

## New Jersey Issues Temporary Rules Addressing GILTI, FDII, Addback Provisions

### Overview

The New Jersey Division of Taxation (Division) has issued temporary corporation business tax (CBT) regulations, effective April 8, 2020 through October 5, 2020, addressing:

- i) Whether global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII), including IRC section 250 deductions, qualify for dividend exclusion;
- ii) Whether GILTI and FDII must be included in the numerator of the CBT apportionment factor;
- iii) Statutory intercompany interest and intangible expense deduction disallowance provisions in light of certain changes to New Jersey's "foreign country exception" as well as the impact of New Jersey's combined reporting regime;
- iv) Whether previously taxed dividend income may be excluded from entire net income in certain situations; and
- v) The taxation of dividends included in entire net income for periods from January 1, 2017 through January 1, 2019.<sup>1</sup>

This Tax Alert summarizes the temporary regulations.

### Whether GILTI and FDII, including IRC section 250 Deductions, Qualify for Dividend Exclusion

The amount of income reported for federal income tax purposes pursuant to section 951A (GILTI) and section 250(b) (FDII) must be included in New Jersey entire net income; neither amount is considered to be a dividend or a deemed dividend.<sup>2</sup> GILTI and FDII do not qualify for the dividend exclusion of N.J.S.A. 54:10A-4(k)(5).<sup>3</sup>

For purposes of computing the allowable I.R.C. section 250(a) deduction, in order to arrive at the taxable amount of GILTI and FDII included in the tax base for New Jersey CBT purposes, a deduction is disallowed if the amounts of income included for federal tax purposes are exempt or excluded from entire net income for New Jersey tax purposes.<sup>4</sup> The same limitations for claiming the deduction for GILTI and FDII under I.R.C. section 250 for federal income tax purposes shall also apply for New Jersey tax purposes.<sup>5</sup>

If a taxpayer includes GILTI income from a related member in its entire net income, the taxpayer may claim an exception to the requirement to addback related member expenses.<sup>6</sup> The taxpayer must file adequate documentation to demonstrate that related member's GILTI income is included in the taxpayer's entire net income with the Director of the Division.<sup>7</sup>

To the extent a combined group can demonstrate that the members included in the combined group on the same New Jersey combined return are controlled foreign corporations ("CFCs") that generate the GILTI income, and the income of that CFC is already included in the entire net income of the combined group, the GILTI income may be excluded.<sup>8</sup> The combined group must provide to the Director sufficient documentation to prove, by clear and convincing evidence,

<sup>1</sup> Specially Adopted Amended Rule N.J.A.C. 18:7-5.18; Specially Adopted New Rules N.J.A.C. 18:7-3.25, N.J.A.C. 18:7-5.19, and N.J.A.C. 18:7-5.20, N.J. Div. of Tax. (effective 4/8/20 and expires on 10/5/20), available [here](#).

<sup>2</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.19(a), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>3</sup> *Id.*

<sup>4</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.19(b), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>5</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.19(c), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>6</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.19(d), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>7</sup> *Id.*

<sup>8</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.19(e), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

that income was already included.<sup>9</sup> The portion of the I.R.C. section 250(a) deduction allowed under N.J.S.A. 54:10A-4.15, where attributable to the GILTI and FDII income, shall be allowed regardless of the intercompany eliminations, deferrals, or exclusions on Schedule A-8 for combined returns.<sup>10</sup>

### **Whether GILTI and FDII Must be Included in the Numerator of the CBT Apportionment Factor**

#### Separate Returns

For privilege periods beginning on and after January 1, 2018, taxpayers filing separate returns must include GILTI, and the receipts attributable to the FDII, after adjustment for the I.R.C. section 250(a) deductions, in the denominator of the allocation factor.<sup>11</sup> The net GILTI and net FDII are only included in the numerator of the allocation factor if such amounts would be considered to be a New Jersey receipt; otherwise net GILTI and net FDII are only included in the denominator of the allocation factor.<sup>12</sup>

#### Combined Returns

For combined groups where the CFC is not included as a member of the combined group on the same New Jersey combined return, the net GILTI and net FDII will be in the denominator of the combined group allocation factor and will be included in the member's numerator where appropriate, as applicable.<sup>13</sup> The combined group denominator factor shall not include the CFC's receipts.<sup>14</sup>

