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New Jersey State Tax Updates

On February 20, 2014, the New Jersey Division of Taxation issued a revised Intangible Asset Nexus Initiative and a new Partnership Tax and Partner Fees Initiative as part of its voluntary disclosure program.[1]

Each initiative runs from March 15, 2014, through May 15, 2014, and may offer tax and penalty benefits beyond what New Jersey typically offers as part of its standard voluntary disclosure program.

Background

Similar to most states, the Division historically allowed a taxpayer to voluntarily come forward to report and pay taxes due. In return, the Division has typically waived all penalties and limited the number of years for which the taxpayer was required to report and pay tax to the current year and three previous taxable years (i.e., a four-year look-back period).[2] However, depending on the taxpayer's reasons for not filing and paying, the Division could impose a longer look-back period. A taxpayer that has previously been contacted by the Division, is registered for the tax at issue, or is under criminal investigation is not eligible to participate in the voluntary disclosure program.

One exception to the standard four-year look-back period has been applied to intangible asset holding companies, where the Division would apply look-back to 1996 except where a taxpayer had come forward under some other special voluntary disclosure or amnesty initiative. For example, and most recently, for taxpayers that came forward during the period September 15, 2012, through January 15, 2013, the look-back was limited to taxable years beginning after December 31, 2003.[3] Notwithstanding its general penalty waiver policy, New Jersey has applied a five-percent penalty to taxable years beginning before February 1, 2009, with respect to amnesty-eligible tax liabilities pursuant to a tax amnesty that ended on June 15, 2009.[4]

Intangible Holding Company Initiative

Under the revised Intangible Asset Nexus Initiative, which generally applies to an intangible holding company that has a licensing arrangement with an affiliated operating company using an intangible in the state, New Jersey limits the look-back period on an intangible asset holding company that voluntarily comes forward and reports and pays the Corporation Business Tax to periods beginning after July 1, 2010 (equates to a three-year look-back period with respect to calendar-year corporations). In addition, New Jersey will waive all penalties. However, the taxpayer must file all required returns and pay the tax due within 45 days of executing a voluntary disclosure agreement. The related operating company

1See: www.state.nj.us/treasury/taxation/IntangibleAsset.shtml and www.state.nj.us/treasury/taxation/Partnership.shtml.
2 See: www.state.nj.us/treasury/taxation/voldisc.shtml.
3. State Tax News, Vol. 41, No. 3, New Jersey Division of Taxation (Fall 2012).
4. State Tax News, Vol. 38, No. 1, New Jersey Division of Taxation (Spring 2009).

may claim an add-back exception for the taxable years open under the statute of limitations and thus, claim a deduction for the intangible expenses, including related interest expenses, paid to the intangible asset holding company. [5]

Partnership Tax and Partnership Fees Initiative

Under the new Partnership Tax and Partner Fees Initiative, New Jersey limits the look-back period to taxable years beginning on or after January 1, 2010 (which also equates to a four-year look-back period) with respect to a partnership that voluntarily comes forward and reports and pays the nonresident partner tax and the $150 per partner fee.[6] In addition, New Jersey will waive all penalties. Similar to the Intangible Asset Nexus Initiative, the taxpayer must file all required returns and pay the tax due within 45 days of executing a voluntary disclosure agreement. Partners that have not satisfied their New Jersey reporting and payment requirements may also come forward under this program.

An intangible holding company that complies with the revised Intangible Asset Nexus Initiative may take advantage of significant benefits. First, the look-back period under the revised program is approximately seven years shorter than under the previous program and over fifteen years shorter than the standard look-back period. Moreover, the look-back period generally corresponds to the four-year refund statute. Therefore, if the operating company amends its returns, it could receive the benefit of the intangible expense and related interest expense deductions for all of the taxable years for which the holding company paid the tax. A taxpayer could not previously realize this benefit because the look-back period was usually much longer than the refund statute. Lastly, because the look-back period excludes taxable years beginning on or before July 1, 2010, there are no throw-out issues and a corporation may avoid the five-percent amnesty penalty entirely.[7] Accordingly, New Jersey is offering significant incentives for taxpayers to take part in this voluntary disclosure program.

With respect to the new Partnership Tax and Partner Fees Initiative, the taxpayer has the benefit of a fixed four-year look-back period without the risk that the Division could look back to additional taxable years. In addition, if the partners are non-filers as well, they may get the same benefit as the partnership obtains under this program. A partner that has filed, but perhaps not reported the partnership income, may be able to take advantage of penalty abatement.

5. See also N.J.S.A. § 54:10A-4(k)(2)(I); N.J.A.C. § 18:7-5.18(a)(1).
6. See N.J.S.A. §§ 54:10A-15.11(a)(1) and 54A:8-6(b).
7. The throw-out rule is eliminated for taxable years beginning after July 1, 2010. N.J.A.C. § 18:7-8.7(d).

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New Jersey State Tax Updates

The New Jersey Tax Court issued a letter opinion to amplify its bench opinion in Lorillard Licensing concerning the throw-out rule "Subject to Tax" standard.

