KPMG

This Week in State Tax (TWIST)

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Nebraska: Supreme Court Holds TCJA Repatriation Income Not Deductible Dividend

The Nebraska Supreme Court recently upheld a district court ruling holding that repatriation income under IRC section 965 did not qualify for the state's "deemed dividends received" deduction. Recall, the Tax Cuts and Jobs Act of 2017 (TCJA) required the shareholders of certain controlled foreign corporations (CFCs) to include the accumulated earnings and profits of the CFCs from 1986 through 2017 on their 2017 federal tax return (i.e., section 965 or repatriation income) and imposed a 10 percent federal tax on that amount. The taxpayer reported the repatriation income on its 2017 federal tax return but did not include it on its Nebraska corporation income tax return. In December 2021, the taxpayer amended its 2017 Nebraska return to include the section 965 income. In March 2022, the taxpayer filed a request with the Department of Revenue seeking a declaratory order to amend its 2017 Nebraska return to claim the dividends received deduction for the section 965 income. The Tax Commissioner denied the order. In the Commissioner's view, the deduction did not apply to section 965 inclusion income. The taxpayer appealed to the district court, which affirmed the Commissioner's position. The taxpayer then appealed to the Nebraska Supreme Court.

The court first noted that it was undisputed that the IRC section 965 income was properly included in federal taxable income: the starting point for Nebraska taxable income. At issue was whether the section 965 income was considered "dividends ... deemed to be received" and thus eligible for deduction under Nebraska law. The Tax Commissioner contended that nothing in the language of IRC section 965 deems the income inclusion to be a dividend. The taxpayer, on the other hand, argued that section 965 deemed the income inclusion as having been received as a distribution from the retained earnings of its CFCs, and such distribution should have been treated as a dividend for purposes of the deduction.

The court ultimately held that the section 965 income was not a dividend deemed received by the taxpayer. The court relied heavily on the U.S. Supreme Court's recent Moore decision when characterizing the income. In that case, the Justices characterized section 965 inclusions as "pass-through income," which attributed earnings of the CFCs to the shareholders without regard to whether those earning are distributed to the shareholders. Thus, the pass-through income did not operate as a deemed distribution (i.e., a deemed dividend received) and as such was not deductible. Notably, the court's opinion did not consider whether the taxpayer was entitled to any apportionment factor representation related to the IRC section 965 income, as is generally the case for other types of "pass-through income" (e.g., a partner's distributive share of a partnership's income).

Please contact Kara Hernandez for more information on Precision Castparts Co. v. Nebraska Department of Revenue (August 30, 2024).