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TITLE 280 – DEPARTMENT OF REVENUE

CHAPTER 20 – DIVISION OF TAXATION

SUBCHAPTER 25 – BUSINESS CORPORATION TAX

PART 15 – Treatment of Repatriated Income 2017

15.1 Purpose

These rules and regulations implement various provisions of R.I. Gen. Laws Title 44 as they relate to the treatment of accumulated foreign income deemed repatriated under the federal law commonly known as the Tax Cuts and Jobs Act (Pub. Laws 115-97) and as implemented in new 26 U.S.C. § 965. These sections outline the inclusion of 965 Income for Rhode Island purposes, the apportionment of 965 Income, and the application of certain deductions for purposes of the Rhode Island Business Corporation Tax.

15.2 Authority

These rules and regulations are promulgated pursuant to R.I. Gen. Laws §§ 44-11-9 and 44-1-4. These rules and regulations have been prepared in accordance with the requirements of R.I. Gen. Laws § 42-35-1 *et seq.* of the Rhode Island Administrative Procedures Act.

15.3 Application

These rules and regulations shall be liberally construed to permit the Division of Taxation the authority to effectuate the purpose of R.I. Gen. Laws § 44-11-1 *et seq.* and other applicable state laws and regulations.

15.4 Severability

If any provision of these rules and regulations, or the application thereof to any person or circumstances, is held invalid by a court of competent jurisdiction, the validity of the remainder of the rules and regulations shall not be affected hereby.

15.5 Findings of Fact

A. The Tax Administrator makes the following findings of fact that support the promulgation of this regulation:

1. The United States Congress passed legislation commonly known as the Tax Cuts and Jobs Act ("TCJA") (Pub. Laws 115-97) on December 20,

2017. The President of the United States signed the TCJA into law on December 22, 2017.

2. The TCJA includes a number of significant tax updates, including changes that affect individuals, businesses, and international entities.

3. The TCJA, under 26 U.S.C. § 965(a), imposes a one-time transition tax on the accumulated post-1986 deferred foreign income (deemed dividend) of certain deferred foreign income corporations earned before the end of calendar year 2017. This transition tax is established for tax year 2017.

4. R.I. Gen. Laws § 44-11-11(a) defines “net income” as federal taxable income subject to certain adjustments. R.I. Gen. Laws § 44-11-12 states what type of income is not included in Rhode Island net income.

5. 26 U.S.C. § 965(c) provides for a deduction that reduces the tax liability on 965 Income. 26 U.S.C. § 965(h) allows taxpayers the option to pay the 965 Income tax liability over eight (8) years. However, Rhode Island has no authority to defer payment on recognized income without adding interest and penalty.

6. 26 U.S.C. § 965 provides S corporation shareholders the option to make an election for deferred recognition of Section 965 net tax liability at the federal level until certain “triggering events”. Rhode Island recognizes income for Rhode Island purposes at the time it is recognized for federal income tax purposes.

7. Rhode Island law currently contains no statutory requirement to provide a dividend received deduction (“DRD”) for Subpart F income. Nor does Rhode Island law allow for any increased Rhode Island income tax liability arising from 965 Income to be paid in installments over the course of several years.

8. In response to federal and Rhode Island case law, since Rhode Island does not have statutory authority to provide a DRD for dividend income provided by corporations not subject to the Business Corporation Tax, Rhode Island has historically administratively allowed corporate taxpayers to take a DRD for certain types of foreign-source income such as non-U.S. source dividends and Subpart F income received by a C corporation. The amount of the Rhode Island DRDs in the context of foreign source income has been equivalent to the level of DRD provided to corporations under prior federal income tax law for dividends paid by domestic corporate subsidiaries to parent C corporations as disclosed on their Federal Corporate Income Tax Return.

9. The TCJA is imposing a one-time repatriation tax on 965 Income subject to a special and additional Section 965(c) deduction amount, and Rhode Island now employs combined reporting for C corporations. These facts

distinguish the prior case law and urge against Rhode Island providing a DRD for 965 Income amounts included as net income at the Rhode Island level.

