STATE OF MAINE
KENNEBEC, ss.

MAINE BOARD OF TAX APPEALS
DOCKET NO. BTA-2023-2

[CORPORATE TAXPAYER],

Petitioners

v.

DECISION

MAINE REVENUE SERVICES,

Respondent

[Corporate Taxpayer] and its Maine-nexus unitary affiliates (the "Company") appeal from a decision on reconsideration by Maine Revenue Services ("MRS") which determined that, for tax year 2017, twenty percent (20%) of the Company's deferred foreign income under I.R.C. § 965 was subject to Maine income tax and not eligible for alternative apportionment under the Augusta Formula pursuant to 36 M.R.S. § 5200-A. The Company disagrees. We uphold the assessment in full.

I. Background

At all relevant times, the Company was a multinational corporation doing business in more than 200 countries and every state, including the State of Maine. Further, a part of the Company's unitary group was a Maine corporation.

In 2017, Congress enacted the Tax Cuts and Jobs Act ("TCJA") Pub. L. No. 115-97, 131 Stat. 2054 (2017), which made extensive changes to the manner in which the federal government taxed the income of domestic corporations with foreign operations. Relevant to this appeal, the TCJA required a one-time repatriation of deferred foreign income ("DFI").

In 2021, MRS commenced a field audit of the Company's 2017 through 2019 Maine corporate income tax returns. The Company determined that it was entitled to exclude its entire

2017 repatriated DFI of [amount] from its Maine net income through the factor relief provided by the "Augusta Formula." On audit, MRS determined that 20% of that amount, or [amount] must be included in the Company's Maine net income and that the Company is not eligible for relief under the Augusta Formula. Following the audit, MRS assessed corporate income tax and interest against the Company in the total amounts of [amount] and [amount], respectively. On reconsideration, MRS upheld the assessment in full. The Company timely appealed.

On appeal, the Company argues that MRS erred in the computation of the "worldwide" and "dividend exclusion" "legs" of the "Augusta Formula" by including 100% of its DFI in both "legs." In contrast, MRS argues the Augusta Formula does not apply to the Company's 2017 DFI. It is the Company's burden to show that they are entitled to the relief they seek. 36 M.R.S. § 151-D(10)(F). We consider the matter on appeal de novo. *Id.* § 151(2)(G).

II. Law

Annually, Maine imposes a tax on the Maine net income of "each group of corporations that derives income from a unitary business carried on by two or more members of an affiliated group." 36 M.R.S. § 5200(1). The Maine net income with respect to a unitary business carried on by two or more members of an affiliated group, "means the taxable income of the unitary business under the laws of the United States as modified by section 5200-A and apportionable to this State under chapter 821." *Id.* § 5102(8).

A corporation having income from business activity taxable both within and without Maine must determine the amount of its federal taxable income apportionable to Maine by multiplying its Maine net income by the "sales factor," that is, a fraction, the numerator of which is the total sales of the taxpayer in this State during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the period. *Id.* § 5211(1), (8), (14). However, if apportionment provisions of section 5211:

> do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the tax assessor may require, in respect to all or any part of the taxpayer's business activity, if reasonable. . . [t]he employment of any other method to effectuate an equitable apportionment of the taxpayer's income.

Id. § 5211(17)(D)

A. Historical Origin of the Augusta Formula[1]

MRS developed the Augusta Formula pursuant to its discretionary authority under section 5211(17) following the 1991 mandate of the Law Court in *Tambrands, Inc., v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991), which directed MRS to develop an apportionment formula that would fairly represent a taxpayers business activity within this state, consistent with due process. *Id.* at 1045. The Augusta Formula applies a water's edge method and a worldwide combined method, with foreign source dividends included in the corporation's apportionable business income.

Under the Augusta formula, MRS

> (A) Determines the Taxpayer's taxable income using Maine's statutory water's edge method with foreign source dividends included in the taxpayer's apportionable business income [the "statutory leg"].
>
> (B) Determines the Taxpayer's taxable income using the worldwide combined reporting method (the "worldwide leg").
>
> (C) Determines the Taxpayer's taxable income using Maine's statutory water's edge method without foreign source dividends included in the taxpayer's apportionable business income (the "dividend exclusion leg" [or floor]).

