



INFORMATION NOTICE
CORPORATION TAXES AND PERSONAL INCOME TAX
2018-1: Tax Cuts and Jobs Act of 2017
April 20, 2018

I. Purpose

On December 22, 2017, President Trump signed into law Public Law 115-97, which was originally referred to as the Tax Cuts and Jobs Act of 2017 (“2017 Tax Reform”).¹ The 2017 Tax Reform changed certain international tax provisions, in part, by introducing a Repatriation Transition Tax (“RTT”) in section 965 of the Internal Revenue Code of 1986 (the “IRC”). This Information Notice discusses the application of the RTT to Corporate Net Income Tax (“CNIT”) and Personal Income Tax (“PIT”).

II. Repatriation Transition Tax

The 2017 Tax Reform imposed a tax on untaxed earnings and profits (“E&P”) of foreign corporations accumulated after 1986 and prior to 2018.² For most taxpayers, the income subject to RTT is taxed in the last tax year beginning before January 1, 2018.

The RTT also includes a deduction (referred to as the “RTT Deduction”) that effectively reduces the federal tax on the repatriated income from 35% to either 15.5% or 8%, depending on whether the E&P relates to cash and cash equivalents or other assets.³

Most taxpayers may elect to pay their RTT tax liability over eight years.⁴ Real estate investment trusts described in section 856 of the Code (“REITs”) are subject to a special rule: They

¹ The title of the Tax Cuts and Jobs Act of 2017 was changed to “An Act to provide for reconciliation pursuant to title II and V of the concurrent resolution on the budget for fiscal year 2018” in order to satisfy Senate procedural requirements.

² The earnings are included in the income of a U.S. shareholder on the last day of the last taxable year of the foreign corporation that began before January 1, 2018. IRC § 965(a).

³ See IRC § 965(c).

⁴ See IRC § 965(h).

may elect to defer the income under section 965 and the RTT Deduction over an eight-year period.⁵ Corporations other than REITs may defer the liability with respect to RTT over eight years. REITs, on the other hand, recognize the net income with respect to RTT over an eight-year period.

On March 13, 2018, the Internal Revenue Service (“IRS”) issued Internal Revenue Service News Release IR 2018-53 (the “IRS Notice”), which provided additional information to help taxpayers with the RTT filing and payment requirements. The IRS Notice specified that taxpayers with RTT must include the gross income with respect to the RTT (“RTT Income”) and RTT Deduction on Form 965—Transitional Tax Statement (the “RTT Statement”).⁶ This means RTT Income and the RTT Deduction will not be included in federal taxable income before special deductions and the net operating loss deduction; rather RTT Income and the RTT Deduction will be included on the RTT Statement, the net tax of which is shown on Schedule J of Form 1120.

III. Application of the Repatriation Transition Tax to Corporate Net Income Tax

A. RTT Income is subject to CNIT

Pennsylvania law provides that a corporation’s CNIT base begins with “taxable income . . . as returned to and ascertained by the federal government . . .”⁷ The IRC defines “taxable income” as gross income less certain deductions provided in the IRC.⁸ Thus, Pennsylvania law incorporates by reference the IRC provisions used to calculate taxable income for federal purposes.⁹ The regulations clarify the term “taxable income” as it states:

[a]s used in this chapter, the term ‘*taxable income*’ means ‘*Federal taxable income before net operating loss deduction and special deductions*’ . . . as returned to and ascertained by the Federal government and as modified or adjusted under section 401(3)1. of the TRC . . . unless the context clearly indicates otherwise.”¹⁰

⁵ See IRC § 965(m).

⁶ See Q3 of the IRS Notice. . .

⁷ 72 P.S. §7401(3)1.(a).

⁸ See IRC § 63(a).

⁹ See *Commonwealth v. Rohm and Haas Co.*, 368 A.2d 909, 912 (Pa. Cmwlth. 1977), *aff’d sub nom. Commonwealth v. Westinghouse Electric Co.*, 386 A.2d 491 (Pa. 1978), appeal dismissed, 439 U.S. 805 (1978).

¹⁰ 61 Pa. Code § 153.11 (definition of “taxable income”).

