

# SPECIAL ADOPTION

## TREASURY—TAXATION

### (a)

#### DIVISION OF TAXATION

#### Corporation Business Tax Act

#### Specially Adopted Amendment: N.J.A.C. 18:7-5.18

#### Specially Adopted New Rules: N.J.A.C. 18:7-3.25, 5.19, and 5.20

Special Amendments and New Rules Adopted: April 8, 2020, by John J. Ficara, Acting Director, Division of Taxation. Filed: April 8, 2020, as R.2020 d.057.

Authority: N.J.S.A. 54:10A-27, 54:10A-4.14, 54:50-1, and P.L. 2018, c. 48 and c. 131.

Effective Date: April 8, 2020.

Expiration Date: October 5, 2020.

**Take notice** that, in accordance with P.L. 2018, c. 48, and c.131, the Division of Taxation (Division) has adopted amendments to N.J.A.C. 18:7-5.18 and new rules at N.J.A.C. 18:7-3.25, 5.19, and 5.20 to implement the statutory requirements of the law. These amendments and new rules became effective on April 8, 2020, upon acceptance for filing by the Office of Administrative Law. The specially adopted amendments and new rules will be effective for a period not to exceed 180 days from the date of acceptance for filing, that is, until October 5, 2020.

The Division will propose to readopt these rules pursuant to the rulemaking requirements of the Administrative Procedure Act, N.J.S.A. 52:14B-1 et seq., on or prior to October 5, 2020.

**Full text** of the special adoption follows (additions indicated in boldface **thus**; deletions indicated in brackets [thus]):

#### SUBCHAPTER 3. COMPUTATION OF TAX

#### 18:7-3.25 Computation of the tax on dividends included in entire net income for privilege periods beginning on and after January 1, 2017, but beginning before January 1, 2019

(a) 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.

(b) Notwithstanding the allocation factor in (a) above, pursuant to N.J.S.A. 54:10A-8, the Director of the Division of Taxation may adjust the taxpayer's allocation factor, as prescribed pursuant to (a) above, if the allocation factor does not properly reflect the activity, business, receipts, capital, entire net worth, or entire net income of a taxpayer reasonably attributed to New Jersey.

(c) In privilege periods beginning on and after January 1, 2019, a taxpayer is not allowed to use the statutory formula provided at (a) above. Dividends included in the entire net income in privilege periods on and after January 1, 2019, must follow the standard allocation formula set forth at N.J.A.C. 18:7-8.7 and 8.12.

#### SUBCHAPTER 5. ENTIRE NET INCOME; DEFINITION, COMPONENTS, AND RULES FOR COMPUTING

#### 18:7-5.18 Related party transactions

(a) Interest paid, accrued, or incurred to a related member shall not be deducted in calculating entire net income, except that a deduction [shall] may be permitted:

1. (No change.)

2. If the taxpayer establishes, to the satisfaction of the Director of the Division of Taxation, that the disallowance of a deduction is unreasonable by [showing the extent the related party pays tax in New Jersey on the income stream, or the taxpayer and the Director agree in writing to the application or use of an alternative method of apportionment; or] **clear and convincing evidence, and any one of the following circumstances 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; or

3. If the taxpayer and the Director agree in writing to the application or use of an alternative method of apportionment; or

[3.] 4. To the extent that the taxpayer establishes that the interest is directly or indirectly paid, accrued, or incurred to:

i. A related member in a foreign nation [which] that has in force a comprehensive income tax treaty with the United States[, provided, however, that] **and, for tax years beginning on or after January 1, 2018, the taxpayer also establishes that:**

(1) The related member was subject to tax in the foreign nation on a tax base that included the amount paid, accrued, or incurred; and

(2) The related member's income received from the transaction was taxed at an effective tax rate equal to or greater than a rate of three percentage points less than the rate of tax applied to taxable interest by the State of New Jersey. In claiming this exception, the taxpayer shall disclose on its return for the privilege period:

Recodify existing (1)-(4) as (A)-(D) (No change in text.)

ii. (No change.)

