Maryland Income Tax

Tax Alert

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Maryland Guidance on the Reporting and Taxation of IRC §965 Repatriation Income for Tax Year 2017

The Tax Cuts and Jobs Act (TCJA) created a new provision under Internal Revenue Code (IRC) Section 965 requiring certain taxpayers with untaxed foreign earnings and profits to pay tax as if those earnings had been repatriated to the United States beginning in tax year 2017. TCJA imposes a one-time transition tax on these untaxed, accumulated foreign earnings for any U.S. shareholder of any controlled foreign corporation (CFC) or other foreign corporation that is at least 10% owned by a domestic corporation. The amounts are included in a taxpayer's gross income as Subpart F income. The provision will increase federal taxable income; however, the Maryland subtraction modification for foreign dividends will exclude a portion of the increase from Maryland adjusted gross income for certain qualifying taxpayers.

Is repatriated income included in Maryland taxable income?

Repatriated income reported at the Federal level must be reported at the Maryland level. Maryland law provides any amendment to the Internal Revenue Code enacted in the same calendar year as the tax year that the amendment affects will not impact the calculation of Maryland taxable income. *See* §10-108 of the Tax General Article of the Annotated Code of Maryland. (TG) However, Maryland taxable income will include the amendment to the Internal Revenue Code if the Comptroller determines that the impact of the amendment on State income tax revenue is less than $5,000,000. The Comptroller's Bureau of Revenue Estimates determined[1] the State revenue impact of the amended repatriation provision of IRC §965 will be

[1] The Bureau of Revenue Estimates (the "Bureau") did not at the time, and does not now, believe that the Repatriation Tax effective for tax year 2017 would trigger a $5.0 million impact for fiscal year 2018 so as to invoke the auto-decoupling provision as set forth in Tax-General Article § 10-108, Annotated Code of Maryland. See letter from Andrew M. Schaufele, Bureau of Revenue Estimates to the Honorable Lawrence J. Hogan, Honorable Thomas Miller, Jr., and Honorable Michael E. Busch dated February 16, 2018 describing the minimal revenue impact of federal tax changes related to international tax reform in the TCJA, available at: https://finances.marylandtaxes.gov/static_files/revenue/federalimpact/60_Day_Report_HR_BP%202018.pdf. For corporate income tax, the existing subtractions from income for most related foreign dividends as set forth in Tax General Article § 10-307 (b), (c), and (d) would eliminate the majority of repatriated dollars from State taxation. For individual income tax, the Senate's version of the TCJA was not known until early December and the final bill was not passed by Congress until December 15, 2017 (signed into law on December 22, 2017). Given the late passage of the bill and the uncertainty surrounding the Treasury Department's treatment of this income, as well as the impact from myriad other provisions, the Comptroller does not expect taxpayers to take account of this impact

less than $5,000,000, which does not trigger the decoupling provision. Therefore, such income is included in the calculation of Maryland taxable income.

As a conformity state, Maryland complies with federal law unless Maryland law provides otherwise. Under the TCJA, §965 post-1986 repatriated income is included in federal taxable income. Maryland has not enacted legislation that would exclude §965 income from Maryland taxable income; therefore, to the extent applicable, it must be included on Maryland Forms 502, 510, 500, or 504. Maryland law provides a subtraction modification for corporations that receive dividends if: (1) the receiving corporation owns, directly or indirectly, 50% or more of the paying corporation's outstanding shares of capital stock; and (2) the paying corporation is organized under the laws of a foreign government. TG §10-307.

Who has repatriated income under §965 of the Internal Revenue Code?

U.S. shareholders subject to the repatriation provision of §965 include domestic corporations, individuals, S corporations, partnerships, estate, trusts, cooperatives, REITs, RICs and tax-exempt organizations. Notably, all U.S. shareholders of a CFC previously filing a Form 5471 should determine if there is an obligation to file and pay the tax under §965 for 2017. Note, however, that even if a United States shareholder has not previously filed Form 5471, the U.S. shareholder may be subject to tax under §965. If the U.S. shareholder has repatriated income reported at the federal level, it will flow through to the Maryland returns.