15.6 Definitions

A. "965 Income" means the accumulated post-1986 deferred foreign income of deferred foreign income corporations earned before the end of calendar year 2017 that is included as gross income by a U.S. shareholder under 26 U.S.C. § 951(a)(1) pursuant to 26 U.S.C. § 965(a).

B. "Apportionment" means the same as its definition set forth in the Division's Combined Reporting regulation (Part 10 of this Subchapter).

C. "Combined reporting" means the same as its definition set forth in the Division's Combined Reporting regulation (Part 10 of this Subchapter).

D. "Common ownership" means the same as its definition set forth in the Division's Combined Reporting regulation (Part 10 of this Subchapter).

E. "Corporation" means the same as its definition set forth in the Division's Combined Reporting regulation (Part 10 of this Subchapter) and Apportionment of Net Income regulation (Part 9 of this Subchapter).

F. "Deferred foreign income corporation" means the same as its definition set forth in 26 U.S.C. § 965(d).

G. "Dividend received deduction" or "DRD" means a Rhode Island tax deduction not provided by the Internal Revenue Code that a C corporation may claim that is equal to a percentage of the dividends that it receives from, or the Subpart F Income attributable to, foreign corporations whose stock it owns, as defined by the Internal Revenue Code prior to the enactment of the TCJA and as prescribed by the RI-1120C.

H. "Division of Taxation" means the Rhode Island Department of Revenue, Division of Taxation. The Division may also be referred to in this regulation as the "Division of Taxation", "Tax Division", or "Division".

I. "Foreign corporation" means the same as its definition set forth in the Division's Combined Reporting regulation (Part 10 of this Subchapter).

J. "Internal Revenue Code" or "IRC" means the most current edition of Title 26 of the United States Code.

K. "Member" means the same as its definition set forth in the Division's Combined Reporting regulation (Part 10 of this Subchapter).

L. “Net income” means Rhode Island net income as defined in R.I. Gen. Laws § 44-11-11, as amended. This includes Net 965 Income since Rhode Island net income is broadly defined as a taxpayer’s taxable income under the laws of the United States, and no exclusions under R.I. Gen. Laws § 44-11-11, as amended, apply to Net 965 Income.

M. “Net 965 income” means 965 Income less any federal deductions provided by 26 U.S.C. § 965.

N. “Nonunitary foreign corporation subsidiary” means any foreign corporation subsidiary that both:

1. is not a combined group member with the corporation that recognizes such income; and

2. would not be a combined group member with the corporation that recognizes the income if the water’s edge rules did not apply.

3. The preceding principles apply whether the corporation that recognizes the Net 965 Income files as part of a combined group or files a separate return.

O. “Partnership” means the same as its definition set forth in the Division’s Combined Reporting regulation (Part 10 of this Subchapter).

P. “Pass-through entity” means the same as its definition set forth in the Division’s Combined Reporting regulation (Part 10 of this Subchapter).

Q. “Rhode Island combined group” means the same as the definition of “combined group” set forth in the Division’s Combined Reporting regulation (Part 10 of this Subchapter).

R. “Single sales factor” means the same as its definition set forth in the Division’s Combined Reporting regulation (Part 10 of this Subchapter).

S. “Subpart F income” means the same as its definition set forth in 26 U.S.C. § 952.

T. “Tax administrator” means the same as its definition set forth in the Division’s Combined Reporting regulation (Part 10 of this Subchapter).

U. “Three-factor apportionment” means the same as its definition set forth in the Division’s Combined Reporting regulation (Part 10 of this Subchapter).

V. “Transition tax” means any one-time increase in Rhode Island income tax arising from the recognition of 965 Income.

W. “Unitary business” means the same as its definition set forth in the Division’s Combined Reporting regulation (Part 10 of this Subchapter).