On January 14, 2014, the New Jersey Tax Court issued a letter opinion to augment its August 9, 2013, bench opinion in *Lorillard Licensing Co., LLC v. Director, Division of Taxation*, Docket No. A-2033-13T1. From the bench, Presiding New Jersey Tax Court Judge Patrick DeAlmeida ruled that the New Jersey Division of Taxation must apply the nexus standard under the United States Constitution for purposes of determining whether the taxpayer – a company that licensed trademarks and trade names to an affiliate that used them in all fifty states – is "subject to tax" in such other states when applying the Corporation Business Tax ("CBT") throw-out rule. While the holding in the letter opinion does not deviate from the bench opinion ruling, the letter opinion does provide important insight.

Background

For taxable years beginning on or after January 1, 2002, and before July 1, 2010, a taxpayer was required to exclude receipts from the CBT apportionment factor denominator when assigned to a state where the taxpayer was not "subject to tax" (i.e., the throw-out rule).[8]
It had been the Division's position that the "subject to tax" standard under the throw-out rule requires a taxpayer to actually file a return in the state where the receipts are assigned and the return must include the subject receipts.[9]

New Jersey Tax Court Holding and Rationale

In *Lorillard*, the New Jersey Tax Court held that, because *Lorillard's* licensing activities when directed toward New Jersey are sufficient to cause it to be subject to New Jersey tax under the United States Constitution, then such activity when directed toward another state must be sufficient to cause it to be subject to tax in the other state for purposes of avoiding throw-out. This conclusion applies without regard to whether such other state actually imposed a tax on *Lorillard* or whether *Lorillard* actually filed a return in such other state. The New Jersey Tax Court concluded that the same nexus standard applies for both purposes because there is only one United States Constitution.

The New Jersey Tax Court found it irrelevant whether *Lorillard* filed a return or whether the state actually exercised its jurisdiction to tax because, as the New Jersey Tax Court stated, "New Jersey has no legitimate interest in considering the tax policy and practices of other States when determining whether to apply the [t]hrow-[o]ut [r]ule."

8. N.J.S.A. § 54:10A-6(B) (2010).

9. See e.g., Instructions, 2010 New Jersey Form CBT-100, p. 7.

New Jersey State Tax Updates

The New Jersey Tax Court based its holding in *Lorillard* on the New Jersey Supreme Court's holdings in *Whirlpool Properties, Inc. v. Director Division of Taxation,* 208 N.J. 141 (2011), and *Lanco, Inc. v. Director, Division of Taxation,* 188 N.J. 380 (2006). In *Whirlpool*, the New Jersey Supreme Court held that, under the United States Constitution's Commerce Clause fair apportionment requirement, the throw-out rule may survive a facial constitutionality challenge if applied only to untaxed receipts assigned to those states that lacked jurisdiction to tax the corporation – either because of insufficient connection under the United States Constitution or because of congressional action. In other words, based on *Whirlpool*, the fair apportionment requirement of the United States Constitution's Commerce Clause is violated if New Jersey increases its apportionment through the throw-out rule when another state could have imposed tax on such receipts. In *Lanco*, the New Jersey Supreme Court held that an out-of-state trademark holding company that licensed its intangibles to an affiliate that used the trademarks in New Jersey had nexus with the state under the United States Constitution. Thus, the New Jersey Tax Court in *Lorillard* determined that when, *Lanco* and *Whirlpool* are read together, the Division is precluded from applying throw-out to those receipts assigned to a state to which *Lorillard* directs its licensing activities.

According to the New Jersey Tax Court's Letter Opinion in *Lorillard*, the Division has appealed the case to the New Jersey Superior Court, Appellate Division.

Potential Refund Claim

A taxpayer that followed the Division's throw-out rule policy of excluding sales assigned to a state where the taxpayer did not file a return may have overstated its New Jersey receipts factor and, thus, its CBT. Therefore, if the taxable year is still open, a taxpayer may be able to submit a refund claim if, for example, the taxpayer licensed intangibles for use in another state, but didn't file a return in such other state, and on its CBT return threw out sales sourced to such other state.

Open Question

Under New Jersey's throw-out statute, throw-out was not permitted if the taxpayer was subject to a tax on or measured by profits or income, or business presence or business activity. In a 2003 question–and-answer publication, the Division was asked, for purposes of the throw-out rule, what type of taxes the Division would consider as "business presence" or "business activity" taxes. The Division responded that "[t]hese taxes would include: net worth taxes, gross receipts taxes, single business tax, but not property taxes, excise taxes (like the cigarette tax), payroll tax, or sales tax."

New Jersey State Tax Updates

However, the New Jersey Supreme Court in Whirlpool stated that throw-out would be appropriate in a case where the other state could not impose a tax due to federal law, e.g., P.L. 86-272.

An open question might be whether the New Jersey Supreme Court would continue with that holding if an argument were made that the other state could impose a gross receipts tax or a net worth tax.

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