The RTT is a tax imposed upon U.S. shareholders of certain foreign corporations.¹¹ For federal income tax, RTT Income is included in the U.S. shareholder's subpart F income. Subpart F income is included in the definition of federal taxable income. Accordingly, RTT Income is subject to CNIT because it is part of federal taxable income.

The fact that RTT Income and the RTT Deductions are not included in "federal taxable income before net operating loss deduction and special deductions" does not exclude RTT Income and RTT Deductions from CNIT. In fact, the regulation specifically allows the starting point to calculate CNIT to differ from federal taxable income before net operating loss deduction and special deductions where "the context clearly indicates otherwise."¹² This is an instance where the context clearly indicates otherwise. The RTT Statement incorporates RTT Income and the RTT Deduction into federal taxable income. Thus, RTT Income is included in the definition of federal taxable income before net operating loss deduction and special deductions.

B. The RTT Deduction is Included in the State Tax Base

The RTT Deduction also provides a separate deduction from the RTT. Whether or not the RTT Deduction is deductible for CNIT depends upon whether the RTT is a "special deduction" for federal income tax purposes. If the RTT Deduction is treated as a "special deduction," the corporate taxpayer is not entitled to the RTT Deduction in calculating CNIT.

Special deductions are those deductions set forth in Part VIII of the IRC. The RTT Deduction is not a special deduction because it is imposed by IRC section 965, which is not contained within the special deduction provisions of the IRC. Thus, the RTT Deduction is included in determining the state tax base. The RTT Deduction reduces the RTT Income, and the resulting amount is referred to as the "Net RTT Income".

C. Net RTT Income is subject to a Pennsylvania Dividends Received Deduction

Pennsylvania law allows an additional deduction for corporations that receive dividends from a foreign corporation ("PA DRD").¹³ The PA DRD is a specific deduction from federal

¹¹ See IRC § 965(a).

¹² 61 Pa. Code § 153.11 (*emphasis added*).

¹³ See 72 P.S. § 7401(1)(b).

taxable income, the amount of which is the same percentage as the federal dividends received deduction for dividends received from a domestic subsidiary.¹⁴ Subpart F income is a dividend for CNIT purposes.¹⁵ The Department of Revenue treats Net RTT Income as a subpart F income and therefore also treats Net RTT Income as a dividend for CNIT. Accordingly, Net RTT Income is also subject to a PA DRD, which is a percentage of Net RTT Income.

D. Treatment of RTT Income for Apportionment Purposes

For apportionment purposes, no portion of the RTT Income is included in the corporation's sales factor because RTT Income is treated as a dividend for CNIT and dividends are excluded from the sales factor.¹⁶ To be sure, if the RTT Income is classified as a dividend and thus subject to a PA DRD, it must also be classified as a dividend for the sales factor.

E. Deferral of RTT Liability

The 2017 Tax Reform allows taxpayers to elect to pay the RTT liability over eight years. This election is not applicable for CNIT, except in the case of REITs, because the federal election defers the taxpayer's RTT liability but has no effect on its federal taxable income. However, for REITs that elect to defer income inclusions under section 965(m) of the IRC, its RTT Income and RTT Deduction will be included in their CNIT as those amounts are subject to federal income tax.

F. Examples

The following examples illustrate how RTT Income, the RTT Deduction, and the PA DRD work together.

Illustration 1: Assume Corporation A is a calendar year taxpayer that owns 100% of FC1, which is foreign corporation. Also assume dividends from a wholly-owned domestic subsidiary receive a 100% dividends received deduction for federal corporate income tax. At the end of its 2017 tax year, FC1 has \$1,000,000 of post 1986 E&P.

Here, as shown below, the RTT has no effect on Corporation A's CNIT.

¹⁴ See IRC § 246 (federal dividends received deduction).

¹⁵ See *Commonwealth v. Emhart Corp.*, 278 A.2d 916 (Pa. 1971).

¹⁶ See 72 P.S. § 7401(2)1.(E) (“‘Sales’ means all gross receipts of the taxpayer not allocated under this definition other than dividends received . . .”).

