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The *BIS* Case: A Big Shift in New Jersey's Unitary Business Rule and the Taxation of Corporate Partners

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In 2011, in *BIS LP, Inc. v. Director, Division of Taxation,* [1] a New Jersey appellate court ruled that income generated by a New Jersey-headquartered partnership and passed through to its out-of-state corporate limited partner was not subject to the state's corporate income tax (the corporation business tax, or "CBT"). This decision has an impact, however, well beyond the specific issues in the case:

- Certain out-of-state corporate partners and partnerships may be able to recover all of the tax they paid—despite New Jersey's tax regime concerning payments on behalf of nonresident partners.
- Other corporate partners continue to have a choice on how to compute the tax attributable to their partnership interests.
- Companies will have another tool in their anti-nexus arsenal.
- Companies with net operating losses (NOLs) may be able to increase their carryovers.
- Companies with dividends from less-than-80%-owned subsidiaries may be able to exclude those dividends altogether.

These effects are potentially game-changing—even though the decision appears, at first glance, to involve a simple, narrow issue. In *BIS,* the court determined that a 99% limited partner and an underlying limited partnership were nonunitary. What is surprising is that the court made that determination even though the partnership was the limited partner's only asset and the general partner was another affiliate. Even more surprising, the court agreed that a refund was due; the court thereby set aside the statutory scheme requiring a partnership to remit tax on behalf of nonresident partners. [2] As a result, any company that conducts activities through a limited partnership should consider filing a refund claim if the partner has no independent nexus with New Jersey.

Further, as indicated above, the court's decision has significance well beyond the specific issues in the case. The decision reinforces that corporate partners have flexibility to compute their tax in one of two ways—either (1) by flowing up the income and factors from the partnerships, or (2) by using a separate-accounting approach. [3] Perhaps the biggest impact of *BIS* may be felt outside the partnership context. For one thing, we think the court's decision in *BIS* may signal a willingness by the courts to refuse to extend New Jersey's broad economic-nexus policies beyond royalty companies. For another, the decision definitely lowers the bar on establishing a nonunitary

relationship. This is especially important for companies with net operating losses. In New Jersey, dividends absorb net operating loss carryovers.[4] Under *BIS,* a taxpayer that receives dividends should find it easier to establish that the dividends are paid from nonunitary subsidiaries, and thus the dividends should not absorb NOLs. Further, New Jersey's statute provides only a 50% deduction for dividends from less-than-80%-owned subsidiaries; no deduction is permitted for dividends from less-than-50%-owned subsidiaries.[5] Again, under *BIS,* a taxpayer should find it easier to exclude the dividend altogether by establishing that the payor is nonunitary.

Background

The taxpayer in this case, BIS LP, Inc. ("BIS"), had a 99% limited partnership interest in a limited partnership called BISYS Information Solutions L.P. ("Solutions LP"), which was formed under Delaware law. Solutions LP was engaged in a data processing business and was headquartered in New Jersey; its New Jersey apportionment percentage was about 50%. By contrast, BIS was a Delaware corporation with no offices, property, or employees in New Jersey.

BIS was a wholly owned subsidiary of a holding company, BISYS, Inc. (BISYS), also a Delaware corporation and a subsidiary of BISYS Group, Inc. BISYS, with a one percent interest, was the general partner in Solutions LP. Although BIS and BISYS shared some corporate officers, there was no evidence that those officers performed activities on behalf of BIS in New Jersey. BIS's only connection to New Jersey, therefore, was its interest in Solutions LP. The flow chart in Exhibit 1 illustrates the entities' structure.

New Jersey's tax scheme for partnerships.

The controversy involved BIS's CBT for the 2002 privilege period, which was the first period for which BIS filed a New Jersey return.[6] BIS was organized in 1999 but, for periods prior to 2002, merely having a limited partnership interest in a partnership doing business in New Jersey was generally insufficient for nexus.[7] Then, legislation enacted in 2002 expanded the CBT statutory nexus standard, and the Division of Taxation's position was that merely owning a limited partnership interest was sufficient for nexus.[8]

Of course, the legislature recognized the difficulty of enforcing the CBT on out-of-state limited partners.[9] So at the same time it expanded the CBT nexus standard, the legislature also established a tax payment mechanism for partnerships with nonresident partners.[10] As a result, partnerships became taxpayers for CBT purposes and had to pay tax on behalf of any nonresident partners.[11] A nonresident partner, however, was not absolved from filing a CBT return. But if a nonresident partner neglected to file, the legislature anticipated that New Jersey would at least be able to collect tax from the partnership on any income that it derived from the state.[12]

Under the statute, the amount of tax to be remitted by the partnership is computed by using the partnership's apportionment factors to apportion to New Jersey the nonresident partners' share of partnership entire net income, and multiplying the result by the corporate tax rate of 9% (6.37% for individuals).[13] The tax paid is ratably credited to each nonresident partner. As set forth in the regulation, if a partner's return shows that its actual liability is less than the amount remitted, the excess tax is refunded to the partner.[14]