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[1] MRS issued a Maine Tax Alert entitled "Maine Tax Treatment of Federal Deferred Foreign Income." (Maine Tax Alert, Vol. 28, Issue 11, October 2018). In part, the 2018 Tax Alert provided:

> Under Maine tax law, as last amended by PL 2017 c. 474 . . . accumulated post-1986 deferred foreign income is subject to Maine income tax. . . . For taxable corporations, Maine law allows a deduction equal to 80% of the apportionable DFI, net of foreign earnings and profits (E&P) deficit deduction (IRC § 965(b)), that is included in federal gross income.

The Tax Alert further noted that the "deduction for 80% of deferred foreign income . . . must be excluded from the sale factor apportionment calculation on Form 1120ME, Schedule A, line 1, or any other apportionment formula employed to attribute income to Maine."

The result of calculation A becomes a cap, the result of calculation C becomes a floor, and the Assessor determines taxable income in the following manner: if,

> B>A: The taxpayer pays the amount calculated under Maine's water's edge statute with foreign subsidiaries dividends included and no factor relief;
>
> B<C: The taxpayer pays the amount calculated under Maine's water's edge reporting method with the foreign subsidiaries dividends excluded and no factor relief;
>
> A>B>C: The taxpayer pays the amount calculated under the worldwide reporting method and the Assessor provides factor relief, i.e., adjusts the denominators of the payroll, sales, and property factors to account for the inclusion of the foreign subsidiaries' dividends to reach this result.

In 1996, the Law Court upheld the Assessor's application of the Augusta Formula in determining corporate income tax liability. *E.I. Du Pont de Nemours & Co. v. State Tax Assessor*, 675 A.2d 82, 84 (Me. 1996). Specifically, the Court found that application of the Augusta Formula ensured that the Company's tax liability fairly represented its business activity in the State of Maine, consistent with constitutional due process. *Id.* at 89. The Court opined as follows regarding the challenges inherent in apportioning foreign source dividends:

> A state is faced with an almost impossible task in assuring that a multijurisdictional business shoulders its fair share of the burden of taxation. The United States Supreme Court has noted that arriving at precise territorial allocations of "value" is often an elusive goal both in theory and in practice, *Container Corp. of America v. Franchise Tax Bd.,* 463 U.S. 159, 182, 77 L. Ed. 2d 545, 103 S. Ct. 2933 (1983), and hence, rough approximation rather than precision is sufficient as a matter of practical tax administration. *International Harvester Co. v. Evatt,* 329 U.S. 416, 422, 91 L. Ed. 390, 67 S. Ct. 444 (1946). Indeed, "every method of allocation devised involves some degree of arbitrariness." *Barclays Bank v. Franchise Tax Bd.,* 114 S. Ct. 2268, 2269, 129 L. Ed. 2d 244, 253 (1994).

Id. at 90. The Court concluded, "[t]he Augusta Formula's use of the worldwide combined reporting method as a check on the tax assessed on the income of a multijurisdictional corporation with foreign subsidiaries was an appropriate response to our mandate in *Tambrands.” Id.* at 91.

B. Tax Cuts and Jobs Act

Prior to the 2017 enactment of the TCJA, the federal government utilized a “worldwide” system of taxation whereby domestic corporations were taxed on their worldwide income, regardless of where the income was generated. Domestic corporations that controlled foreign corporations, however, generally were not taxed on the earnings from those foreign corporations unless those earnings were distributed, with certain exceptions. *See* 26 U.S.C. §§ 951-965 (2007).[2]

> The TCJA replaced the system of worldwide federal income taxation with: a territorial system, where corporations are generally taxed only on their domestic source profits. *As part of this change, the TCJA created a new, one-time tax: the [Mandatory Repatriation Tax (“MRT”)]. The MRT modified Subpart F by classifying [controlled foreign corporation] earnings after 1986 as income taxable in 2017. See 26 U.S.C. §§ 965(a), (d) (2017)*. (Emphasis added).