[4.] 5. For purposes of this subsection:

i.-v. (No change.)

vi. "Related entity" means [a]:

(1) A stockholder who is an individual, or a member of the stockholder's family enumerated in I.R.C. § 318, if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially, or constructively, in the aggregate, at least 50 percent of the value of the taxpayer's outstanding stock; [a]

(2) A stockholder, or a stockholder's partnership, limited liability company, estate, trust, or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts, and corporations own, directly, indirectly, beneficially, or constructively, in the aggregate, at least 50 percent of the value of the taxpayer's outstanding stock; or [a]

(3) A corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of I.R.C. § 318, if the taxpayer owns, directly, indirectly, beneficially, or constructively, at least 50 percent of the value of the corporation's outstanding stock. The attribution rules of I.R.C. § 318, [shall] apply for purposes of determining whether the ownership requirements of this definition have been met;

vii. The disclosure requirement for interest paid to a related member [shall be] is deemed to be satisfied if the taxpayer provides a schedule of:

(1)-(4) (No change.)

viii. (No change.)

[5.] 6. Examples:

Example 1: Royal Palm, Ltd., a foreign parent corporation, owns directly or indirectly 100 percent of the outstanding shares of a U.S. domestic subsidiary, Red Oak, Inc. and 100 percent of the outstanding shares of Little Palm, Ltd., a foreign subsidiary, a corporation. Royal Palm, Ltd. and Little Palm, Ltd. are domiciled in jurisdictions subject to a comprehensive income tax treaty with the United States of America. Red Oak, Inc. is in need of short term and/or long term funding. Little Palm,

Ltd. is established by Royal Palm, Ltd. to represent the worldwide affiliated group and issue commercial paper, or enter into financing arrangements with lending institutions, or borrow funds from unrelated parties on behalf of the affiliated group. The proceeds of these transactions are then used to fund the operating or capital investment activities of one or more of the members of the worldwide affiliated group. Interest expense attributable to amounts lent by Little Palm, Ltd., the foreign subsidiary, to Red Oak, Inc., the U.S. domestic subsidiary, and any costs associated with the origination of the lending which are assessed to Red Oak, Inc. as expense recovery of the lending originations, would not be added back to Red Oak's Federal taxable income provided that the loans are at arm's length rates and properly documented.

Example 2-4 (No change.)

Example 5: Mr. Jones, a New Jersey resident, owns 100 percent of the shares of Zippy Corp., a corporation properly capitalized and organized and doing business in New Jersey. Zippy Corp. has not made a New Jersey [S election] **S-election**. Mr. Jones loans Zippy Corp. money at an arm's length rate under an arm's length contract. Zippy Corp. may take an interest deduction, provided that one of the exceptions applies: for example, if Mr. Jones pays New Jersey [Gross Income Tax] **gross income tax** at a rate within three percent of nine percent, then Zippy Corp. may take the deduction. If Zippy Corp. does not get a deduction, Mr. Jones may not exclude the interest income from his gross income tax taxable income.

Example 6: Mr. Smith, a New Jersey resident, owns 100 percent of the shares of Pin Corp., a corporation organized and doing business in New Jersey. Pin Corp. has not made a New Jersey [S election] **S-election**. Mr. Smith lends Pin Corp. \$ 5,000 at an arm's length rate under an arm's length contract. When Pin Corp. files its Form CBT-100, the Stockholder's Equity reflected on its Balance Sheet, Schedule B, is \$ 200.00. Mr. Smith paid gross income tax on the payments received from Pin Corp. However, Pin Corp. may not claim an interest deduction for interest paid to Mr. Smith. The "loan" is actually a contribution to capital, since the corporation is undercapitalized.

(b) Interest expenses and costs [and], **as well as**, intangible expenses and costs directly or indirectly paid, accrued, or incurred in connection with a transaction with one or more related members shall not be deducted in calculating entire net income, except that a deduction [shall] **may** be permitted:

1. If the interest expenses and costs [and], **as well as**, intangible expenses and costs are directly or indirectly paid, accrued, or incurred to a related member in a foreign nation [which] **that** has in force a comprehensive income tax treaty with the United States[,] **and, for tax years beginning on or after January 1, 2018, the taxpayer establishes 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;**

**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 three percentage points less than the rate of tax applied to taxable interest by the State of New Jersey; and**

**iii.** In claiming this exception, the taxpayer shall disclose on its return: Recodify existing i.-iv. as (1)-(4) (No change in text.)