The BIS Dispute—Initial Proceedings

In *BIS,* Solutions LP (the partnership) made a tax payment on behalf of BIS (the corporate limited partner) that BIS took as a credit on its CBT return. (Originally, BIS did not contest that it had nexus with New Jersey.) The Division audited BIS's return and issued a tax assessment of nearly

$718,000[15]; with penalties and interest through 1/1/06, the assessment totaled more than $889,000. In response, BIS not only contested the assessment, it also requested a refund of the nearly $1.5 million in tax that it had originally reported. BIS asserted that its limited partnership interest was merely an investment in a security and was thus insufficient contact for CBT nexus under the Due Process and Commerce Clauses of the U.S. Constitution. At the administrative appeal level, BIS offered to settle the matter by waiving its right to a refund if the Division agreed to withdraw its assessment. But the Division rejected this offer. This ultimately proved to be a costly decision for the Division.

In 2009, the New Jersey Tax Court ruled in favor of BIS.[16] The Tax Court concluded that BIS's activities were insufficient for nexus and ordered the Division to issue BIS its requested refund.[17] The court reasoned that Solutions LP's activities could not be attributed to BIS for nexus purposes because the two entities were not integrally related. According to the Tax Court, BIS's relationship to Solutions LP was that of a passive investor since BIS had no control or potential for control over the partnership. Further, whereas Solutions LP was a data-processing company, BIS was a mere holding company. The Division appealed this aspect of the Tax Court's decision to the Appellate Division of the New Jersey Superior Court, which is New Jersey's intermediate court of appeals.

Appellate Division Affirms Tax Court

As framed by the appeals court, the nexus issue depended on two questions: (1) whether BIS was deriving receipts from New Jersey based on its distributive share of the partnership's income, and (2) whether BIS and Solutions LP were unitary. This analytic framework followed from the statute and the Division's regulations. Under the statute, a corporation has CBT nexus if it is "deriving receipts from sources within this State," subject to any limitations imposed by the Constitution and laws of the U.S.[18] Under the relevant portion of the Division's "corporate partner and partnerships" regulation, a foreign corporate limited partner has nexus for CBT purposes if the business of the partnership is integrally related to the business of the foreign corporation.[19] In other words, if a corporate limited partner is unitary with a partnership doing business in the state, the partner has CBT nexus.

Deriving receipts.

Regarding the first question, the appeals court agreed with the Tax Court that a partner's distributive share of partnership income did not constitute "deriving receipts" for nexus purposes. Put another way, the court refused to conclude that *a partner* is "deriving receipts" merely because *the partnership* is "deriving receipts."[20]

Unitary business.

Regarding the unitary business question, the appeals court examined a list of factors set forth in the Division's "corporate partners and partnerships" regulation "that either singly or in combination may suggest that the corporation and partnership are part of a unitary business...."[21] Those factors include the following:

(1) Substantial intercompany-partnership transactions.
(2) The partnership interest is the only or the most substantial asset of the corporation.
(3) The partnership interest produces all or most of the income of the corporation.
(4) The corporation and the partnership are in the same line of business.
(5) There is substantial overlapping of employees and offices.
(6) There is sharing of operational facilities, technology, and/or know-how.

An earlier case considered the "unitary" issue. This was not the first time that a New Jersey court considered these factors in determining whether a partner was unitary with the underlying partnership. In *Chiron Corporation v. Director, Division of Taxation,* [22] the Tax Court considered the unitary business question in the context of a 50/50 joint pharmaceutical venture between Chiron (the taxpayer) and another pharmaceutical company (Ortho Diagnostic Systems, Inc.). [23] Unlike *BIS,* the underlying issue in *Chiron* did not involve nexus. Rather, the unitary business question determined whether Chiron had to compute its CBT by flowing up the income and apportionment factors of the joint venture (i.e., if the two were unitary) or, alternatively, whether Chiron could use the separate-accounting method. [24]

The Tax Court determined that Chiron and the joint venture were not unitary. As a result, Chiron was forced to compute its CBT using the separate-accounting method (which, in Chiron's situation, increased its liability). The court reached this conclusion even though Chiron had met several of the unitary factors set forth in the Division's regulation. For example, Chiron and the joint venture were engaged in similar lines of business; Chiron shared technology and engaged in other transactions with the joint venture; and much of Chiron's receipts and income were attributable to the joint venture. Of course, since Chiron was only a 50% partner, it lacked the ability to control the joint venture. This fact may explain the Tax Court's conclusion that Chiron and the joint venture were not unitary.

Unitary factors as applied to BIS. On its face, BIS seemed to present a more daunting challenge of showing that the partner and partnership were nonunitary. After all, BIS was a 99% partner and conducted no business outside its interest in the partnership. Further, the other partner was BIS's corporate parent. So many expected that the Division would prevail. [25]

Nonetheless, the appeals court affirmed the Tax Court's decision. The appeals court first summarized the facts and the circumstances of BIS's formation. As noted by the court, BIS's only asset was its interest in Solutions LP, which also produced all of BIS's income. The Solutions LP data-processing business previously had been conducted by one of BIS's affiliates. In 1999, however, BIS's corporate parent undertook a series of reorganization steps to create a series of holding company/limited partnership entities. As part of this undertaking, the parent company transferred 99% of this data-processing business to BIS and the remaining 1% to Solutions LP. BIS, in turn, contributed its share of the business to Solutions LP in exchange for the 99% limited partnership interest. After the restructuring, BIS was the sole limited partner and BIS's parent was the 1% general partner.