Moore v. United States, 36 F.4th 930, 933 (9th Cir. 2022), cert. granted, 2023 WL 4163201 (June 26, 2023). The federal MRT on deferred foreign income eliminated, in part, the windfall that U.S. corporations with foreign holdings would have otherwise received when the TCJA ended the worldwide system. The TCJA, however, included benefits for shareholders of controlled foreign corporations, including the elimination of other taxes on undistributed earnings and profits. *Id.* In addition, under the TCJA, deferred foreign income was taxed at reduced rates, and the federal income tax due under the MRT could be paid in interest-free installments over eight years. See 26 U.S.C. §§ 965(c) (h) & (i).

C. Maine’s Response to TCJA

[2] It was estimated in 2015 that $2.6 trillion in offshore earnings controlled by U.S. corporations was not subject to U.S. taxation. *Moore v. United States*, 36 F.4th 930, 933 (9th Cir. 2022), cert. granted, 2023 WL 4163201 (June 26, 2023); see also H.R. Rep. No. 115-409, at 375 (2017) (domestic corporations that did not reinvest foreign earning in the U.S. “have accumulated significant untaxed and undistributed foreign earnings”).

In response to the TCJA, in 2018, the Maine Legislature enacted "An Act to Conform to the United States Internal Revenue Code of 1986 and Provide Tax Relief to Maine Families," (the "2018 Maine Act") which became effective, on an emergency basis, on September 12, 2018. P.L. 2017, ch. 474. The 2018 Maine Act added the following subsection to 36 M.R.S.A. § 5200-A(2), which identifies amounts to be subtracted from the "taxable income of the taxpayer under the laws of the United States" in calculating Maine's corporate income tax:

> DD. An amount equal to 80% of the apportionable deferred foreign income that the taxpayer included in federal gross income during the taxable year in accordance with the Code, Section 965(a) as adjusted by Section 965(b). Any amount subtracted from federal taxable income under this paragraph must be excluded from the sales factor of any apportionment formula employed to attribute income to this State.

P.L. 2017, ch. 474, § D-3.

Testimony from the Commissioner of the Department of Administrative and Financial Services before the Joint Standing Committee on Taxation explained the rationale behind this change in Maine law:

> Part D addresses a significant—but transitional—TCJA change in international business taxation. In transitioning to a territorial corporate income tax system, the TCJA included a one-time "deemed repatriation" provision for calendar year 2017 that requires certain US shareholders—principally parent corporations—to pay taxes on the accumulated post-1986 deferred earnings and profits of their foreign subsidiaries. A new federal deduction, the "participation exemption", results in the earnings and profits being taxed at a reduced rate depending on how they are held.
>
> Part D conforms to the federal deemed repatriation but makes two important changes. First, the "participation exemption" is removed. This deduction was used at the federal level to reach specific tax rates; because Maine sets its own tax rates and applies its own dividend received subtraction, this deduction is unnecessary. Second, the "participation exemption" is replaced with a new 80% subtraction modification applied to the repatriated income. Maine has a longstanding policy of allowing a 50% subtraction modification for certain international dividends and similar income. This existing 50% subtraction modification is one of the means available under Maine

> law to address the constitutional concerns and related apportionment concerns that exist in state taxation of international transactions — that is, ensuring a framework for an overall reasonable match between the income included and the factors (such as sales) producing the income. Due to the unique nature of deemed repatriation, both in terms of the broad time frame at issue and the large amounts of funds involved, these constitutional and apportionment concerns are of increasing importance and scope. Accordingly, to address these heightened concerns, this Part proposes to raise the subtraction modification to 80% for the repatriated income.

An Act to Update References to the United States Internal Revenue Code Contained in the Maine Revised Statutes: Hearing on LD 1655 Before the J. Standing Comm. on Taxation, 128th Legis. (2018) (testimony of Alec Porteous, Commissioner of the Department of Administrative and Financial Affairs).

III. Discussion

MRS created the Augusta formula to abrogate constitutional concerns which arose out of *Tambrands* in 1991. The policy was promulgated under alternative apportionment authority of MRS. Subsequently, in response to enactment of the TCJA, in 2018, Maine enacted 36 M.R.S.A. § 5200-A(2) (DD) to conform to federal law by providing a new one-time subtraction modification applied to repatriated income, post-1986, through 2016.