X. “Unitary foreign corporation subsidiary” means any foreign corporation subsidiary that both:

1. is not a combined group member with the corporation that recognizes such income; and

2. would be a combined group member with the corporation that recognizes the income if the water’s edge rules did not apply. The preceding principles apply whether the corporation that recognizes the Net 965 Income files as part of a combined group or files a separate return.

3. The preceding principles apply whether the corporation that recognizes the Net 965 Income files as part of a combined group or files a separate return.

Y. “Water’s edge rules” means the same as its definition set forth in the Division’s Combined Reporting regulation (Part 10 of this Subchapter).

Z. Any term used in this Regulation and not defined herein shall have the same meaning as when used in a comparable context in other Rhode Island regulations relating to corporate income tax, unless a different meaning is clearly required.

15.7 Dividend Received Deduction

A. C Corporations

1. Rhode Island Net Income. A C-corporation that receives Net 965 Income attributable to a foreign corporation subsidiary must include such income in Rhode Island income, subject to the provisions of this regulation regarding DRDs, intercompany eliminations, apportionment, and other matters.

2. Other Includible Income. Net 965 Income is includible in income and no DRD applies if the Net 965 Income is attributable to a foreign corporation subsidiary that is treated as a member of a combined group with the corporation that recognizes such income only to the extent of such foreign corporation subsidiary’s U.S. source income and factors as discussed in § 10.7(H)(2)(a) of this Subchapter.

   a. Example: Alpha Corp is a domestic C corporation member of a Rhode Island combined group that also includes the U.S.-source items of Alpha Corp’s 100% owned subsidiary Bravo Corp, a foreign corporation, pursuant to § 10.7(H)(2)(a) of this Subchapter. Alpha Corp recognizes $350,000 in Net 965 Income attributable to Bravo Corp. Alpha Corp would include in Rhode Island taxable income the entire $350,000 Net 965 Income with no DRD offset, and the combined group return would not eliminate as an intercompany item any portion of the $350,000.

3. Intercompany Eliminations. Under the Division's Combined Reporting regulation (Part 10 of this Subchapter), Net 965 Income includible in Rhode Island income that is attributable to any foreign corporation subsidiary that is a member of a combined group with the corporation that recognizes such Net 965 Income should be eliminated from a combined return as an item of intercompany income only to the extent such Net 965 Income is attributable to accumulated deferred foreign income earned by the foreign corporation subsidiary during periods in which it was a combined group member. Accordingly, to the extent such Net 965 Income is attributable to accumulated deferred foreign income earned by the foreign corporation subsidiary during periods in which it was not a combined group member, the US corporation recognizing such income will include the income in Rhode Island taxable income.

   a. Example: Hotel Corp is a domestic C corporation member of a Rhode Island combined group that also includes its 100% owned subsidiary India Corp, a foreign corporation. Hotel Corp and India Corp became Rhode Island combined group members together commencing on January 1, 2015, and were not Rhode Island combined group members with each other prior to that date. Hotel Corp recognizes $300,000 in Net 965 Income. $25,000 of such Net 965 Income is attributable to accumulated deferred foreign income earned by India Corp on or after January 1, 2015. Hotel Corp and the combined group would include $275,000 of the Net 965 Income in Rhode Island taxable income with no elimination or DRD offset, and the combined group would eliminate $25,000 of the Net 965 Income as an intercompany item.

4. Unitary Foreign Corporation Subsidiary. No DRD applies to Net 965 Income includible in Rhode Island income that is attributable to an Unitary Foreign Corporation Subsidiary.

