

Reed Smith Teleseminar Series

NJ Tax Court Guts Throwout Statute *Does This Mean Throwout Never Applies?*

September 19, 2013 ■ 12:00 pm EDT

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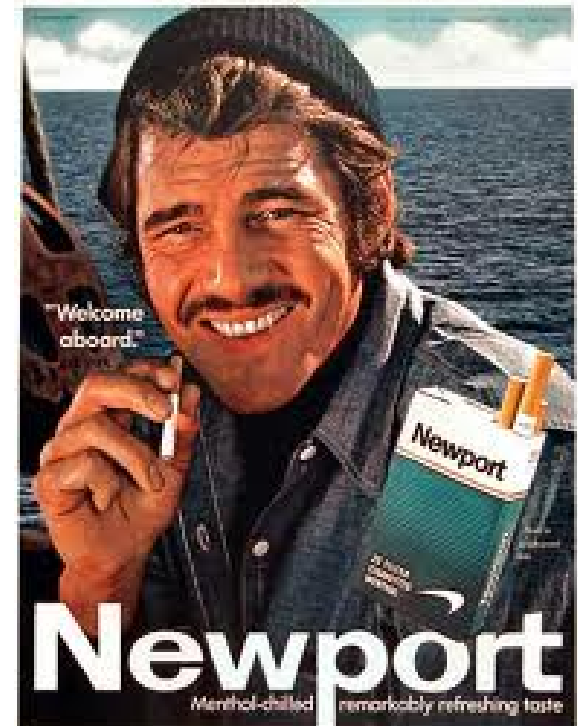
Background Regarding Throwout

- Statute and policy
 - ✓ Enacted in 2002
 - ✓ Loophole: “nowhere sales” of goods
- Facial challenges
- NJ Supreme Court’s ruling in *Whirlpool*
 - ✓ Interpreted to avoid facial unconstitutionality
 - ✓ Only applies to states without jurisdiction to tax



Lorillard

- Facts
 - ✓ Physical presence in NC only
 - ✓ Licensed IP to affiliate; royalty based on U.S. sales
 - ✓ NJ asserted 100% sales factor
- Tax Court's ruling
 - ✓ If NJ has jurisdiction to tax, all states have jurisdiction to tax
 - ✓ Throwout cannot apply to IHC



Judge DeAlmeida: Quotes from Bench

- “New Jersey can’t have it both ways. It can’t prevail in *Lanco* and say *Lanco* is subject to tax as a trademark holding company in New Jersey but Lorillard Licensing may not be subject to tax in the other 50 states.”
- “If another state had jurisdiction to tax, then that’s all that’s required.”
- “The fact that another state may not have imposed a tax, even though it had jurisdiction to do so, is not relevant.”
- “The fact that another state may have failed, even though it had a tax ... to audit Licensing ... perhaps Licensing didn’t even file a return in states where it should have and those states missed it. Those facts are all irrelevant under this ruling.”



Making Sense of Tax Court's Ruling

- The Division's unusual litigation strategy
- Reconciling throwout statute with *Whirlpool*
 - ✓ NJ tax can't depend on other states' policies
 - ✓ Only one constitutional nexus standard
- If *Lorillard* upheld, throwout applies only to goods shipped from NJ to states where taxpayer has no activity
- Consistent with legislative history

How Will Division Respond?

- Appeal *Lorillard*?
 - ✓ Upcoming conference call
 - ✓ 45 days to appeal
- Bury *Lorillard* and shift focus to *Whirlpool*?
- Concede throwout doesn't apply to IHCs?
 - ✓ Argue that IHC property and payroll distortive
 - ✓ Focus on other throwout situations
 - ✓ Abandon throwout litigation altogether

Next Steps for IHCs

- *Lorillard's* impact on Whirlpool and other IHCs
 - ✓ Refund claims due within 4 years
 - ✓ May affect affiliate's addback exception
- If executed VDA, review your terms:
 - ✓ If used "punt" method, Division may have to withdraw assessment
 - ✓ Refund opportunities based on sourcing
- What about foreign royalties?



Applying *Lorillard* to Services

- **New Jersey sourcing rules—lots of options**
 - ✓ Not a UDITPA state
 - ✓ General: costs, time, or “other method”
 - ✓ *Mayer & Schweitzer* and market bias
 - ✓ Retroactive application of new regulation

- **Specific industries**
 - ✓ Transaction processing—the 25:50:25 rule
 - ✓ Financial services—location of borrower or domicile
 - ✓ Asset management—location of “customer”
 - ✓ Communications

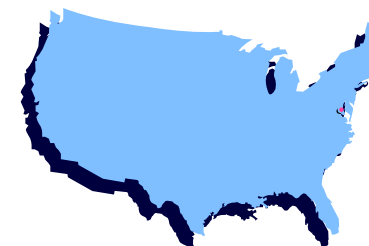


Applying *Lorillard* to Services

Strategy

- ✓ Companies with presence in NJ:
 - Source to market states (especially COP states)
 - No throwout in those states

- ✓ Companies with presence outside NJ:
 - If possible, source to where service is performed
 - No throwout in any other state



P.L. 86-272 Protected?

- Typical scenarios
 - ✓ In New Jersey, shipping out
 - ✓ No connection with New Jersey
- *Whirlpool*
 - ✓ Holding
 - ✓ Dicta on P.L. 86-272
- The Washington B&O example
- The *SanMar* case
- Strategy: Don't throw out!



***Lorillard* and Interest Addback**

Background

- Interest paid to affiliates
- Depends on where lender is “subject to a tax”

Addback Statute

"...subject to a tax..."

Throwout Statute

"...subject to a tax..."

Lorillard and Addback

Division's Problem

- *Lorillard*: “If another state had jurisdiction to tax, then that’s all that’s required”
- “Subject to tax” in lender’s domicile state
 - ✓ Domicile state’s tax policy is ignored under *Whirlpool*
 - ✓ Example: Unitary combined state has “jurisdiction to tax”
- Taxpayer to-do: File claims on any addback

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