In the instant case, the Company reported [amount] in DFI on its amended 2017 Maine tax return. The Company argues that this entire amount should be excluded from parts B and C of the Augusta formula. MRS argues that 20% of that figure, or [amount], must be included in parts B and C of the Augusta formula. The Company may prevail in two ways. The Company may show that MRS has acted counter to its stated policy regarding the Augusta formula. *See Corporate Taxpayer v. Me. Revenue Servs.*, BTA-2019-9 (Me. Bd. Tax App. August 19, 2020). Alternatively, the Company may show that it is entitled to the modifications it seeks because the default formula does not fairly represent the extent of its business activity in this State. 36 M.R.S.A. § 5211(17).

In support of its position, the Company argues that DFI is similar in nature to Subpart F income. However, the Board agrees with MRS that DFI under the TCJA differs significantly from the foreign-sourced income that has historically been eligible for relief under the Augusta Formula. Unlike foreign dividends (or historic Subpart F income), which ordinarily come from foreign earnings and profits earned in the year of the tax return, under the TCJA, mandatory repatriation of DFI reflects foreign subsidiaries' earnings and profits over a thirty-year period. What the Company identified as DFI in 2017 was roughly [amount] in accumulated post-1986 foreign source earnings and profits of its foreign subsidiaries that had not been previously taxed. The Maine Legislature understood the complexity of this issue and the need to address apportionment concerns when it added Section 5200-A(2)(DD) and provided taxpayers an 80% subtraction modification for deferred foreign income, as recommended by the Commissioner, and discussed above. In *Du Pont,* the Law Court reasoned that, when faced with the "almost impossible task" of fairly taxing a multijurisdictional business "rough approximation rather than precision is sufficient as a matter of practical tax administration." 675 A.2d at 90.

The Company argues that because Congress inserted the one-time mandatory repatriation tax in Section 965 within Subpart F of the Code, DFI should be treated identically to other Subpart F income. The TCJA, however did not change the definition of "Subpart F income" in 26 U.S.C. § 952; rather, it merely added language to Section 965 that "the subpart F income of a foreign corporation . . . shall be increased" by accumulated post-1986 deferred foreign income. We agree with MRS's argument that the mandatory repatriation tax in Section 965 was a 'novel concept,' *Moore*, 36 F.4th at 934, and DFI is unlike dividends and Subpart F income that historically have been eligible for factor relief under the Augusta Formula.

There is no indication in the 2018 Maine Act that Maine intended to apply any other factor relief or discount that may have applied historically in other contexts. Indeed, given the State's decision to afford a one-time 80% discount, it would be illogical to apply factor relief because the result would be more than an 80% discount, and thus, would be directly contrary to the 2018 Maine Act. Finally, the Company could have petitioned MRS for another method of equitable apportionment within the meaning of section 5211(17) but did not do so.

IV. Decision

For the above reasons we find that for tax year 2017, the Company has not shown that MRS has failed to follow the Augusta Formula or that the application of the Augusta formula by MRS does not fairly reflect its business activity within this state. The Assessment is affirmed in full.

The Board may, in limited circumstances, reconsider its decision on any appeal. If either party wishes to request reconsideration, that party must file a written request with the Board within 20 days of receiving this decision. Contact the Appeals Office at 207-287-2864 or see the Board's rules, available at http://www.maine.gov/boardoftaxappeals/lawsrules/, for more information on when the Board may grant reconsideration. If no request for reconsideration is filed within 20 days of the date of this proposed decision, it will become the Board's final administrative action. If either party wishes to appeal the Board's decision in this matter to the Maine Superior Court, that party must do so within 60 days of receiving this decision. During the 60-day period in which an appeal may be filed with the Superior Court, the taxpayer may contact Maine Revenue Services at 207-624-9595 for a statement of the amount then due. After that 60-day period has expired, Maine Revenue Services will contact the taxpayer with an updated statement of the amount or amounts due at that time.

BY ORDER OF THE BOARD

Date: ________________ ______________________________, Chair/Member