   a. Example: Charlie Corp and Delta Corp are C corporation members of a Rhode Island combined group. Echo Corp is a foreign corporation that is not a member of the combined group due to the water's edge rules, is owned 80% by Charlie Corp, and is engaged in a unitary business with Charlie Corp and Delta Corp. Charlie Corp in tax year 2017 for federal income tax purposes recognizes $100,000 in 965 Income attributable to Echo Corp, offset by 26 U.S.C. § 965(c) deductions totaling $30,000, resulting in Net 965 Income of $70,000. Charlie Corp makes a 26 U.S.C. § 965(h) election to pay the 965 net tax liability in installments for federal tax purposes. Because Echo Corp is more than 50% owned by group member Charlie Corp and is engaged in a unitary business with the group, it would be a member of the Rhode Island combined group but for the water's edge rules. Therefore, the combined group return would include as an item of income $70,000 in Net 965 Income, and no DRD would apply. Despite Charlie Corp's election under 26 U.S.C. § 965(h), the entire $70,000 must be included in the 2017 combined return and any additional Rhode Island tax due as a result of the $70,000 income item is not deferred.

5. Nonunitary Foreign Corporation Subsidiary. If a corporation recognizes Net 965 Income includible in Rhode Island income, attributable to a Nonunitary Foreign Corporation Subsidiary, such Net 965 Income is entitled to a DRD equal to the DRD that would be available under federal income tax law as incorporated into Rhode Island tax computations if such subsidiary were a domestic rather than a foreign entity and the includible Net 965 Income was a dividend.

   a. Example: Foxtrot Corp and Golf Corp are C corporation members of a Rhode Island combined group. Hotel Corp is a foreign corporation that is not a member of the combined group, is owned 70% by Foxtrot Corp, and is not engaged in a unitary business with Foxtrot Corp and Golf Corp. Foxtrot Corp in tax year 2017 for federal income tax purposes recognizes $200,000 in 965 Income attributable to Hotel Corp, offset by 26 U.S.C. § 965(c) deductions totaling $70,000, resulting in Net 965 Income of $130,000. Even though Hotel Corp is more than 50% owned by group member Foxtrot Corp, Hotel Corp is not engaged in a unitary business with the group members and therefore would not be a member of the Rhode Island combined group even if the water's edge rules did not apply. As a result, the combined group return would include as an item of income $130,000 in Net 965 Income but a DRD of $104,000 would be available on the group return (80% of the Net 965 Income). If the facts are the same except that Hotel Corp is owned 10% by Foxtrot Corp, the combined group return would include as an item of income $130,000 in Net 965 Income but a DRD of $91,000 would be available on the group return (70% of the Net 965 Income).

6. Dividend Income from Pass-Through Entity. A corporation may recognize Net 965 Income as a result of an allocation of such income from a pass-through entity that directly or through tiers of other pass-through entities owns the deferred foreign income corporation giving rise to such Net 965 Income. The corporation must include any such allocation of Net 965 Income in Rhode Island income. The availability of a DRD to such corporation shall be determined by applying the principles of § 15.7(A) of this Part to the relationship between the corporation and the foreign corporation under the Division's Combined Reporting regulation (Part 10 of this Subchapter).

a. Example: Juliett Corp is a C corporation that files a separate Rhode Island return. Juliett Corp owns an 80% interest in limited partnership Kilo, LP, which owns a 70% interest in foreign corporation Lima Corp. Kilo, LP recognizes $150,000 in 965 income attributable to Lima Corp, offset by 26 U.S.C. § 965(c) deductions totaling $30,000, resulting in Net 965 Income of $120,000. Kilo, LP issues to Juliett Corp a Form K-1 allocating 80% x $120,000 = $96,000 in Net 965 Income. Juliett Corp and Lima Corp are not engaged in a unitary business and therefore if the water's edge rules did not apply would not file a combined return, irrespective of what percentage of Lima Corp is deemed to be owned by Juliett Corp for purposes of the combined return common ownership test. Juliett Corp would include in Rhode Island Income $96,000 in allocated Net 965 Income, offset by a DRD of $96,000 x 80% = $76,800.

