: (1) the 95% DRD applies to all taxpayers; (2) the 95% DRD applies at the group level, not

on a post-allocation basis; and (3) if the 95% DRD is calculated by each member, post-allocation, that it can be done in a manner that divides the DRD among the members, but does not exclude the combined group from receiving the full 95% DRD. As is, the current guidance (Special Adoption Regulation and the 2019 CBT-100U return) is insufficient.

Additional guidance is also needed on the tax treatment of dividends and GILTI and how a taxpayer avoids getting taxed twice, first on GILTI in the year it is earned, and then on a foreign dividend in the year the dividend is received. Given the lack of clear guidance, foreign source income is potentially taxed up to 150% (e.g., 50% of GILTI and 100% of foreign dividends).

With the October 15 filing date rapidly approaching, it is imperative that these issues be addressed and resolved as quickly as possible so that companies can make calculations for 2019 tax returns, for book purposes, and for future year distributions.

If the Division believes that it is authorized or required to limit the 95% DRD in a manner that denies the full (or any) benefit of the DRD to members of a combined group, **we respectfully request a (virtual) meeting between the Division and COST (and a few COST members) to discuss the basis of this position and allow us to provide our understanding of Title 54 and the consequential distortive and discriminatory impact of such a position.**

Sincerely,

  
Karl Frieden

  
Stephanie Do

cc: COST Board of Directors  
Douglas L. Lindholm, COST President & Executive Director

# NJ - Hypothetical Example of Disparate Impact of NJ Dividends Inclusion/Exclusion Provisions

Scenario One Year of Section 965 Deemed Repatriation NJ Returns Filed on a Separate Legal Entity Basis					Scenario Two Year of Section 965 Deemed Repatriation NJ Returns Filed on a Separate Legal Entity Basis					Scenario Three
<b>Assumption:</b> Companies A, B, and C each filed in NJ					<b>Assumption:</b> Companies A & B filed in NJ in year of 965 Companies C & D did <u>not</u> file in NJ in year of 965					Same as Scenario Two but DRD is Computed on Combined Basis
	Company A	Company B	Company C	Total for All Companies	Company A	Company B	Company C	Company D	Total for All Companies	
Section 965 Deemed Repatriation	250,000,000	325,000,000	450,000,000	1,025,000,000	250,000,000	325,000,000	450,000,000	150,000,000	1,175,000,000	
95% NJ Dividend Exclusion	(237,500,000)	(308,750,000)	(427,500,000)	(973,750,000)	(237,500,000)	(308,750,000)			(546,250,000)	
Dividends Included in NJ Entire Net Income	12,500,000	16,250,000	22,500,000	51,250,000	12,500,000	16,250,000			28,750,000	
NJ Allocation Percentage	2%	5%	3%		2%	5%	0%	0%		
NJ Tax Rate	11.5%	11.5%	11.5%		11.5%	11.5%	11.5%	11.5%		
NJ Tax on Section 965 Deemed Repatriation	250,000	812,500	675,000	1,737,500	250,000	812,500	0	0	1,062,500	
<b>Scenario One 2019 Unitary Filing NJ Return Filed on the Default Unitary Water's Edge Basis - Includes Companies A, B, and C Received Cash Distribution Related to 965 - Included in Book Income but Excluded from Federal Taxable Income</b>					<b>Scenario Two 2019 Unitary Filing NJ Return Filed on the Default Unitary Water's Edge Basis - Includes Companies A, B, and C Received Cash Distribution Related to 965 - Included in Book Income but Excluded from Federal Taxable Income</b>					
	Company A	Company B	Company C		Company A	Company B	Company C	Company D	Unitary Combined Amount	
Cash Repatriation (Book)	A 250,000,000	325,000,000	450,000,000	1,025,000,000	A 250,000,000	325,000,000	450,000,000	150,000,000	1,175,000,000	1,175,000,000
Federal Schedule M to Remove PTEP	(250,000,000)	(325,000,000)	(450,000,000)	(1,025,000,000)	(250,000,000)	(325,000,000)	(450,000,000)	(150,000,000)	(1,175,000,000)	(1,175,000,000)
Dividends Included in Federal Taxable Income	0	0	0	0	0	0	0	0	0	0
NJ Disallowance of PTEP Exclusion Per NJ Special Adoption Reg Sec 18:7-5.20	+A 0	0	0	0	+A 0	0	450,000,000	150,000,000	600,000,000	600,000,000
Dividends Included in NJ Entire Net Income	B 0	0	0	0	B 0	0	450,000,000	150,000,000	600,000,000	600,000,000
<b>NJ Single Sales Factor</b>										
NJ Sales - Sep Co	150,000,000	75,000,000	0		150,000,000	75,000,000	0	75,000,000		225,000,000
EW Sales - Combined	750,000,000	750,000,000	750,000,000		750,000,000	750,000,000	750,000,000	750,000,000		750,000,000
	C 20%	10%	0%		C 20.00%	10.00%	0.00%	10.00%		40%
Dividends in NJ Combined Taxable Income x NJ Allocation Factor	D 0	0	0	0	D 120,000,000	60,000,000	0	60,000,000	240,000,000	240,000,000
					<i>(Total "B" Divid X Sep Co. "C" Appt)</i>					
<b>NJ Dividend Exclusion</b>										
Div in NJ Tax Base x Sep Co SSF x 95%	E 0	0	0	0	E 0	0	0	(57,000,000)	(57,000,000)	(228,000,000)
Dividends In NJ Taxable Income (D - E)	F 0	0	0	0	F 120,000,000	60,000,000	0	3,000,000	183,000,000	12,000,000
NJ Tax Rate	G 11.5%	11.5%	11.5%		G 11.5%	11.5%	11.5%	11.5%		11.5%
NJ Tax on Cash Distribution (F X G)	0	0	0	0	13,800,000	6,900,000	0	345,000	21,045,000	1,380,000
				Tax Under NJ SAR 18:7-5.20					Tax Under NJ SAR 18:7-5.20	Tax Applied on Combined Basis
				No Tax Required Because Co. C Filed in NJ in Year of 965					Tax Only Required Because Co. C Did Not File in NJ in Year of 965	Tax Only Required Because Co. C Did Not File in NJ Year of 965