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New Jersey to begin examining intercompany transactions with related foreign affiliates

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The New Jersey Division of Taxation announced in a recent Technical Advisory Memorandum that it will be adjusting intangible expense deductions of a domestic taxpayer made to a foreign affiliate or parent if it determines that the items do not accurately reflect true income or expenses. [New Jersey Division of Taxation [TAM 2011-22](#), 12/7/2011]

In computing entire net income for the New Jersey Corporate Business Tax, taxpayers are required to add back intangible expenses paid to related members or entities. There are several exceptions to this requirement, including intangible expenses paid to a related member in a foreign nation that has in force a comprehensive income tax treaty with the United States.

The New Jersey Division of Taxation (Division) declared in TAM 2011-22 that it intends to use its existing authority to adjust items of income, expenses, allocation factors and tax returns to examine transactions between domestic and foreign affiliated companies to ensure that the New Jersey taxpayer reports the appropriate amount of expenses and deductions.

The Division Director may make adjustments to a New Jersey taxpayer's entire net income to reflect the true income earned and expenses incurred in the state to reach a "fair and reasonable determination" of the amount of tax payable," defined as "one that would have been payable by a taxpayer reporting the same transaction(s) on a



separate entity basis where the parties to the transaction(s) had independent economic interests."

To determine whether the New Jersey affiliate's intangible expense deductions meet the arm's length standards of IRC Section 482 and New Jersey law, the Division may request certain documentation, including the following: an overview of the domestic taxpayer's business; description of its structure; identification of the transfer pricing methodology selected and why such methodology was determined to be the most appropriate for transfer pricing purposes; and an explanation of the economic analysis relied upon in making the determination. Documentation satisfying the requirements of IRC Section 6662, a third party transfer pricing study, or an advanced pricing agreement (APA) approved by the Internal Revenue Service will satisfy the documentation requirements. However, approved APAs may be reviewed by the Division. ([TAM 17](#))

Once the Division has received the requested documentation, it may undertake its own arm's length analysis of the transactions and if it determines that an adjustment must be made, it will do so by adjusting entire net income of the domestic taxpayer, including a disallowance of up to 100 percent of the deduction arising from payments to a foreign affiliate or parent.

If a taxpayer fails to provide the requested documentation, the Division may disallow up to 100 percent of the deduction and may contact and commence an audit of the foreign affiliate or parent.

PwC Observes

"There is no mention in the TAM of whether a foreign licensor will be deemed to have nexus in New Jersey and be subject to the Corporate Business Tax," notes Hardeo Bissoondial, SALT partner with PwC in Florham Park, New Jersey. "It appears the Division will audit the foreign affiliate *only if* the domestic affiliate fails to provide the requested documentation and, if the audit commences, it will be only for purposes of determining the domestic affiliate's entire net income. If the Division does not assert nexus against the foreign affiliate, it will be interesting to see how it distinguishes between foreign and domestic licensors."

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