2. If the interest expenses and costs [and], **as well as**, the intangible expenses and costs that the taxpayer establishes meet both of the following:

i. (No change.)

ii. The transaction giving rise to the interest expenses and costs or the intangible expenses and costs between the taxpayer and the related member did not have as a principal purpose the avoidance of any portion of [the] tax;

3. If the taxpayer establishes, **to the satisfaction of the Director**, that the adjustments are unreasonable by [showing the extent that the payee pays tax to New Jersey on the income stream; or] **clear and convincing evidence, and any one of the following circumstances 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; or**

4. If the taxpayer and the [director] **Director** agree in writing to the application or use of an alternative method of apportionment[.];

[5.] (c) For purposes of [this subsection] (b) **above:**

Recodify existing i.-v. as 1.-5. (No change in text.)

[vi.] **6.** "Intangible expenses and costs" means and includes:

Recodify existing (1)-(2) as **i.-ii.** (No change in text.)

[(3)] **iii.** Royalty, patent, technical, and copyright fees;

Recodify existing (4)-(5) as **iv.-v.** (No change in text.)

Recodify existing vii.-viii. as **7.-8.** (No change in text.)

[ix.] **9.** "Related entity" means [a]:

**i.** A stockholder who is an individual, or a member of the stockholder's family enumerated in I.R.C. § 318, if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially or constructively, in the aggregate, at least 50 percent of the value of the taxpayer's outstanding stock; [a]

**ii.** A stockholder[,], or a stockholder's partnership, limited liability company, estate, trust, or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts, and corporations own, directly, indirectly, beneficially, or constructively, in the aggregate, at least 50 percent of the value of the taxpayer's outstanding stock; or [a]

**iii.** A corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of I.R.C. § 318, if the taxpayer owns, directly, indirectly, beneficially, or constructively, at least 50 percent of the value of the corporation's outstanding stock. The attribution rules of I.R.C. § 318, [shall] apply for purposes of determining whether the ownership requirements of this definition have been met;

[x.] **10.** (No change in text.)

[6.] (d) Examples **applicable to (b) above are as follows:**

Example 1: Large Co. A.G., a foreign corporation, domiciled in a jurisdiction that has entered into a comprehensive tax treaty with the United States of America, owns directly or indirectly 100 percent of the outstanding shares of three U.S. domestic subsidiaries (Red Corp., White Corp., and Blue Corp.) and 100 percent of the outstanding shares of Funding, N.V., a foreign subsidiary. Red Corp. and White Corp. utilize certain technology developed by Large Co. A.G. in their daily operations of manufacturing products for resale. Blue Corp. was formed to hold, and does hold, the U.S. rights to certain technologies developed by Large Co. A.G.[.] Red Corp. and White Corp. pay a royalty to Blue Corp. for the ability to use the technology developed by Large Co. A.G. in its daily operations. Blue Corp. pays an annual royalty to Large Co. A.G. based on the amount of royalties it receives from Red Corp. and White Corp. Amounts paid to Blue Corp. by Red Corp. and White Corp. would not be subject to disallowance. Also the amounts paid by Blue Corp. to Large Co. A.G. would not be subject to disallowance.

Example 2: Same facts as Example 1, except that, Large Co. A.G. has entered into an agreement to securitize certain financial assets. Red Corp. sells its receivables to White Corp., a bankruptcy remote, special purpose company, at a discount. White Corp. pledges the receivables to a lending institution that issues commercial paper backed by those receivables. Large Co. A.G. and Red Corp. have guaranteed that 100 percent of any receivable pledged is collectible. The discount on the sale of the receivables by Red Corp. to White Corp. is not subject to disallowance.

Example 3: A limited partner receives guaranteed payments for its investment in a limited partnership. The payment is similar to a payment on preferred stock. The related member rules apply if the guaranteed payment is above market/arm's length values.

**(e) Subsections (a), (b), (c), and (d) above do not apply to transactions between related members included in a combined group reported on the New Jersey combined return. Subsections (a), (b), (c), and (d) above only apply to transactions between members of a combined group reported on the New Jersey combined return and related members not included in the combined group reported on the New Jersey combined return.**

**Example:** Companies A and B are members of a combined group (Combined Group E) that files a mandatory New Jersey combined return. Related member Companies C and D are not part of the combined group filing the New Jersey combined return. Subsections (a), (b), (c), and (d) above apply to transactions between Combined Group E and Companies C and D, but do not apply to Companies A and B because those companies are in Combined Group E.

