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A Washington National Tax Services (WNTS) Publication

August 25, 2011

New Jersey Appeals Court upholds limited partner's lack of nexus

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The Superior Court, Appellate Division of New Jersey upheld a state tax court decision that a foreign corporation was not subject to the corporation business tax (CBT) because it simply held a passive interest in a limited partnership, was not unitary with the partnership, and was not otherwise doing business in the state. [*BIS LP, Inc. v. Division of Taxation,* N.J. Superior Ct., Appellate Division, Docket No. A-1172-09T2, 8/23/11]

Background

BISYS Group, Inc. provides information processing and technology outsourcing services. Beginning in 1999, BISYS Group reorganized certain of its divisions to create a series of holding company/limited partnership entities. As a result of the reorganization, BISYS, Inc. (BISYS) was a wholly-owned subsidiary of the BISYS Group, and BIS LP, Inc. (BIS) was a wholly-owned subsidiary of BISYS. BISYS and BIS entered into an agreement whereby BISYS was the general partner with a 1 percent interest and BIS was the limited partner with a 99 percent interest in BISYS Information Solutions, LP (Solutions), a limited partnership that held all of the former BISYS banking information solutions division. Solutions conducted business in New Jersey.

BIS contended that it was not subject to the CBT because it lacked a constitutional presence in the state. The Director, Division of Taxation ("Director") rejected that contention citing BIS's unitary relationship with Solutions in New Jersey. After an assessment was issued, BIS appealed to the New Jersey Tax Court, which granted a summary judgment motion in favor of BIS finding that BIS and Solutions were not unitary and that BIS's interest in Solutions was akin to a foreign corporation that simply holds a limited liability partnership interest in a foreign New Jersey partnership. (View a summary of the Tax Court's decision). The Director appealed the decision to the New Jersey Superior Court, which granted a de novo review of the grant of summary judgment. (The tax court also upheld BIS's status as an investment company. That portion of the tax court decision was not appealed.)

Appeal

On appeal, the Director argued BIS was "plainly devised to export taxable income from New Jersey." The superior court, appellate division ('court") rejected this argument, noting that the Director admitted all material facts relating to the reorganization and its purposes set forth in BIS's statement of undisputed facts, which did not include tax avoidance. The thrust of the Director's argument, however, was that given the unitary nature of the relationship between BIS and Solutions, BIS was doing business in New Jersey. Under the New Jersey regulations explaining the doing business provisions of state law, a foreign corporate limited partner of a limited partnership doing business in the state is considered exercising its franchise to do business in the state if (among other things) the business of the partnership is integrally related to the business of the foreign corporation. To avoid an unconstitutional tax, the state uses a unitary business approach to address what is meant by integrally related.

Unity argument

Specifically, the Director argued that the tax court, in concluding that BIS only had a passive interest in Solutions, failed to take into account rights and obligations reserved to BIS in the reorganization agreement. For instance, the agreement required BIS to consent to the sale or transfer of the general partner's interest in Solutions and had the right of first refusal regarding the sale of the partner's interest. However, this does not indicate unity nor does it establish that BIS was doing business in New Jersey, the court explained. The court reiterated the tax court's conclusions that BIS was a passive investor in Solutions and had no control or potential for control in the business partnership and that Solutions and BIS were in different lines of business. Further, the fact that BIS and the Solutions' general partner shared some corporate officers was not enough to establish a unitary relationship.

The court, citing regulation N.J.A.C. 18:7-7.6(g)(3), listed several factors indicating a unitary business:

- The partnership interest is the only or the most substantial asset of the corporation;
- The partnership interest produces all or most of the income of the corporation;
- The corporation and the partnership are in the same line of business;
- There is substantial overlapping of employees and offices; and

- There is sharing of operational facilities, technology, or know-how.

The partnership interest was BIS' only or most substantial asset and produced BIS' income. However, the entities were not in the same line of business, there was not a "substantial' overlapping of officers, and there was no sharing of offices, operational facilities, technology or know-how. Thus, the court upheld the conclusion that a unitary business did not exist.

The Director argued that the tax court gave "short shrift' to *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768 (1992) and other cases that established three objective factors for determining whether related businesses are unitary: (1) functional integration; (2) centralization of management; and (3) economies of scale. The court noted that functional integration and economies of scale were not present because the entities were in different lines of business: BIS was an investment company and Solutions' business was banking information data processing. The sharing of mailing addresses and certain corporate officers does not show there was centralized management, the court added.

New Jersey statutes

The Director turned to the language of N.J.S.A. Sec. 54:10A-2, under which the CBT is imposed on corporations "...for the privilege of deriving receipts from sources within this State..." The statute also provides that the taxpayer's exercise of its franchise in the state is subject to taxation if its in-state business activity is sufficient to give the state jurisdiction to impose the tax under U.S. Constitutional standards. BIS countered that the tax court correctly concluded that the BIS had no constitutional presence or nexus to New Jersey. The Director contended that the language of the statute, added in 2002, demonstrated the Legislature's intent that the CBT be applied broadly to all circumstances permitted under the constitution. The court looked at legislative statements supporting the 2002 amendments and found that they merely reveal an intent to close loopholes to prevent corporations from transferring profits to related out-of-state companies. Such an intent cannot override constitutional limitations on taxing power, and the tax court correctly applied the statute without the need to discuss the legislative history of the amendments, the court explained.

The Director also asserted that partnership distributions are business receipts and that BIS existed only to own 99 percent of Solutions, to derive receipts from Solutions, and to attempt to profit tax free from Solutions by exporting those taxable receipts from New Jersey. The court found this argument flawed because the record does not show BIS was created only to attempt to export taxable receipts from the state.

PwC Observes

"This decision shows the importance of documenting business purpose for corporate reorganizations," explains Hardeo Bissoondial, SALT Partner with PwC in Florham Park.

"The court's rejection of the Director's broad application of nexus is refreshing for taxpayers, especially in light of the recently adopted New Jersey regulations on nexus for financial businesses. Taxpayers with similar facts should consider filing protective refund claims," Bissoondial suggests.

"It is unclear whether the Director will appeal to the State Supreme Court."

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