As a limited partner, BIS had limited influence over the partnership. The partnership agreement did not permit BIS to take part in the active management of Solutions LP, to perform any acts on behalf of Solutions LP, or to "have a voice in or take part in" Solutions LP's business affairs or operations. Rather, the partnership agreement provided the general partner with "the sole and exclusive right to manage the business and affairs" of Solutions LP. Only some limited rights were reserved for BIS. For example, the agreement required BIS's consent before additional partners could be admitted, or before the partnership could merge or consolidate with another entity. BIS also had a right of first refusal in case the general partner elected to sell its partnership interest.

After setting forth the relevant facts, the appeals court next analyzed the unitary business factors (listed above) contained in the Division's "corporate partners and partnerships" regulation. The appeals court recognized that BIS met two of the six relevant factors: the partnership interest was BIS's only or most substantial asset; and the partnership interest produced all of BIS's income.

Despite the regulation's stating that "either singly or in combination," these factors "may suggest that the corporation and partnership are part of a unitary business," the appeals court concluded that there was no unitary relationship. The court reasoned that the corporation and partnership were in different lines of business. On this point, it agreed with the Tax Court that BIS was

engaged in a holding company business whereas Solutions LP conducted a data-processing business. It dismissed the Division's argument that Solutions LP had been organized for tax-avoidance purposes, noting that none of the facts in the record supported this. The court further noted that the Division had admitted BIS's statement of undisputed material facts that the taxpayer did not have a place of business in New Jersey, nor any employees, agents, representatives, or property in the state. Although BIS and Solutions LP shared some corporate officers, the court concluded that the sharing of some officers and office space is insufficient, on its own, to show a unitary business.[26]

The appeals court did not limit its unitary business analysis to the factors set forth in the Division's regulation. Citing *Allied-Signal, Inc. v. Director, Division of Taxation,*[27] the appeals court discussed three objective, constitutional factors that also must be considered in determining whether related businesses are unitary: (1) functional integration; (2) centralization of management; and (3) economies of scale. The court concluded that there was neither functional integration nor economies of scale because BIS (an investment company) and Solutions LP (a data-processing business) were engaged in different businesses. Further, the court concluded that merely sharing a mailing address and some corporate officers did not establish centralized management.

The Division also argued, however, that equally important to the unitary determination is the "flow of values" between Solutions LP and BIS that the U.S. Supreme Court also set forth in *Allied-Signal.* According to the Supreme Court, a "unitary business may exist without a flow of goods between the parent and subsidiary, if instead there is a flow of value between the entities." In *BIS,* however, because the court had determined that BIS and Solutions LP were not involved in a single enterprise or line of business, the court concluded that this argument by the Division was irrelevant and there was no need to consider whether there was a flow of value between the entities. Accordingly, the appeals court agreed with the Tax Court that there was no constitutional basis for imposing the CBT at issue.

Is the New Jersey court setting a new trend?

Compared to the approach taken by some courts in other states, the *BIS* decision may represent a welcome new trend.[28] For example, in *Revenue Cabinet v. Asworth Corp.,*[29] the Kentucky Court of Appeals held that a corporate limited partner's 99% interest in a limited partnership doing business in the state gives rise to substantial nexus—regardless of whether the partner had any physical presence in the state. As a result, the Kentucky court (unlike the appeals court in *BIS*) concluded that imposing tax on the out-of-state limited partner did not offend either the Due Process Clause or the Commerce Clause. The Kentucky court, and other state courts that reached a similar conclusion,[30] relied on the aggregate theory of partnerships rather than the entity theory of partnerships. Under the aggregate theory, a partnership is *not* an entity separate and distinct from its individual partners.[31] Interestingly, the appeals court in *BIS* did not specifically address the aggregate theory even though it effectively rejected that theory in favor of the entity theory of partnerships.[32]

In *BIS,* the appeals court stopped short of ordering the Division to issue a refund to BIS. The Division, in its brief, had argued that, if a refund were due, it should be ordered paid to Solutions LP, not to BIS. In the Division's view, because the partnership remitted the tax, only the partnership can receive a refund. The court noted that this issue had not been properly raised by the Division, which did not articulate the issue in a separate point heading in its initial brief. While an analysis of this issue is found in the Division's reply brief, the court said that is not the proper vehicle by which to introduce new issues. But because of the public interest in the issue, the appeals court remanded the case back to the Tax Court for the limited purpose of determining which entity should receive the refund.

