Revenue Ruling 24-21-1
Corporate Income Tax

February 17, 2021

Subpart F Income

Issue

To what extent does Subpart F income qualify as a dividend or deemed dividend for purposes of the Nebraska dividend and deemed dividend deduction from federal adjusted gross income, or for corporations and fiduciaries federal taxable income?

Conclusion

Subpart F income is not categorically a dividend or deemed dividend. However, those portions of Subpart F income that are dividends or deemed dividends can be deducted from federal adjusted gross income or federal taxable income pursuant to the Nebraska dividend and deemed dividend deduction.

Analysis

The rules concerning Subpart F income in the Internal Revenue Code (IRC), Subt. A, Ch. 1, Subch. N, Pt. III, Subpt. F, were first enacted as part of the Revenue Act of 1962, and were significantly expanded as part of the Tax Reform Act of 1986. Subpart F income provisions eliminate deferral of U.S. tax on certain categories of foreign income by taxing U.S. persons that own 10% or more of a controlled foreign corporation (CFC) on their pro rata share of some income of the CFC. Subpart F provisions require the shareholders of CFCs to include in gross income their pro rata share of the CFC's income. Nebraska law allows a deduction from federal adjusted gross income, or for a corporation or fiduciary federal taxable income, for dividends received or deemed to be received from corporations that do not meet the requirements of IRC § 243. Neb. Rev. Stat. §§ 77-2716(5) and 77-2734.04(23).

Nebraska law does not define the term "dividend or deemed dividend." However, for purposes of Nebraska income tax, terms "have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required." Neb. Rev. Stat. § 77-2714. The IRC defines dividend as "any distribution of property made by a corporation to its shareholders…" IRC § 316. "[A]ctual dividends require a distribution by a corporation and receipt by the shareholder." *Rodriguez v. C.I.R.*, 722 F.3d 306, 309 (5th Cir. 2013). "There must be a change in ownership of something of value." Id. Subpart F inclusions "exist specifically to account for instances where CFCs do not make transfers of value to shareholders." *Id.* at 310. Because the Subpart F inclusions do not involve any distribution or change in ownership, the inclusions are not actual dividends. *Id.* There are instances where Congress will authorize items of income to be treated as a dividend. *Id.* at 311. However, "when Congress decides to treat certain inclusions as dividends, it explicitly states as much." *Id.* See IRC § 851(b) language stating inclusions "shall be treated as dividends." There are no statutory provisions which deem Subpart F income, as a whole, to be a dividend. This statutory silence combined with the instances in which the statutory language deems other items of income to be treated as dividends supports the DOR determination that Congress did not intend that Subpart F income, as a whole, be treated as a dividend. *Id.* at 311. Subpart F income, as a whole, is neither a dividend nor deemed dividend under federal law. *Id.* at 309. Consequently, it is also not a dividend or deemed dividend under Nebraska law.

Some Subpart F inclusions are specifically deemed to be dividends in the IRC. They are as follows:

- IRC § 964(e)(4) gains on the sale or exchange by a CFC of stock in another foreign corporation. For tax year 2019, this is reported on line 16a, Schedule C, Form 1120.
- IRC § 245A(e)(2) hybrid dividends. For tax year 2019, this is reported on line 16b, Schedule C, Form 1120.
- IRC § 954(c)(1)(A) Foreign Personal Holding Company dividends. For tax year 2019, this is included on line 16c, Schedule C, Form 1120.

Because Nebraska law follows the IRC's dividend designations, the gross income reported under these subsections are dividends or deemed dividends for purposes of the Nebraska dividend and deemed dividend deduction provided in Neb. Rev. Stat. § 77-2716(5).

In addition to the Foreign Personal Holding Company dividends, line 16c, Schedule C, Form 1120 includes "[o]ther inclusions from CFCs under Subpart F." Therefore, Nebraska deductions for Foreign Personal Holding Company dividends included on line 16c, Schedule C, Form 1120 must be specifically identified on the Nebraska Schedule II, Form 1120N. To claim the Nebraska dividend deduction for Foreign Personal Holding Company dividends, taxpayers must attach Worksheet A, Schedule I, Form 5471 to the Form 1120N as well as documents or worksheets that specifically identify the amount of Foreign Personal Holding Company dividends claimed.

Any deduction for Subpart F income claimed as a dividend or deemed dividend other than those specifically designated above will be disallowed.

Apportionment

If a corporate taxpayer is taxable in Nebraska and one or more other states, the income of the corporate taxpayer must be apportioned to Nebraska based on the Nebraska receipts as compared to all receipts as provided by Neb. Rev. Stat. §§ 77-2734.05 to 77-2734.15. The entire federal taxable income of a corporate taxpayer is subject to apportionment except for "adjustments required to be made under the Nebraska Revenue Act of 1967." Neb. Rev. Stat. § 77-2734.06. The sales factor shall not include any "sales that are a part of the production of income that is not subject to apportionment." Neb. Rev. Stat. § 77-2734.10(4). Sales includes all gross receipts of the taxpayer. Neb. Rev. Stat. Neb. Rev. Stat. § 77-2734.04(20). Thus, the denominator of the sales factor should include the Subpart F income included in gross income of the corporate taxpayer and exclude the part of Subpart F income that is deducted as dividends received or deemed received pursuant to the Neb. Rev. Stat. § 77-2716(5).

Under Subpart F income provisions, a U.S. shareholder of a CFC computes an amount of the CFC's income that must be included in its gross income. Subpart F income provisions do not define the income as a sale of tangible personal property. Therefore, Subpart F income is sourced to Nebraska under the provisions for sales other than sales of tangible personal property. Sales other than sales of tangible personal property are in the numerator of the sales factor as provided in Neb. Rev. Stat. § 77-2734.14(3)(a) through (k). Subdivisions (a) through (j) deal with sales of services, interest and dividends from intangible assets held in connection with a treasury function, interest and fees from loans, credit cards and other financial instruments, and licenses and rentals. Those subdivisions do not address the sourcing of Subpart F income. Subdivision (k) states "Sales other than sales of tangible personal property not specifically addressed in this subsection must be sourced so as to fairly represent the extent of the taxpayer's business activity in this state." In the event that there is not a way to identify how much activity, that results in Subpart F income, is associated with Nebraska to "fairly represent the extent of the taxpayer's business activity in this state," then taxpayers must include Subpart F income in their sales factor denominator, and exclude this income from their sales factor numerator. See Neb. Rev. Stat. § 77-2734.14(3)(k). All other items of income must be apportioned according to the provisions of Neb. Rev. Stat. §§ 77-2734.01 through 77-2734.14 and the regulations adopted thereunder.

For information on the treatment of 965 repatriated income and GILTI, see GIL 24-19-1, Income Tax: Section 965 Transition Tax For Tax Year 2017, and GIL 24-20-1, Income Tax: Global Intangible Low-Taxed Income and Foreign-Derived Intangible Income.

APPROVED:

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Tax Commissioner
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