(f) A taxpayer may claim an unreasonable exception, if that taxpayer includes Global Intangible Low Taxed Income (GILTI) in its entire net income from a related party and the expenses from the same related party would otherwise be required to be added back. See N.J.A.C. 18:7-5.19.

#### 18:7-5.19 Global Intangible Low Taxed Income (GILTI) and Foreign-Derived Intangible Income (FDII) for corporation business tax purposes

(a) For New Jersey corporation business tax purposes, the amount of income reported for Federal income tax purposes pursuant to I.R.C. § 951A (GILTI) and § 250(b) (FDII) must be included in New Jersey entire net income in the same manner as for Federal tax purposes, and neither amounts are considered to be a dividend or a deemed dividend. GILTI and FDII do not qualify for the dividend exclusion of N.J.S.A. 54:10A-4(k)(5).

(b) In computing the allowable I.R.C. § 250(a) deduction pursuant to N.J.S.A. 54:10A-4.15, in order to arrive at the taxable amount of GILTI and FDII included in the tax base for New Jersey corporation business tax purposes, a deduction will be disallowed if the amounts of income included for Federal tax purposes under I.R.C. §§ 951A and 250 are exempt or excluded from entire net income under the provisions of the Corporation Business Tax Act.

(c) The same limitations for claiming the deduction for GILTI and FDII under I.R.C. § 250 for Federal tax purposes shall also apply for New Jersey tax purposes.

(d) 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 add back related member expenses under N.J.S.A. 54:10A-4.4 upon filing with the Director of the Division of Taxation adequate documentation to demonstrate that related member GILTI income is included in the taxpayer's entire net income.

(e) 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 that generate the GILTI income, and the income of that controlled foreign corporation is already included in the entire net income of the combined group, the GILTI income may be excluded on Schedule A-8. The combined group must provide to the Director sufficient documentation to prove, by clear and convincing evidence, that income was already included. The portion of the I.R.C. § 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.

(f) For privilege periods beginning on and after January 1, 2018, a taxpayer filing a separate return must include the GILTI, and the receipts attributable to the FDII, after adjustment for the I.R.C. § 250(a) deductions, in the denominator of the allocation factor. The net GILTI (that is, the GILTI reduced by the I.R.C. § 250(a) GILTI deduction) and net FDII (that is, the receipts attributable to the FDII reduced by the I.R.C. § 250(a) FDII deduction) are only included in the numerator of the allocation factor if, based on N.J.S.A. 54:10A-6 and 54:10A-6.1 and N.J.A.C. 18:7-8.1 through 8.17, such amounts would be considered to be a New Jersey receipt; otherwise net GILTI (that is, the GILTI reduced by the I.R.C. § 250(a) GILTI deduction) and net FDII (that is, the receipts attributable to the FDII reduced by the I.R.C. § 250(a) FDII deduction) are only included in the denominator of the allocation factor.

1. The taxpayer may petition for relief pursuant to N.J.S.A. 54:10A-8 and N.J.A.C. 18:7-10.1.

#### 2. Separate Return Example:

B forms Shell and Bell as conduits to shift income from high tax nations to lower tax nations in order to lower B's overall tax burden. Shell and Bell are controlled foreign corporations located in a low tax nation. B owns 100 percent of Shell and Bell. B files a separate New Jersey return. Although Shell does not have income effectively connected to a business in the U.S. within the meaning of the Internal Revenue Code, through a series of transactions Shell derives receipts from U.S. sources, including New Jersey sources. Shell also derives income from other countries. Bell does not have any U.S. source income and only has income from Europe. Both Shell and Bell are integrated in B's worldwide business. For Federal purposes, B is required to include in its entire net income the GILTI that was generated from both Shell and Bell. B also sells goods directly to customers in foreign nations for use outside of the U.S. Some of B's export contracts stipulate that the customer will take possession of the goods in B's New Jersey warehouse before the goods are exported.

The portion of the net GILTI (that is, the GILTI reduced by the I.R.C. § 250(a) GILTI deduction) attributable to New Jersey from receipts derived from non-effectively connected U.S. source income would be included in B's numerator. The portion of the net FDII (that is, the receipts attributable to the FDII reduced by the I.R.C. § 250(a) FDII deduction) attributable to New Jersey receipts would be in B's numerator. The net GILTI (that is, the GILTI reduced by the I.R.C. § 250(a) GILTI deduction) and net FDII (that is, the receipts attributable to the FDII reduced by the I.R.C. § 250(a) FDII deduction) are included in the denominator of the allocation factor.