The Division's Difficult (and Awkward) Position on Remand

The Division will have a difficult time on remand—especially in light of its regulation and audit policy. The Division's regulation specifically provides that amounts remitted by a partnership "will be deemed to have been paid by the respective partner" and that "[a]ny excess tax payments may be refunded to the partner."[33] Based on this regulation, the Division has made audit determinations that it is the partner—not the partnership—that must claim a refund if the partnership overpays. In fact, the Division has a case pending in Tax Court in which it denied a refund requested by a partnership but will not allow the partner to file a refund claim because the statute of limitations has expired.[34] So the Division is in the awkward position of asserting the exact opposite arguments in two pending Tax Court cases (albeit before two different judges).

Going forward, the Division may attempt to limit the application of BIS to its facts. For example, the factual record contained no suggestion of tax avoidance. In subsequent audits and appeals, the Division is unlikely to concede this fact so readily. The Division also may try to assert that it can impose an entity-level tax on the partnership even if the partner lacks sufficient nexus. As described above, the statutory and regulatory framework suggests that this is an option.[35] But under that framework, only a partnership with *nonresident* partners would be required to pay any entity-level tax: a partnership with *resident* partners is required to file an information return, but is not required to pay any tax on its income. This would facially discriminate against interstate commerce.

Under the Commerce Clause,[36] a taxing scheme cannot discriminate between in-state and out-of-state interests or provide a direct commercial advantage to local business.[37] The Division may attempt to defend such discrimination based on the compensatory tax doctrine. Under that doctrine, a facially discriminatory tax law may be sustained if the law is "designed simply to make interstate commerce bear a burden already borne by intrastate commerce."[38] The Division, however, would have to satisfy the three-part test set forth by the U.S. Supreme Court in *Fulton Corp. v. Faulkner.*[39] First, the Division would have to identify the intrastate tax burden for which it is attempting to compensate. Second, the Division would have to show that the tax on interstate commerce roughly approximates the tax on intrastate commerce. Third, the events on which the interstate and intrastate taxes are imposed must be substantially equivalent. The Division would likely have a difficult time satisfying this test. In general, the compensatory tax doctrine cannot be invoked outside the sales and use tax context to justify a discriminatory tax.[40]

Accordingly, to the extent that a partnership doing business in New Jersey has paid tax on behalf of any nonresident partners, refund claims should be filed to recover that tax. Both the partner and the partnership should consider filing refund claims to avoid potential statute of limitations problems, since it is unclear which entity the court will decide is entitled to the refund. (In general, New Jersey's statute of limitations for refunds is four years from the date of payment of tax.[41]) Even if a taxpayer's nonunitary facts are relatively weak (and even if the taxpayer takes the position in other states that the partner and partnership are unitary), *BIS* demonstrates that even closely aligned entities can be nonunitary for New Jersey CBT purposes.

Significance of the *BIS* Decision Extends Well Beyond the Issue in the Case

Nonresident corporate partners are not the only taxpayers that will benefit from the appellate court's decision in *BIS.*

Factor flow-up vs. separate accounting.

The unitary business principle is relevant also for corporate partners (including both resident and nonresident partners) that definitely have nexus, on their own, with New Jersey. Specifically, a unitary (or nonunitary) relationship determines whether a partner must compute its tax using the flow-up (or separate-company) method. In *Chiron,* as discussed above, the court agreed with the Division that a partner and partnership were nonunitary; as a result, the partner had to use the separate-accounting method.

But the Division has not necessarily applied the unitary business test consistently.[42] And as *BIS* makes clear, the application of the unitary business test to a particular set of facts is neither obvious nor predictable. Often, a given taxpayer's fact pattern can support either a unitary or a nonunitary position. If so, the taxpayer should compute its tax using both methods and consider using the method that results in the lesser tax liability.

Limiting the Division's expansive economic-nexus policies.

The *BIS* decision may inhibit the Division's recent efforts to expand its economic-nexus policy. For example, last year the Division promulgated a regulation under which an out-of-state financial business is subject to CBT (even if it has no physical presence in the state) merely for receiving interest involving New Jersey borrowers or property.[43] Under that economic-nexus standard, which the Division is applying retroactively, simply investing in loans originated by another financial business is sufficient for nexus. There are a number of appeals pending at the administrative level on this issue and the lead case is pending at Tax Court.

Of course, the New Jersey Supreme Court, first in *Lanco, Inc. v. Director, Division of Taxation,*[44] and again in *Praxair Technology, Inc. v. Director, Division of Taxation,*[45] concluded that physical presence is not required for income-tax nexus. But those cases involved intangible holding companies.

The New Jersey Tax Court rejected the Division's attempt to apply a "deriving receipts" nexus standard to a software company with no physical presence in the state.[46] Now, in *BIS* we have an appellate court recognizing that there are constitutional limitations to economic nexus. If a 99% interest in a limited partnership is insufficient for nexus, a passive minority investment in a loan portfolio should also be insufficient for nexus. Thus, *BIS* may mean that the Division's recent nexus regulation is in jeopardy.

Exclusion of dividends from nonunitary subsidiaries.

