

N.J. Increases Tax on P.L. 86-272-Protected Companies—Should You Comply?

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In the days leading up to Monday's deadline to file CBT returns, some of our clients that are protected from New Jersey income tax by P.L. 86-272 have asked us whether they should comply with New Jersey's Alternative Minimum Assessment (or "AMA"),¹ which, by the express terms of the statute only applies to companies that are protected by P.L. 86-272. Our answer is "no," do not pay that AMA. Because this question has come up several times, we are issuing this alert to taxpayers just in time for their filing on Monday.

AMA's Impact on P.L. 86-272 Protected Companies

Until 2011, if a company was immune from income tax under P.L. 86-272, its New Jersey corporate tax liability was zero. Beginning with the 2011 tax year, however, New Jersey's Division of Taxation is imposing gross receipts tax on these companies. The Division's policy discriminates against companies protected from New Jersey tax by P.L. 86-272. If your company is affected, consider taking a return position that the tax doesn't apply.

This new tax increase results from the application of the AMA, which was enacted in 2002 to supplement New Jersey's corporate income tax. The AMA was designed to raise revenue: a taxpayer had to pay the greater of the AMA or regular income tax. Since the AMA was computed based on gross receipts or gross profits (rather than net income), it applied even if a taxpayer was immune from income tax under P.L. 86-272.

Fortunately, virtually no P.L. 86-272-protected taxpayers had to pay the tax before the 2011 tax year. Because of how the tax was computed, if your New Jersey sales fraction was proportionately higher than your New Jersey property and payroll fractions, your AMA was zero.² P.L. 86-272-protected companies fit this profile because of New Jersey's throwout rule, which required taxpayers to exclude receipts from their sales-fraction denominator if sourced to a state where they were immune from tax.³ Because of throwout, P.L. 86-272-protected companies tended to have relatively high New Jersey sales fractions. So while throwout was in effect, P.L. 86-272-protected companies typically had no AMA liability.

But now that throwout has been repealed starting with the 2011 tax year,⁴ P.L. 86-272-protected companies may suddenly find themselves subject to tax in New Jersey. Even though the AMA expired for most taxpayers in 2006,⁵ it still applies to taxpayers that are P.L. 86-272 protected. The tax effect can be significant. For the typical taxpayer with a gross margin of 50% or more, the AMA is approximately \$100,000 for every billion dollars of everywhere sales.

Filing Options

Forcing P.L. 86-272-protected companies (and only P.L. 86-272-protected companies) to pay AMA is unconstitutional. By explicitly imposing AMA only on companies protected by P.L. 86-272, the AMA discriminates, on its face, against interstate commerce: The only taxpayers that still have to pay AMA are corporations domiciled outside New Jersey that engage in interstate commerce in New Jersey. Therefore, if your company is P.L. 86-272 protected and finds itself subject to AMA for the 2011 tax year, consider taking a return position that the AMA doesn't apply. Keep in mind that if the Division challenges this position, it can impose a 5% underpayment penalty. Also, in light of New Jersey's 25% failure-to-file penalty,⁶ filing a return and paying the statutory minimum may be a better option than simply not filing any return at all.

If you have questions about the AMA and filing options for P.L. 86-272 protected companies or other New Jersey tax issues, please contact the authors of this article, or the Reed Smith lawyer with whom you usually work. For more information on Reed Smith's New Jersey tax practice, visit www.reedsmith.com/njtax.

1. N.J.S.A. § 54:10A-5a.
2. This aspect of the AMA had its own constitutional problems. See Kyle O. Sollie & David J. Gutowski, "Refund Deadline Looms for New Jersey Alternative Minimum Assessment," *State Tax Notes* (3/27/07).
3. See N.J.S.A. 54:10-6(B) (repealed for tax years beginning on or after July 1, 2010 by P.L.2008, c. 120). The constitutionality of throwout was upheld in *Whirlpool Properties, Inc. v. Director, Div. of Taxation*, 26 A.3d 446 (N.J. 2011). *Whirlpool* was remanded back to the New Jersey Tax Court on the non-constitutional issues.
4. P.L.2008, c. 120.
5. N.J.S.A. § 54:10A-5a(e).
6. N.J.S.A. § 54:49-4(a).

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