(g) Pursuant to N.J.S.A. 54:10A-4.7, the combined group's sales fraction denominator includes the receipts of the business entities that are included as members of the combined group on the same New Jersey combined return.

1. For combined groups where the controlled foreign corporation is not included as a member of the combined group on the same New Jersey combined return, the net GILTI (that is, the GILTI reduced by the I.R.C. § 250(a) GILTI deduction) and net FDII (that is, the receipts attributable to the FDII reduced by the I.R.C. § 250(a) FDII deduction), will be in the denominator of the combined group allocation factor, and will be included in the member's numerator where appropriate, as applicable. The combined group denominator factor shall not include the controlled foreign corporation's receipts.

2. For combined groups where the controlled foreign corporation 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 controlled foreign corporation's entire net income is included in the combined group entire net income, the GILTI must be excluded from the combined group allocation factor. The controlled foreign corporation's receipts, net of the I.R.C. § 250(a) deduction that was attributable to GILTI income, will be included in the denominator of the combined group allocation factor. The controlled foreign corporation member's receipts, net of (that is, reduced by) the I.R.C. § 250(a) GILTI deduction that was attributable to GILTI income, will be included in that member's numerator where appropriate, as applicable. The net FDII (that is, the receipts attributable to the FDII reduced by the I.R.C. § 250(a) FDII deduction) will be included in the denominator of the combined group allocation factor, and will be included in the appropriate member's numerator, as applicable.

#### 3. Combined Return Example:

Combined group A includes T, X, Y, Z, Q, and P as members on the same New Jersey combined return. T is the controlled foreign corporation that generated GILTI. In addition to the GILTI generating activities, T also has effectively connected income, some of which is from New Jersey sources. Z is a controlled foreign corporation that generated GILTI income, but had a net tested loss. T's effectively connected income did not generate GILTI. Z has U.S. source income that is not effectively connected income, some of which is New Jersey source income. Q is the member that is required to include the GILTI income for Federal tax purposes because Q is a shareholder of T and Z. X and Y have FDII attributable receipts from sales to non-U.S. customers. Based on the terms of the export contracts and for insurance purposes, the customers take possession

at X's and Y's joint New Jersey warehouse before the goods are exported to the customers' respective home countries. P does not have receipts from customers located outside of the U.S. P only has U.S. source income, and does not have FDII or GILTI.

The combined group denominator would not include the GILTI income that Q was required to include in income for Federal purposes, and Q's GILTI income amount would be excluded out of the combined group entire net income because both T's and Z's income/loss is included in the combined group entire net income already, as T and Z are included as members of the combined group on the same New Jersey combined return as Q. T's and Z's receipts that generated the GILTI should be reported net of the I.R.C. § 250(a) GILTI deduction in the group denominator. T's effectively connected income did not generate the GILTI, thus T's New Jersey receipts would not be net of (that is, not reduced by) the I.R.C. § 250(a) GILTI deduction. If Z's U.S. source income generated the GILTI, and that income was from New Jersey sources, then Z's numerator should include GILTI net of (that is, reduced by) the I.R.C. § 250(a) GILTI deduction. X's and Y's receipts attributable to the FDII income should be included net of (that is, reduced by) the I.R.C. § 250(a) FDII deduction in the combined group denominator. X's and Y's New Jersey receipts attributable to the FDII income should be included net of (that is, reduced by) the I.R.C. § 250(a) FDII deduction in their respective numerators. P's receipts will be in the combined group denominator and P's New Jersey receipts will be in P's numerator. The full I.R.C. § 250(a) deductions will be allowed to be taken in computing the combined group entire net income.

(h) GILTI and FDII derived from a Combined Group Member's Independent Business Operations. There are instances where a portion of a member's business operations can be independent of the unitary business activity of the combined group. Such member of a combined group must complete Schedule X and report the separate portion of its business operations (and those operations that are not part of another combined group that files a New Jersey combined return). If the income from those operations is GILTI income or FDII income, that income must be reported on Schedule X.

**18:7-5.20** Previously taxed subsidiary dividends received by a taxpayer

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

1. 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

2. The taxpayer filed, and paid, an amount greater than the minimum tax to New Jersey in that previous tax year.

(b) 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 of Taxation with adequate documentation of the previously taxed dividend income.