New Jersey's dividends-received deduction is less generous than the federal deduction.[47] Dividends are fully deductible only if received from an 80%-or-more-owned subsidiary. Dividends from other subsidiaries owned at least 50% are only 50% deductible.[48] And no deduction is allowed for dividends from subsidiaries owned less than 50%. Nonetheless, if an out-of-state taxpayer receives a dividend from a nonunitary subsidiary, the taxpayer can take the position that the dividend is nonoperational income that must be excluded from its tax base entirely—regardless of its ownership percentage.[49]

The unitary business principle, of course, limits a state's authority to tax value and income that cannot be attributed to taxpayer's in-state activities.[50] As explained above, in *BIS* the appellate court concluded that BIS and Solutions LP were engaged in different businesses (a "holding company" and an "operating company" were distinct enough to be different), and that sharing the same mailing address and corporate officers did not prove centralized management. Under the

court's narrow interpretation of the unitary business principle, there should be many situations in which a corporate shareholder is not unitary with its dividend-paying subsidiary—even if the shareholder has a significant ownership interest in the subsidiary and there is some overlap of officers. Taken on its face, *BIS* suggests that as long as the payee and payor are engaged in different businesses, they often will be considered nonunitary.

Do not let nonunitary dividends absorb NOL carryovers.

Even if a taxpayer's percentage interest in a subsidiary meets the statutory ownership requirements (so that the taxpayer is entitled to a dividends-received deduction), New Jersey's statutory ordering rules can result in the taxpayer's getting no economic benefit from the deduction. This is because the New Jersey statute effectively requires a taxpayer to compute the NOL, and NOL carryovers, before claiming a dividends-received deduction.[51] As a result, to the extent that a taxpayer receives a deductible dividend, its NOL carryover is reduced. Despite the obvious unfairness of this, the New Jersey courts have upheld the statutory scheme.[52] But the New Jersey courts have not addressed the situation where a dividend is received from a nonunitary subsidiary.

If a dividend is from a nonunitary subsidiary, and if the stock does not serve an operational function in the taxpayer's business,[53] then New Jersey cannot indirectly tax the dividend by reducing the taxpayer's NOL carryover. The New Jersey statutory scheme is analogous to the scheme that was struck down by U.S. Supreme Court in *Hunt-Wesson, Inc. v. Franchise Tax Board of California.*[54] That case involved California's "interest offset" statute, which required an out-of-state taxpayer to reduce its otherwise deductible interest expense by the amount of nonbusiness dividend income received from nonunitary subsidiaries.[55] The Court concluded that the offset was, in reality, an impermissible tax on nonunitary dividends.

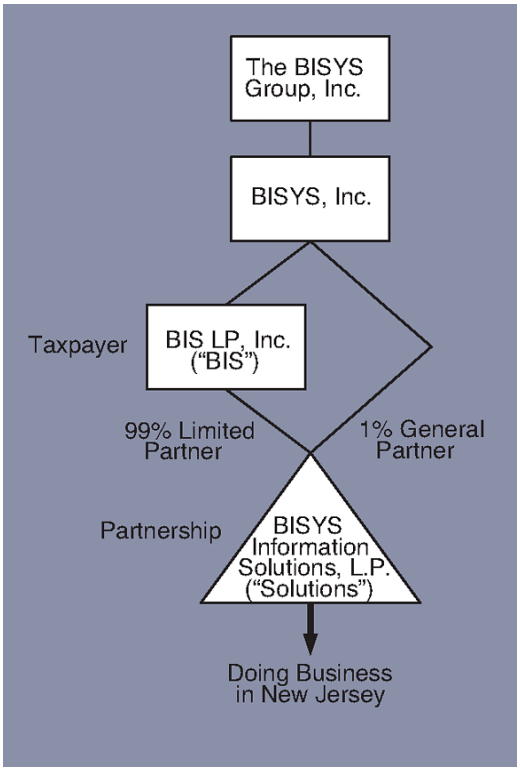
Where a taxpayer receives otherwise deductible nonunitary dividends, New Jersey's NOL ordering rules similarly result in an impermissible tax. Allowable deductions attributable to unitary net operating losses should not be reduced by nonoperational dividends received from nonunitary subsidiaries. Rather, an out-of-state taxpayer should simply exclude any nonunitary dividends from its tax base. Since the dividends will not be included in the taxpayer's entire net income, the taxpayer will not have to offset them with NOLs. After *BIS,* establishing that a corporation is nonunitary with its dividend-paying subsidiary should be substantially easier in many cases.

Conclusion

In recent years, New Jersey has sought to expand its CBT nexus standard to cover such activities as licensing intangibles,[56] selling canned software,[57] issuing credit cards and originating loans,[58] and receiving interest from financial investments.[59]

In *BIS,* however, the New Jersey appellate court, contrary to decisions reached by other states' courts, held that merely owning a limited partnership interest in a partnership doing business in New Jersey was insufficient for nexus. As a result, companies that are organized as limited partnerships may be able to avoid paying New Jersey tax on the partnership's income and activities. The *BIS* decision takes on even greater significance because of the court's unitary business analysis. Under the court's narrow interpretation of the unitary business principle, taxpayers will be able to support filing positions and refund claims in which they have excluded from their tax base income from nonunitary subsidiaries.

