KPMG

This Week in State Tax (TWIST)

January 13, 2025

New Jersey: Tax Court Finds IRC 965 Income Excluded from Gross Income Tax

The New Jersey Tax Court recently held that, for the purposes of the Gross Income Tax (GIT, the New Jersey tax on personal income), “gross income” does not include deemed repatriation amounts included in federal income under the one-time tax imposed by Internal Revenue Code section 965 (“IRC 965 income”), as part of the Tax Cuts and Jobs Act (TCJA). Recall, unlike many states, the New Jersey GIT does not conform to the federal definition of gross income; instead, “gross income” is the sum of specific categories of income, including “dividends”. Dividends are defined in New Jersey law as “any distribution in cash or property made by a corporation … (1) out of accumulated earnings and profits, or (2) out of earnings and profits of the year in which such dividend is paid.” In a notice issued shortly after the passage of the TCJA, the Division of Taxation (Division) stated that IRC 965 income was a “deemed repatriation dividend” and should be included in gross income for GIT purposes. The taxpayers did not include any portion of the IRC 965 income reported on their federal return on their New Jersey GIT return. On audit, the Division issued a notice of deficiency assessing GIT, penalties, and interest. The taxpayers appealed to the Tax Court arguing that IRC 965 income was not a dividend under New Jersey law because the statutory definition requires an actual distribution or payment to be made. It also argued that, even if IRC 965 income could be categorized as a dividend, the Division did not follow proper administrative procedure in promulgating its notice.

The Tax Court ruled in favor of the taxpayers, finding that IRC 965 income was not included within the statutory definition of “dividend”. In the court’s view, the statutory reference to “distribution” means that an actual payment or transfer of money or property is a required element of a “dividend”, and that no such transfer occurred here. Although the Division argued this interpretation unduly emphasized the meaning of a single word in a way that caused disharmony with the principles of the GIT, the Tax Court held that the statute was clear and unambiguous on this point, meaning application of the principle of avoiding undue emphasis was unwarranted. The court further noted that the legislature explicitly included “deemed” payments as part of gross income in other sections of the GIT statute, and it could have done the same to include undistributed corporate earnings and profits within the definition of dividends. Finally, although the legislature had amended the Corporate Business Tax Act to address IRC 965 income, it had not made similar amendments to the GIT Act. Having found that IRC 965 income was not included within the statutory definition of dividends, the court did not consider the taxpayers’ procedural argument. Contact James Venere with questions about *Amin v. Director, Division of Taxation*.
