Changes to the Dividend Exclusion and the Historic Ordering of Net Operating Losses, the Dividend Exclusion, and the International Banking Facility Deduction

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Tax: Corporation Business Tax

P.L. 2023, c. 96, which was signed into law on July 3, 2023, made a series of technical corrections, clarifications, and changes to the Corporation Business Tax Act (CBT), Gross Income Tax Act (GIT), and other miscellaneous requirements. This Technical Bulletin discusses the changes to the New Jersey Corporation Business Tax rules related to the dividend exclusion, and the historic ordering of the net operating loss deduction, dividend exclusion, and international banking facility deduction.

The New Ordering Rules

Effective for privilege periods ending on and after July 31, 2023, the dividend exclusion (DRD) and international banking facility deduction (IBF) are now calculated pre-allocation. The prior net operating loss conversion carryover deduction (PNOLs) and net operating losses/net operating loss carryovers (NOLs) are calculated post-allocation. The historic ordering limitation (preventing the DRD and IBF from increasing net operating losses) that existed from 1986 to privilege periods ending prior to July 31, 2023, is not applicable to new net operating losses. The change in historic ordering is prospective only. Taxpayers cannot adjust NOLs and PNOLs from privilege periods ending before July 31, 2023, under the provisions of P.L. 2023, c. 96.

For privilege periods ending on and after July 31, 2023, PNOLs and NOLs are subtracted after deducting the current year exclusions and deductions if the allocated entire net income is greater than zero. As a result of the change in the ordering rules, there no longer is an income limit for applying either the DRD exclusion or IBF deduction. Thus, the DRD exclusion and the IBF deduction can exceed entire net income, which may generate or increase the current year loss.

Note: NOLs are subject to the I.R.C. §172(a)(2) limitation pursuant to N.J.S.A. 54:10A-4(w).

The Dividend Exclusion

For privilege periods ending on and after July 31, 2023, the dividend exclusion is applied to entire net income after New Jersey additions but before New Jersey deductions and before the allocation of entire net income. Dividends (and deemed dividends) from 80% or more owned separate entity subsidiaries are 100% excluded. Dividends (and deemed dividends) from more than 50% but less than 80% owned separate entity subsidiaries are 50% excluded. However, N.J.S.A. 54:10A-4(k)(5)(F)(ii) requires the exclusion to be reduced by 5% of all dividends (and deemed dividends) received by the taxpayer during the privilege period.

Note: Beginning with privilege periods ending on and after July 31, 2023, GILTI is treated as a dividend for New Jersey purposes and can be included in the DRD, if applicable. No IRC § 250 deduction is allowed for either GILTI or FDII. FDII is not a dividend and is not included in the DRD. See TB-110, *Corporation Business Tax GILTI Treatment for Privilege Periods Ending After July 31, 2023,* for more information.

Dividends (and deemed dividends) distributed between combined group members that are included in the same New Jersey combined return are eliminated. The claw-back provision in N.J.S.A. 54:10A-4(k)(5)(F)(ii) does not apply to intercompany dividends (and deemed dividends) between members of the same group filing a New Jersey combined return.

Dividends and Deemed Dividends Received by a Non-U.S. Corporation

Separate Return, Water's-Edge, and Affiliated Group Filers – There are 2 situations in which the DRD cannot be utilized by a non-U.S. corporation that receives dividends (and deemed dividends) from its separate return subsidiaries. First, if the non-U.S. corporation was formed in a foreign nation that has an income tax treaty with the U.S., and under the terms of the treaty those dividends (and deemed dividends) are excluded from income for federal tax purposes and New Jersey purposes, the DRD cannot be utilized. Second, if the non-U.S. corporation's dividends (and deemed dividends) are not part of its effectively connected income, the DRD cannot be utilized. When dividends (and deemed dividends) are not included in the non-U.S. corporation's entire net income, the non-U.S. corporation cannot include them as part of the DRD.

World-wide Group Filers – If a non-U.S. corporation receives dividends (and deemed dividends) from its separate return subsidiaries, the DRD is applicable to these dividends (and deemed dividends) on a return in which the non-U.S. corporation is a member of a combined group that elected to file on a worldwide group basis. This is a result of N.J.S.A. 54:10A-4(kk), which requires that a non-U.S. corporation include all of its world-wide income in the entire net income of the combined group, including its income that is otherwise protected by a treaty.