B. DRD rules not otherwise addressed in this regulation shall remain intact.

15.8 Apportionment

A. Apportionment shall be governed by the Division's Combined Reporting (Part 10 of this Subchapter) and Apportionment of Net Income (Part 9 of this Subchapter) regulations, which shall treat the Net 965 Income like dividend income and apply as follows:

1. A taxpayer that recognizes Net 965 Income and uses a single sales factor to apportion income shall include in receipts for apportionment purposes the Net 965 Income amount, as reduced by any DRD granted under this regulation. The taxpayer shall treat the entirety of such amount as receipts from the taxpayer's activities or transactions outside of Rhode Island and therefore shall include such amount in the denominator but not numerator of the single sales factor.

a. Example: Mike Corp and November Corp are C corporation members of a Rhode Island combined group. Oscar Corp is a foreign corporation that is not a member of the combined group, is owned 70% by Mike Corp, and is not engaged in a unitary business with Mike Corp and November Corp. In tax year 2017 Mike Corp recognizes for federal tax purposes $200,000 in 965 Income and $50,000 in 26 U.S.C. § 965(c) deductions attributable to Oscar Corp, resulting in Net 965 Income of $150,000. For Rhode Island tax purposes, the $150,000 of 965 Net Income is included in the combined return of Mike Corp and November Corp which the combined group properly offsets with an 80% DRD of 80% x $150,000 = $120,000, such that the income attributable to 26 U.S.C. § 965 included in the Rhode Island apportioned tax base is $150,000 - $120,000 = $30,000. Mike Corp, and thus the combined group, include in the single sales factor $30,000 as a non-Rhode Island receipt, included in the denominator but not the numerator of the factor.

2. A taxpayer that recognizes Net 965 Income and uses three-factor apportionment shall include as receipts in the sales factor of the apportionment factor the Net 965 Income amount, reduced by any DRD granted under this regulation. The taxpayer shall treat the entirety of such amount as receipts from the taxpayer's activities or transactions outside of Rhode Island and therefore shall include such amount in the denominator but not numerator of the sales factor. The Net 965 Income shall not affect the taxpayer’s computation of the payroll factor or the property factor, subject to the taxpayer’s right to request alternative apportionment under R.I. Gen. Laws § 44-11-15.

   a. Example: Domestic limited partnership Papa, LP owns a 35% interest in foreign corporation Quebec Corp. Papa LP in tax year 2017 for federal income tax purposes recognizes $250,000 in 965 Income attributable to Quebec Corp, offset by 26 U.S.C. § 965(c) deductions totaling $100,000, resulting in Net 965 Income of $150,000. Papa, LP includes $150,000 with no DRD offset in its Rhode Island income subject to apportionment. Papa, LP receives no DRD because it is a pass-through entity that is not entitled to a DRD under Rhode Island law. Papa, LP in the sales factor of its three-factor apportionment factor includes $150,000 as a non-Rhode Island receipt included in the denominator but not the numerator, but Papa, LP’s payroll and property factors are unaffected by the 965 Income or its ownership interest in Quebec Corp.

3. No portion of Net 965 Income may be included in sales factor receipts for purposes of single sales factor apportionment or three-factor apportionment unless it is included in apportionable Rhode Island taxable income and is not eliminated by a combined return intercompany elimination or offset by a DRD.

15.9 Deferral of Tax Payment

A taxpayer shall not be allowed to defer any payment of the Transition Tax. However, a taxpayer may request a payment plan that would be based on the taxpayer’s ability to pay the liability.

15.10 Filing Procedures

Taxpayers must file a RI Schedule 965 with their 2017 Rhode Island return if the return has not yet been filed. If a 2017 Rhode Island return has already been filed, an amended return must be filed that includes RI Schedule 965. The federal

“IRC 965 Transition Tax Statement” must be included with the RI Schedule 965. Upon request, the taxpayer must provide additional documentation to verify 965 Income and other relevant information. Please see the RI Schedule 965’s instructions for additional information related to filing the schedule.

15.11 Penalty Relief

The Tax Administrator will consider requests to waive tax penalties to the extent they are attributable to 965 Income. To request penalty relief, taxpayers must submit a written penalty waiver request to the Tax Administrator.