

# New Jersey – Tax Court finds throwout rule does not apply to taxpayers subject to tax in other states under New Jersey's economic nexus standard

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## In brief

The Tax Court of New Jersey found that the state must use the same 'economic nexus' standard used to subject a licensor of intangible property to the state's Corporation Business Tax that is used to determine whether that same licensor is 'subject to tax' in other states for purposes of the state's throwout rule. Because the licensor received royalties for property sold in all 50 states, the licensor was 'subject to tax' in all 50 states and, therefore, the throwout rule did not apply to any of its sales. Although this case dealt with licensing revenues, it could very well apply to sellers of tangible personal property that threw out receipts from the New Jersey receipts factor denominator. As a result, refund opportunities may exist for both sellers of intangible and tangible personal property.

The tax court rendered its decision without a written opinion.<sup>1</sup> The discussion below is derived from the transcript of the proceedings, which includes the tax court's oral decision. [*Lorillard Licensing Co., LLC v. Director*, N.J. Tax Court No. 008772-2006 (8/9/13)]

## In detail

### Facts

During the 1999 through 2004 tax years at issue, Lorillard Licensing Company LLC (Licensing) held intangible property used in connection with tobacco products that were produced and sold by a related entity, Lorillard Tobacco (Tobacco). Licensing had no physical presence in New Jersey and filed no New Jersey Corporation Business Tax (CBT)

returns. Pursuant to a royalty agreement, Tobacco paid Licensing a royalty based on Tobacco's sale of products in all 50 states, including sales into New Jersey.

During an audit of the 1999-2004 tax years, the New Jersey Division of Taxation asserted that (1) Licensing had nexus with New Jersey and should file CBT returns and (2) Licensing should apply the state's throwout rule that was in place

for the 2002-2004 tax years. Licensing filed suit in tax court protesting the assertion of nexus and the application of the throwout rule.

Pursuant to the state's 2009 amnesty program, Licensing filed CBT returns for the 1999-2004 tax years, but did not apply the throwout rule for the 2002-2004 returns.

**Lanco economic nexus standard**  
The court recognized that the New Jersey Supreme Court in *Lanco v. Director, Division of Taxation* found sufficient ‘economic’ nexus existed between the state and a trademark holding company whose intangible assets were used by a related company to sell products in the state. It was in the aftermath of this decision that the state implemented the amnesty under which Licensing filed its 1999-2004 CBT returns.

#### **New Jersey’s throwout rule**

Until July 1, 2010, New Jersey required taxpayers to remove from their sales factor denominator any sales that were attributable to states where they were not subject to tax.

In 2011, the New Jersey Supreme Court held in *Whirlpool v. Director of Taxation* that the throwout rule was unconstitutional on its face for sales attributable to states that did not impose an income tax (e.g., Nevada, South Dakota, etc.). The throwout rule may be constitutionally applied to untaxed receipts from states that lack jurisdiction to tax the taxpayer due to insufficient business activity in that state.

#### **Nexus standard for throwout and jurisdiction to tax are the same**

Since the throwout rule, pursuant to *Whirlpool*, could only be applied for sales to states that have no jurisdiction over the taxpayer, the issue in *Lorillard* became - what standard to apply in determining whether Licensing had nexus with other states? Does a court apply New Jersey’s economic nexus standard? If so, then Licensing would have nexus everywhere because Tobacco used Licensing’s intangible property to sell products in all 50 states. Does a court apply the respective state’s nexus standard? If so, would taxpayer have to review the nexus rule in all 50 states to determine whether nexus exists? Additionally, should a court require that a taxpayer actually file in another state to avoid application of the throwout or is satisfying nexus requirements sufficient to be considered ‘subject to tax’ in another state?

The tax court decided that the state “can’t have it both ways.” The state cannot maintain the position that Licensing is subject to New Jersey tax yet not subject to tax in the other 50 states. The court recognized that the license agreement between Licensing and Tobacco applied in all 50 states and that Tobacco sold products in all 50 states. Applying the *Lanco*

economic nexus standard that subjected Licensing to the New Jersey CBT, the court agreed that Licensing would be subject to tax in all other states. Accordingly, the tax court ruled that the throwout rule could not apply to any of Licensing’s sales because all of its sales were made to states where it was ‘subject to tax.’

The court found it irrelevant that License failed to file a return in other states and that other states failed to audit License.

#### **The takeaway**

Although *Lorillard* is currently a non-published tax court oral decision, the rationale remains instructive for taxpayers challenging a throwout assessment.

New Jersey’s throwout rule has been repealed for privilege periods beginning after June 30, 2010. Despite its repeal, the throwout rule continues to be the subject of litigation. Although this case dealt with licensing revenues, it could very well apply to certain sellers of tangible personal property that threw out receipts from the New Jersey receipts factor denominator. As a result, refund opportunities may exist for both sellers of intangible and tangible personal property.

## **Let’s talk**

If you have any questions about the *Lorillard* decision, please contact one of the following PwC state and local tax professionals:

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<sup>i</sup> The transcript is available on Morrison & Foerster LLP's website at the following link:  
<http://www.mofo.com/files/Uploads/Images/130809-Lorillard-vs-Division-of-Taxation.pdf>

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