How does repatriated income impact the Maryland income tax returns?

Taxpayer Type	**Maryland Form**	**Federal Form**	**Effect on Maryland Form**	**Subtraction Modification**
Individual	502	1040	To the extent §965 (a) income is included on Line 21, Other Income, of Form 1040, it will flow through to the Maryland return on Line 1 of Form 502. Note the 965(c) deduction is reflected on Line 1 of Form 502 because Line 21 of Form 1040 reports the net §965 amount	N/A

for State purposes until the tax year 2017 extension deadline in fiscal year 2019. The Bureau does not have any data for either the amount of overseas income that is recognized and taxed in Maryland on an annual basis nor the amount that is held overseas awaiting more favorable treatment. Relative to the magnitude of the income tax, the impact is assumed to be *de minimus*.

			(§965(a) less §965(c) deduction).	
S Corporation	510	1120S	For federal tax purposes, §965 (a) income is reported as "other income" on the shareholders' pro rata share of income, and any §965(c) deduction is reported as "other deductions" on the shareholders' pro rata share of deductions. Additional information is provided to the shareholders with the federal Schedule K-1. For Maryland tax purposes, the net §965 amount (§965(a) less §965(c) deduction) should be reported on Line 2 of Maryland Form 510. The taxpayer must submit a written statement or footnote on the Maryland Schedule K-1 showing the net §965 amount calculation.	N/A
C Corporation	500	IRC 965 Transition Tax Statement	The net §965 amount must be included in Line 1a of Maryland Form 500.[2] IRC 965 Transition	TG §10-307 provides a subtraction modification for dividends received from corporation if: (1)

[2] Maryland imposes tax upon a taxpayer's federal taxable income, as defined and determined pursuant to the Internal Revenue Code (IRC), subject to any modification required or allowed pursuant to Maryland law. Pursuant to TG 10-304 Maryland modified income of a corporation is the corporation's federal taxable income for the taxable year as determined under the IRC. IRC § 63 defines "taxable income" as "gross income minus the deductions" allowed under federal law. The gross income of a taxpayer who is a shareholder in a controlled foreign corporation includes the taxpayer's pro rata share of corporation's subpart F income. IRC § 951(a)(1). Subpart F

			Tax Statement must be attached to Form 500.	the receiving corporation owns, directly or indirectly, 50% or more of the paying corporation's outstanding shares of capital stock; and (2) the paying corporation is organized under the laws of a foreign government.
Partnership	510	1065	For federal tax purposes, §965 (a) income is reported as "other income" on the shareholders' pro rata share of income, and any §965(c) deduction is reported as "other deductions" on the shareholders' pro rata share of deductions. Additional information is provided to the shareholders with the federal Schedule K-1. For Maryland tax purposes, the net §965 amount (§965(a) less §965(c) deduction) should be reported on Line 2 of Maryland Form 510. The taxpayer must submit a written statement or footnote on the Maryland Schedule K-1 showing the calculation of the net §965 amount.	N/A
Fiduciary	504	1041	If the net §965 amount is distributed to the beneficiary, it is included on Line 8, Other Income,	N/A

income includes accumulated post-1986 deferred foreign income deemed repatriated pursuant to federal tax reform legislation. IRC § 965(a).

			of Form 1041. The net §965 amount flows through to Maryland Form 504 on Line 1. If the net §965 amount is not distributed to the beneficiary, it must be included on Line 1 of the Maryland Form 504.	

What if inclusion of repatriated income causes distortion in the Maryland apportionment formula?

If the taxpayer asserts the apportionment formula does not fairly reflect the income attributable to Maryland, it may request an alternative apportionment method. Requests for alternative apportionment must be in writing, propose the alternative apportionment calculation, and must include a copy of the Maryland income tax return and the IRC 965 Transition Tax Statement. The request for alternative apportionment should be submitted at the time the return is filed. If the return has already been filed, taxpayers may still submit the request for alternative apportionment for review. Requests for alternative apportionment should be mailed to:

Comptroller of Maryland
Attn: Legal Section
PO Box 1829
Annapolis, MD 21404-1829

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