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TAXATION

N.J. Unveils Limited Voluntary Disclosure Initiative

Division of Taxation offers program for companies having tax nexus to N.J. due to intangible asset income exploitation

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The New Jersey Division of Taxation recently announced that it is offering a limited voluntary disclosure program specifically directed to address the sensitive situations many out-of-state companies find themselves in as a result of having tax nexus in New Jersey because of owning intangible assets and deriving income from the use of those assets in New Jersey, but not having filed Corporate Business Tax (CBT) returns.

Such companies that come forward voluntarily between Sept. 15, 2012, and Jan. 15, 2013, and comply with their CBT filing requirements for the tax years 2004 and forward (the look-back period is limited to periods beginning after Dec. 31, 2003, or the date business commenced, whichever is later — versus an unlimited look-back since no statute of limitations begins to run without the filing of a tax return), will avoid all penalties, except the 5 percent amnesty period penalties for all tax returns due prior to Feb. 1, 2009.

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A company will have to file all required returns and remit payment of the full tax liability reported within 90 days of executing a voluntary disclosure agreement. Interest will also be assessed on the resulting tax deficiency assessment and must be paid within 30 days of assessment. All returns will be subject to routine audit with respect to issues not specifically covered in the voluntary disclosure agreement.

Furthermore, the standard procedures and requirements for voluntary disclosure agreements need to be satisfied. More specifically, there must not have been any previous contact with the company by the Division of Taxation or any of its agents; the company must not have been registered for the taxes it wishes to come forward on; the company must not be under any criminal investigation; and the company must be willing to pay any outstanding tax liabilities and file the prior years' tax returns in the time period provided. Finally, a written submission must be made detailing all New Jersey business activity and include the commencement date of the activity, if the company is registered in New Jersey and for what taxes, the taxes to be filed and if any trust fund tax had been collected.

As part of this specific initiative, for CBT returns filed under this program the Division of Taxation will consider discretionary throw-out relief by averaging a throw-out receipts fraction with a nonthrow-out receipts fraction, even though for tax years beginning by Jan. 1, 2002, and before July 1, 2010, NJ's throw-out rule required taxpayers to exclude from the sales factor denominator sales attributable to states, possessions or foreign countries where the taxpayer was not subject to income tax. Any such settlement reached will be binding on both parties regardless of any subsequent court decision. If the taxpayer does not settle the throw-out issue on any CBT returns filed under this disclosure program, the division will hold the issue as part of a future audit determination with respect to the return. In addition, under this program, companies that have paid royalties and have added them back to their New Jersey income, are permitted to submit amended returns for all open tax years to claim an exception to the addback.

This initiative allows out-of-state companies generating revenue from use of its intangible property or product in New Jersey to avoid the type of debacle that happened to the Praxair Technology company, which was harshly penalized (30 percent each year: 25 percent late filing and 5 percent amnesty period penalties) and required to file CBT returns from as far back as 1994. By way of background, in *Praxair Technology v.*

Director, Division of Taxation, 201 N.J. Super. 126 (2009), the New Jersey Supreme Court extended the reach of its prior decision in *Lanco v. Director, Division of Taxation*, 379 N.J. Super 562 (2005), *aff'd per curiam*, 188 N.J. 388 (2006), *cert. denied*, 127 S.Ct. 2974 (2007), and held that an out-of-state company that licensed its patents, trademarks/secrets and technology to its parent corporation, which had facilities in New Jersey, had sufficient nexus with the state for the Division of Taxation to impose CBT tax under N.J.S.A. 54:10A-2.

Any out-of-state company that engages in franchising and licensing of property — out-of-state companies that do retail business here through licensees, software/hardware makers, as well as credit card/loan issuing nonresident financial institutions — should consider utilizing this program to limit its exposure and to become eligible for the program's favorable terms.

In that regard, however, before conceding a taxable nexus, companies that have taken nonfiling positions should analyze whether the qualitative nature of their contacts with New Jersey justifies taxability. More specifically, for example, the New Jersey Tax Court in *AccuZip v. Director, Division of Taxation*, and *Quark v. Director, Division of Taxation*, 25, N.J. Tax 158 (2009), held that economic nexus would not be extended to two out-of-state software companies that were selling and licensing software to New Jersey customers, on the basis of its conclusion that the companies were selling tangible personal property, not a software license. Both companies' business activities in New Jersey were limited to the sale of canned software to New Jersey customers. Each sale of software was subject to a licensing agreement, but the consideration paid to the companies was in the form of a single payment for the sale of software rather than periodic royalties. The Tax Court held that the Quark company was doing business through an in-state representation but that AccuZip was not doing business in New Jersey because its contacts did not satisfy the substantial nexus requirements of the Commence Clause.

Furthermore, in *BISLP v. Director, Division of Taxation*, N.J. Sup. Ct. App. Div. No. A-1772-09T2, Aug. 12, 2011 (unpublished), *aff'd* 25 N.J. Tax 88 (N.J. Tax 2009), the Appellate Division held that a foreign corporation that owned 99 percent of a limited partnership operating in the state, and owned no other New Jersey assets, was an investment company not liable for New Jersey corporate business tax. Central to the court's reasoning that an out-of-state corporate limited partner of a limited partnership doing business in New Jersey was not considered to be doing business in New Jersey, since its activities in New Jersey were limited to a passive interest in the partnership, was the lack of functional integration or economies of scale between the two entities, which were engaged in different businesses.

Lastly, with respect to third-party trademark license situations, it should be noted that one out-of-state appeals court has ruled that a related party license does not create taxable nexus. See *Blistex Bracken v. Seattle*, No. 62006-1-1, 152 Wn. App. 1019 (Wash. Ct. App. 2009), where the appeals court concluded that an out-of-state family limited partnership that received royalties from sales of Blistex products did not have nexus with the City of Seattle, and that therefore Seattle business and occupation tax was not due. ■