For combined groups where the CFC is included as a member of the combined group on the same New Jersey combined return, and the GILTI is excluded under (e) above because the CFC's entire net income is included in the combined group entire net income, the GILTI must be excluded from the combined group allocation factor.<sup>15</sup> The CFC's receipts, net of the I.R.C. section 250(a) deduction that was attributable to GILTI income, will be included in the denominator of the combined group allocation factor.<sup>16</sup> The CFC member's receipts, net of the I.R.C. section 250(a) GILTI deduction that was attributable to GILTI income, will be included in that member's numerator where appropriate, as applicable.<sup>17</sup> The net FDII will be included in the denominator of the combined group allocation factor, and will be included in the appropriate member's numerator, as applicable.<sup>18</sup>

### **Addback Provisions**

Within the temporary CBT rules, the Division eliminated the historical unreasonableness exception for the addback of interest and royalties. Rather, a deduction may be permitted if a taxpayer establishes, to the satisfaction of the Director of the Division, the disallowance is unreasonable by clear and convincing evidence, and any one of the following applies:

- i. Unfair duplicate taxation;
- ii. A technical failure to qualify the transactions under the statutory exceptions;
- iii. An inability or impediment to meet the requirements due to legal or financial constraints;
- iv. An unconstitutional result; or
- v. The transaction is equivalent to an unrelated loan transaction.<sup>19</sup>

A deduction may also be allowed to the extent that the taxpayer establishes that the interest, interest expenses and costs, and intangible expenses and costs are directly or indirectly paid, accrued, or incurred to a related member in a

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.19(f), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>12</sup> *Id.*

<sup>13</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.19(g)(1), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>14</sup> *Id.*

<sup>15</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.19(g)(2), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> Specially Adopted Amended Rules N.J.A.C. 18:7-5.18(a)(2), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

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foreign nation that has in force a comprehensive income tax treaty with the United States. Also, for tax years beginning on or after January 1, 2018, the taxpayer must establish that:

- i. The related member was subject to tax in the foreign nation on a tax base that included the amount paid, accrued, or incurred; and
- ii. The related member's income received from the transaction was taxed at an effective tax rate equal to or greater than a rate of 3% less than the rate of tax applied to taxable interest by the State of New Jersey.<sup>20</sup>

In claiming this exception, the taxpayer must disclose certain information on its return.<sup>21</sup> Additionally, a deduction may be permitted if the taxpayer and the Director agree in writing to the application or use of an alternative method of apportionment.<sup>22</sup>

The above does not apply to transactions between related members included in a combined group reported on the New Jersey combined return.<sup>23</sup>

### Previously Taxed Dividend Income may be Excluded

A taxpayer may exclude previously taxed subsidiary dividends from entire net income in a tax year that:

- i. The taxpayer receives and includes in entire net income, in the current tax year, dividends from the same subsidiary for which the taxpayer had included, as paid or deemed paid dividends, in entire net income in a previous tax year; and
- ii. The taxpayer filed, and paid, an amount greater than the minimum tax to New Jersey in that previous tax year.<sup>24</sup>

A taxpayer must be allowed to exclude from entire net income previously taxed subsidiary dividends upon completing and submitting Schedule PT along with their CBT-100 or BFC-1, as applicable, and providing the Director of the Division with adequate documentation of the previously taxed dividend income.<sup>25</sup>

### The Taxation of Dividends Included in Entire Net Income for Periods beginning on and after January 1, 2017, but beginning before January 1, 2019

For privilege periods beginning on and after January 1, 2017, but beginning before January 1, 2019, the tax liability owed for the five percent of dividends paid or deemed paid by an 80 percent or more owned subsidiary included in the taxpayer's entire net income must be based on either the three-year average allocation factor for the taxpayer's 2014 through 2016 privilege periods reported on the taxpayer's tax returns, or 3.5 percent, whichever is lower.<sup>26</sup> Dividends included in the entire net income in privilege periods on and after January 1, 2019, must follow the standard allocation formula set forth in N.J.A.C. 18:7-8.7 and 8.12.<sup>27</sup>

### Considerations

Taxpayers should consider the impact of the temporary regulations when preparing their 2019 combined filings. The Division states that it will propose to readopt these temporary rules on or prior to October 5, 2020.

<sup>20</sup> Specially Adopted Amended Rules N.J.A.C. 18:7-5.18(a)(4), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>21</sup> *Id.*

<sup>22</sup> Specially Adopted Amended Rules N.J.A.C. 18:7-5.18(a)(3), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>23</sup> Specially Adopted Amended Rules N.J.A.C. 18:7-5.18(e), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>24</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.20(a), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>25</sup> Specially Adopted New Rules N.J.A.C. 18:7-5.20(b), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>26</sup> Specially Adopted New Rules N.J.A.C. 18:7-3.25(a), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

<sup>27</sup> Specially Adopted New Rules N.J.A.C. 18:7-3.25(c), N.J. Div. of Tax (effective 4/8/20 and expires on 10/5/20).

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