

New Jersey – Enactment of royalty addback does not preclude out-of-state licensor from being subject to CBT

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In brief

The New Jersey Tax Court ruled that an out-of-state company had a Corporate Business Tax reporting responsibility and had to pay tax on royalty income despite an in-state affiliate adding back royalty expense paid to the company. The court disagreed that the prospect of double taxation precludes the company's New Jersey filing obligation. The court suggested that the potential for double taxation is alleviated by the payor seeking an exception to the addback or the payee seeking alternative apportionment relief.

[[Spring Licensing Group, Inc. v. Director, Division of Taxation](#), N.J. Tax Court, No. 010001-2010 (8/14/15)]

In detail

Facts

Spring Licensing Group (Spring) licensed trademarks to its parent, Spring Industries, Inc. (SII). Spring argued that it was not required to file Corporation Business Tax (CBT) returns following the enactment of New Jersey's related party royalty addback in years when SII filed CBT returns adding back its royalty payments to Spring.

2002 law change enacts addback

Generally, corporations are subject to the CBT if they are 'doing business' in the state. In 2002, the legislature amended the CBT by enacting the Business Tax Reform Act (BTRA), which provided two relevant changes:

- defining 'doing business' in the state to include the receipt of New Jersey receipts and "activity in this state sufficient to give [New Jersey] jurisdiction to

impose the tax under the" United States Constitution

- denying deductions for royalty payments made to a related corporate member by requiring the payor to add back otherwise deductible intangible expenses and costs.

Out-of-state licensor subject to CBT

The 2006 New Jersey Supreme Court decision *Lanco, Inc. v. Director, Div. of Taxation* held that a foreign corporation with

no physical presence in New Jersey was subject to the CBT when it received licensing fees attributable to the state. Even prior to *Lanco*, New Jersey regulations provided that foreign companies receiving royalty income from New Jersey companies were subject to the CBT.

Spring did not contest the Division's assertion of nexus.

Accordingly, the court determined that "Spring should have filed duly completed CBT returns for 2002 and 2003, and paid tax on the portion of royalty income allocated to New Jersey."

Statutory addback does not preclude out-of-state licensor's CBT filing responsibility

Spring asserted that it need not file CBT returns after enactment of the BTRA because New Jersey is made whole since it captures the royalty income via the addback. Otherwise, CBT is paid twice: (1) once from the foreign payee and (2) once from the payor.

The court disagreed, noting that, as a separate company state, "duplication of reporting by corporate family members for an item . . . is not out of the realm of normalcy. . . . Thus, a CBT return filed by a foreign IHC pursuant to *Lanco* while the related member files an independent CBT return, is not a necessarily extraordinary event."

Additionally, the court noted that Spring could have other New Jersey sourced income that it would be obligated to report on a CBT return. Accordingly, the court held that the BTRA's enactment of addback "does not exclude or exempt Spring from filing CBT returns to report its royalty income."

Double taxation addressed through addback exceptions

For a payor, the court noted that "the legislature's response to the specter of double-taxation is the ability of the payor to claim an exception to the addback as being 'unreasonable.' The CBT form provides an exception for intangible expenses and costs paid to

related corporations filing in New Jersey.

For a payee, the court suggested that the Division has the obligation to consider adjustments if the inclusion of income results in some form of dual taxation. To that end, the court noted that nothing precluded Spring from filing a return with a refund claim for relief on grounds that SII's addback resulted in unfair or unreasonable dual apportionment.

The takeaway

This decision highlights the risk that aggressive states may target out-of-state nonfiling licensing companies even when the state is purportedly made whole due to the addback of related party expenses. On audit, nonfilers could be subject to tax, interest, and penalties without the ability for the in-state payee to amend returns and take an addback exception to the extent statutory years are closed. *Spring Licensing* opens the door for licensor corporations to request relief if double taxation is present.

Let's talk

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