Exhibit 1. BIS Corporate Structure



Footnotes

[1] N.J. Super. Ct. App. Div., No. A-1172-09T2, 8/23/11, 2011 WL 3667622 (unpublished opinion), *aff'g* 25 NJ Tax 88, 2009 WL 2367729 (Tax Ct., 2009).

[2] See N.J. Rev. Stat. §54:10A-15.11.

[3] See N.J. Admin. Code §18:7-7.6(g). For a comparison of the separate-accounting and flow-through methods, see Sollie and Gutowski, "Partnership Factor Flow-Through: New Jersey Takes an Unusual Position," 15 JMT 6 (July 2005) .

[4] N.J. Rev. Stat. §54:10A-4(k)(6)(C).

[5] N.J. Rev. Stat. §54:10A-4(k)(5).

[6] BIS was a fiscal-year filer, thus its privilege period covered 7/1/02 through 6/30/03.

[7] See 29 N.J.R. 1686(a) and 4327(a). The New Jersey Register may be accessed online via the website of the New Jersey State Library at www.njstatelib.org (under "For State Government," select "Research Tools—Law Library" and "New Jersey Register").

[8] See the Business Tax Reform Act, A.B. 2501, 7/2/02 (N.J. P.L. 2002, ch. 40), discussed in Hoffman, "The New Jersey Business Tax Reform Act of 2002—Will Other States Follow Suit?," 22 JMT 10 (October 2002) . The Division's position is reflected in 35 N.J.R. 1573(a) (amending N.J. Admin. Code §18:7-7.6(b)).

[9] See Assemb. Budget Comm. Statement to A. 2501 (2/27/02), available online via the New Jersey legislature's website at www.njleg.state.nj.us/2002/Bills/A3000/2501_S2.HTM.

[10] See N.J. Rev. Stat. §54:10A-15.11.

[11] For this purpose, a corporation is considered a nonresident partner, unless it maintains "a regular place of business" in New Jersey. N.J. Rev. Stat. §54:10A-15.11.c. In general, a "regular place of business" means "any bona fide office (other than a statutory office), factory, warehouse, or other space of the taxpayer which is regularly maintained, occupied and used by the taxpayer in carrying on its business and in which one or more regular employees are in attendance." N.J. Admin. Code §18:7-7.2(a).

[12] See Assemb. Approp. Comm. Statement to A. 3045 (6/21/01), available online via the New Jersey legislature's website at www.njleg.state.nj.us/2000/Bills/A3500/3045_S2.HTM.

[13] N.J. Rev. Stat. §54:10A-15.11.a(1). For this purpose, "entire net income" means the distributive share of partnership income as computed for federal purposes plus tax-exempt interest income. N.J. Admin. Code §18:7-17.5(a)3.

[14] N.J. Admin. Code §18:7-17.6(c).

[15] The Division disagreed that BIS qualified as an "investment company"; a taxpayer qualifying as such is entitled to forgo three-factor apportionment and, instead, pay tax on 40% of its income. N.J. Rev. Stat. §54:10A-5(d). The Division also added back intercompany royalty expenses that the partnership had paid to affiliates. See N.J. Rev. Stat. §54:10A-4.4 (disallowing a deduction for certain affiliated royalty expenses).

[16] BIS LP, Inc. v. Director, Division of Tax'n, 25 NJ Tax 88, 2009 WL 2367729 (Tax Ct., 2009).

[17] The Tax Court also held that BIS qualified as an investment company based on its interest in Solutions LP and that the Division's regulation to the contrary, N.J. Admin. Code §18:7-1.15(b)9, could be applied prospectively only, and thus was inapplicable here. The Division declined to appeal this aspect of the Tax Court's decision.

[18] N.J. Rev. Stat. §54:10A-2.

[19] N.J. Admin. Code §18:7-7.6(c).

[20] See N.J. Admin. Code §18:7-8.12 (Other business receipts) (the appeals court observed that this regulation "does not specifically address partnership distributions as a business receipt to be taxed").

[21] N.J. Admin. Code §18:7-7.6(g)3.

[22] 21 NJ Tax 528, 2004 WL 2900516 (Tax Ct., 2004). The appeals court did not cite Chiron in its BIS opinion—probably because it is a decision of the Tax Court and not controlling authority. Further, the Division of Taxation has been trying to distance itself from the position it took in Chiron (that there is a presumption *against* finding a unitary relationship—at least in the context of partnership factor flow-through, which is required when partner and partnership are unitary). But since BIS is an appeals court decision, it is even more likely now than it was after Chiron that partner and partnership are not unitary and thus, a corporate partner may use the separate-accounting method. See note 24, *infra,* and accompanying text.

[23] For a detailed analysis of the Chiron case, see Sollie and Gutowski, *supra* note 3.