	Corporation A
RTT Income	1,000,000
RTT Deduction	(557,143)
	442,857
PA DRD	(442,857)
CNIT Tax Base Before Apportionment	-

Corporation A's federal taxable income is increased by \$1,000,000—the amount of its RTT Income. Corporation A's RTT Deduction equals \$557,143.¹⁷ Thus, Corporation A's Net RTT Income increased its federal taxable income by \$442,857. Corporation A's federal taxable income is further reduced with a PA DRD in the amount of \$442,857.¹⁸

Illustration 2: Assume Corporation B is a calendar year taxpayer that owns 50% of FC2, which is a foreign corporation. Also assume dividends from a 50%-owned domestic subsidiary, as of the time of the RTT inclusion, are eligible for an 80% dividends received deduction for federal corporate income tax purposes. At the end of its 2017 tax year, FC2 has \$1,000,000 of post 1986 E&P.

As shown below, the RTT increased Corporation B's CNIT base by \$88,571.

	Corporation B
RTT Income	1,000,000
RTT Deduction	(557,143)
	442,857
PA DRD	(354,286)
CNIT Tax Base Before Apportionment	88,571

Corporation B's federal taxable income is increased by \$1,000,000—the amount of its RTT Income. Corporation B's RTT Deduction equals \$557,143.¹⁹ Thus, Corporation A's Net RTT

¹⁷ Assuming RTT applies at 15.5%, the RTT Deduction is calculated as follows: $1 - (15.5\% / 35) = .5571428$ x \$1,000,000 = \$557,143. The purpose of the RTT Deduction is to reduce the federal income tax rate from 35% (the corporate tax rate for 2017) to 15.5%. The Tax Cuts and Jobs Act decreased the federal corporate income tax rate from 35% to 21% for tax years beginning in 2018.

¹⁸ $(100\% \times [\$1,000,000 - 557,143]) = 442,857$.

¹⁹ $1 - (15.5\% / 35) = .5571428$ x \$1,000,000 = \$557,143.

Income increased its federal taxable income by \$442,857. Corporation B's federal taxable income is further reduced with a PA DRD in the amount of \$354,286²⁰. Thus, the RTT increased Corporation A's CNIT base by \$88,491.

IV. Application of Repatriation Transition Tax to Personal Income Tax

PIT is imposed on eight separate classes of income, one of which is dividends. For PIT purposes, a dividend is defined as a distribution in cash or property made out of current or accumulated E&P. The RTT is imposed even though no actual distribution of cash or property out of E&P occurs. Because this "deemed dividend" does not involve an actual distribution of cash, it is not a dividend for PIT purposes. If and when an actual distribution of cash out of E&P is made to a PIT taxpayer, it will be subject to PIT as a dividend. PIT taxpayers must report this taxable dividend income regardless of whether they receive a Form 1099-DIV with respect to the actual distribution.

Pass-through entities required by the IRS to report the RTT on Schedule K, line 11 (Form 1065) or line 10 (Form 1120S) as other income should adjust this income out of the Pennsylvania tax base by using Schedule M of the PA-20S/PA-65. Specifically, the income included on Schedule K, line 11 (Form 1065) or line 10 (Form 1120S) will be reported on Schedule M, Part A, line 11, column (a), classified as business income under column (b) and then backed out by reporting the income on Schedule M, Part B, Section C, line d. A statement explaining this adjustment should accompany the return. When an actual distribution of cash out of E&P is made to the pass-through entity, it should be reported on Schedule B, line 5 of the PA-20S/PA-65.

V. Filing Requirements

The Department intends to issue additional guidance for corporate taxpayers by way of a worksheet to guide taxpayers on the adjustments required to modify its federal taxable income before net loss deduction and special deduction to include RTT Income, the RTT Deduction, and the PA DRD.

Many taxpayers filed their 2017 tax returns before the Department issued this Information

²⁰ \$442,857 x 80%=\$354,286.

Notice. Those taxpayers should amend their income tax returns to report their Net RTT Income. No interest or penalties will be imposed to the extent amended tax returns are filed prior to November 15, 2018, and the amendment reflects only the changes necessary to report Net RTT Income in the manner described in this Notice. Such an amended tax return will result in an extension of the statute of limitations for the Department's authority to adjust the taxpayer's liability relating to Net RTT Income to three years from the date of filing the amended tax return. The statute of limitations will not be extended for other items on the originally filed return.