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## *New Jersey Division of Taxation: State not bound by advance pricing agreements with IRS*

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The New Jersey Division of Taxation has issued a technical advisory memorandum (TAM), which it intends to codify in a regulation, stating that while it will "take into consideration" an advance pricing agreement (APA) between a taxpayer and the IRS in evaluating the appropriateness of intercompany pricing, it is not bound by such APAs and may use other criteria in determining a "fair and reasonable tax" under New Jersey law. [New Jersey Division of Taxation, [TAM-17](#), 6/6/2011]

The Division notes in the TAM that N.J. Stat. Ann. Sec. 54:10A-10 provides the Division with authority to make adjustments "as may be necessary to make a fair and reasonable determination of the amount of tax payable[.]" The Division states that "in most cases, when arriving at a 'fair and reasonable tax,' the Division will utilize IRC 482 standards in auditing and adjusting items above line 28 of Schedule A of the Corporation Business Tax return. Where a taxpayer can demonstrate that it has met the standards of IRC 482, no adjustments are likely to be made above Line 28..." The Division also states that because APAs are accepted by the IRS based on Section 482 standards, and these standards are incorporated in New Jersey regulations, "the Division will take into consideration an advance pricing agreement between the taxpayer and the Internal Revenue Service in the evaluation of the appropriateness of intercompany pricing and the determination of a 'fair and reasonable tax.'"

However, the Division states that N.J. Stat. Ann. Sec. 54:10A-10 "goes beyond IRC 482 situations," including a grant of authority to the Division to include a "fair profit" in a taxpayer's income. Further, the statute places the burden of proof on the



taxpayer to "demonstrate by clear and convincing evidence that a report by a taxpayer discloses the true earnings of the taxpayer on its business carried on in this State..." The Division notes that Section 482 is "not the only provision that relates to audits of related taxpayers, and other issues may arise in a particular audit such as 'nexus' rules for affiliates."

Therefore, the Division states that it reserves the right "in particular instances" to use "other criteria" besides an APA that may produce "a fair and reasonable tax."

### ***PwC observes***

"New Jersey is but one state where the failure adheres to all components of an advance pricing agreement is a concern," observes Tony Grasso, State and Local Tax Director with PwC in Florham Park, NJ. "As in the majority of states, New Jersey begins the corporate tax calculation with line 28, but reserves the right to audit items that go into determining that amount. While New Jersey's regulations specifically adopt transfer pricing principles under Section 482, the Division was careful in its notice to delineate areas where its authority to make adjustments varies from federal procedures. Unfortunately, as we have seen on audit already, New Jersey has adopted a policy of challenging APAs as insufficient to produce a 'fair and reasonable' result for state tax purposes in some cases. The resulting uncertainty for taxpayers with APAs in place will be a major issue going forward, both in New Jersey and in other states that adopt a similar approach on audit."

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