[24] Under the separate-accounting method, first a corporate partner's distributive share of the partnership's business income is apportioned to New Jersey by using just the partner's share of the receipts, property, and payroll of the business that the partnership carries on directly. Second, the corporate partner's entire net income (excluding its distributive share of the partnership's income) is apportioned to New Jersey using only the receipts (excluding receipts from the partnership, namely receipts from intercompany transactions), property, and payroll of the business that the corporation carries on directly. Then, these two amounts are added together to determine the corporate partner's entire New Jersey income. See N.J. Admin. Code §18:7-7.6(g)1.

[25] In contrast to the situation in Chiron, it was now the Division that was arguing that the corporate partner and underlying partnership were unitary.

[26] On this point, the court cited Central National-Gottesman, Inc. v. Director, Division of Tax'n, 14 NJ Tax 545, 1995 WL 470134 (Tax Ct., 1995) *aff'd* 677 A2d 265 (N.J. Super. Ct. App. Div., 1996), *cert. den.* 683 A2d 1164 (N.J., 1996) (two divisions were not unitary even though they shared several senior officers, used the same pension fund and employee benefits program, had a common payroll department, and shared office space, a mailroom, and a telephone system).

[27] 504 US 768, 119 L Ed 2d 533 (1992). This case was analyzed in Dyk and Bilich, "*Allied-Signal* and the Unitary Business Principle: Little Guidance, Many Questions," 2 JMT 154 (Sep/Oct 1992).

[28] See Hellerstein and Hellerstein, *State Taxation,* Vol. I, Third Edition (Thomson Reuters/WG&L, 2001-2011), ¶6.12, page 6-85.

[29] Ky. Ct. App., Dkt. Nos. 2007-CA-002549-MR, 2008-CA-000023-MR, 11/20/09, 2009 WL 3877518 , *as modified* 2/5/10 (unpublished), *rev. den.* Ky. S.Ct., 8/18/10, *cert. den.* U.S.S.Ct., Docket No. 10-662, 1/24/11. See U.S. Supreme Court Update, 11 JMT 40 (Mar/Apr 2011) ; see also Ely, Thistle, and McLoughlin, "Recent Developments in State Taxation of Pass-Through Entities and Their Owners," 20 JMT 6 (September 2010).

[30] See, e.g., Borden Chemicals and Plastics, L.P. v. Zehnder, 726 NE2d 73 (Ill. Ct. App. 1st Dist., 2000), *app. den.* Ill. S.Ct., No. 89197, 5/31/00; and Utelcom, Inc. v. Comm'r of Revenue, Mass. App. Tax Bd., No. C262339, 1/31/05, 2005 WL 244820 . Borden was analyzed in Hughes and Fader, "Illinois: Court Allows Pass-Through of Investment Credits," 10 JMT 35 (June 2000) ; Utelcom, in Shop Talk, "Out-of-State Corp. Was Doing Business in Massachusetts Based on Limited Partnership Interest," 15 JMT 39 (January 2006).

[31] See, e.g., N.J. Div. of Tax'n Technical Bulletin, No. TB-3, 6/21/91 (expired 6/30/92) (discussing New Jersey's historical view adopting the entity theory of partnerships for CBT purposes). See also "Division Issues Guidelines on Corporate Partners," *New Jersey State Tax News* (Vol. 20, No. 3; Div. of Tax'n, May/June 1991) ("a corporate partner is not generally permitted to include the partnership's property, payroll and receipts in its allocation factor").

[32] This may be explained by the fact that the parties themselves, in their briefs, did not address either the aggregate theory or entity theory of partnerships.

[33] N.J. Admin. Code §§18:7-17.6(b) and (c).

[34] Gannett New Jersey Partners, L.P. v. Director, Division of Tax'n, N.J. Tax Ct. Docket No. 002486-2011, filed 4/5/11.

[35] See N.J. Rev. Stat. §54:10A-15.11 and N.J. Admin. Code §18:7-17.5.

[36] U.S. Const. art. I, §8, cl. 3.

[37] See, e.g., Boston Stock Exchange v. State Tax Comm'n, 429 US 318, 50 L Ed 2d 514 , 329 (1977).

[38] Fulton Corp. v. Faulkner, 516 US 325, 133 L Ed 2d 796 (1996) (internal quotation marks and citation omitted). Fulton was analyzed in Cummings, "U.S. Supreme Court's Decision in *Fulton* May Lead to Broader Findings of Tax Discrimination," 6 JMT 52 (May/Jun 1996) .

[39] *Id.*

[40] See Oregon Waste Systems, Inc. v. Dept. of Environmental Quality of Oregon, 511 US 93, 128 L Ed 2d 13 (1994) (the Court stated: "In fact, use taxes on products purchased out of state are the only taxes we have upheld in recent memory under the compensatory tax doctrine."). For a bit more on this case, see U.S. Supreme Court Update, 4 JMT 142 (Jul/Aug 1994).

[41] N.J. Rev. Stat. §54:49-14.a; N.J. Admin. Code §§18:2-5.2(c) and 18:7-13.8(a). The due date of the return is deemed the payment date if filing and payment are made prior to the due date.

