

Income/Franchise:

New Jersey Appellate Court Reverses and Remands Ruling on CBT Royalty Expense “Addback” Exception

Docket No. A-3444-18 / A-0002-19, N.J. Super. Ct., App. Div. (9/21/21). In an unpublished decision, the New Jersey Superior Court, Appellate Division (Court), reversed New Jersey Tax Court (Tax Court) rulings from 2019 involving New Jersey’s corporation business tax (CBT) intercompany royalty expense “addback” adjustment, holding that the New Jersey Division of Taxation’s (Division) limited application of N.J.A.C. section 18:7-5.18(b)(3) (*i.e.*, the “unreasonable” exception) and accompanying CBT schedule was an appropriate exercise of discretion, entitled to deference by the Tax Court, and was consistent with implementing legislation enacted in 2002. In doing so, the Court held that an administrative regulation was *not* needed to allow an exception for the contested amount at issue and reversed the taxpayer’s underlying CBT refund claims. The Court additionally remanded the case to the Tax Court “for consideration of the constitutional issues” raised by the taxpayer.

URL: <https://www.njcourts.gov/attorneys/assets/opinions/appellate/unpublished/a3444-18a0002-19.pdf>

Under the facts, the taxpayer’s subsidiary had reported all of the royalties it received from the taxpayer on its separate return for CBT purposes, and the Division had accepted, without change, the subsidiary’s and taxpayer’s underlying respective New Jersey CBT allocation factors. However, pursuant to the Division’s accompanying CBT schedule, the Division deemed only a portion of the royalty expenses paid by the taxpayer to its subsidiary as excepted from the CBT addback requirements because the subsidiary paid a smaller amount of CBT based on its New Jersey allocation factor, which was lower than the taxpayer’s New Jersey allocation factor. In 2019, the Tax Court had granted the taxpayer’s underlying refund claims in this case – reasoning that once the subsidiary, the royalty recipient, had reported as its income the entire amount of the royalties paid to it by the taxpayer, and then paid the requisite CBT on its allocable share of such income to New Jersey, “the legislative concerns of income shifting/exporting machinations, which caused the enactment of N.J.S.A. 54:10A-4.4(b), are allayed.” The Tax Court never reached the constitutional issues because of its determination that the Division did not exercise appropriate discretion. Please contact us with any questions.

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