The term "due date" means the original due date of the return, and does not mean or include any extended due date. N.J. Admin. Code §18:7-13.8(a).

[42] For example, in Jim Beam Brands Co. v. Director, Division of Tax'n, N.J. Tax Ct., Docket No. 000324-2006, filed 2/28/06, a case with facts that appeared similar to Chiron, the Division took the position that the partner and partnership were unitary. (In contrast to Chiron, treating the partner and partnership as a unitary business in Jim Beam *increased* the taxpayer's tax.) This case was resolved, however, before it could be litigated to a decision.

[43] 43 N.J.R. 2193(b). The amended regulation is codified at N.J. Admin. Code §18:7-1.8.

[44] 908 A2d 176 (N.J., 2006), *cert. den.* U.S.S.Ct., 6/18/07. Lanco was discussed in Sollie and Gutowski, "New Jersey: What Now for Intangible Holding Companies in the Wake of *Lanco*?," 15 JMT 18 (January 2006).

[45] 988 A2d 92 (N.J., 2009), *rev'g* 961 A2d 738 (N.J. Super. Ct. App. Div., 2008). Praxair was discussed in Shop Talk, "States' Jurisdiction to Tax: Some Random Musings on Nexus," 20 JMT 41 (May 2010).

[46] AccuZIP, Inc. v. Director, Division of Tax'n, 25 NJ Tax 158, 2009 WL 2517103 (Tax Ct., 2009).

[47] *Compare* N.J. Rev. Stat. §54:10A-4(k)(5) *with* IRC §243.

[48] N.J. Rev. Stat. §54:10A-4(k)(5).

[49] N.J. Rev. Stat. §54:10A-6.1 provides that "nonoperational income" is not apportioned and must be specifically assigned. "Nonoperational income" is income other than "operational income," which means "income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations and includes investment income serving an operational function." *Id.* New Jersey-headquartered companies are subject to tax on 100% of their nonoperational income.

[50] See, e.g., Allied-Signal, Inc. v. Director, Division of Tax'n, *supra* note 27. While the unitary business principle is briefly discussed in the text above, a detailed discussion is beyond the scope of this article. But see Dyk and Bilich, *supra* note 27.

[51] N.J. Rev. Stat. §54:10A-4(k)(6). "Net operating loss ... means the excess of the deductions over the gross income ... without ... the exclusions in paragraph[] ... (5) of this subsection" (i.e., the dividends-received deduction). Also, the NOL carryover is "the excess, if any, of the amount of the loss over the sum of the entire net income, computed without the exclusions permitted in paragraph[] (5) of this subsection ..., for each of the prior privilege periods to which the loss may be carried." *Id.,* §§54:10A-4(k)(6)(B) and (C).

[52] See Ronson Corp. v. Director, Division of Tax'n, 22 NJ Tax 652, 2005 WL 3093316 (Super. Ct. App. Div., 2005).

[53] For a discussion of the continued relevance of the operational function test in determining whether income from an interest in another business produces apportionable income, see Hellerstein, "*MeadWestvaco* and the Scope of the Unitary Business Principle," 108 J. Tax'n 261 (May 2008) (discussing *MeadWestvaco Corp. v. Illinois Dept. of Revenue,* 553 US 16, 170 L Ed 2d 404 (2008), *vac'g and rem'g Mead Corp. v. Dept. of Revenue,* 861 NE2d 1131 (Ill. Ct. App. 1st Dist., 2007), *app. den.* Ill. S.Ct., 1/24/07, in which the U.S. Supreme Court unanimously vacated and remanded the decision of the Illinois Appellate Court. The Illinois court had permitted the state's Department of Revenue to tax an apportioned share of Mead Corporation's gain on the sale of its Lexis/Nexis division. In its ruling, the Supreme Court reaffirmed that the unitary business principle is the linchpin of apportionability, but cast serious doubt on the continuing relevance of the operational function test in the context of certain business dispositions.).

[54] 528 US 458, 145 L Ed 2d 974 (2000) (disallowance of an otherwise allowable deduction based on the level of out-of-state income is effectively an extraterritorial tax on the out-of-state

income). Hunt-Wesson was analyzed in Hellerstein, "Constitutional Restraints on State Interest Expense Allocation After *Hunt-Wesson,*" 10 JMT 4 (October 2000)**.**

[55] Hunt-Wesson, Inc. v. Franchise Tax Bd. of Calif., *supra* note 54, page 464 ("California's statute does not directly impose a tax on nonunitary income. Rather, it simply denies the taxpayer use of a portion of a deduction from unitary income.").

[56] Lanco, Inc. v. Director, Division of Tax'n, *supra* note 44; Praxair Technology, Inc. v. Director, Division of Tax'n, *supra* note 45.

[57] AccuZIP, Inc., *supra* note 46.

[58] See 35 N.J.R. 1573(a) (amending N.J. Admin. Code §18:7-7.6(b)).

[59] *Id.*