

## NJ Releases Throwout Guidance: How Should Taxpayers React?

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Yesterday, the New Jersey Division of Taxation released guidance concerning its application of the throwout rule in light of the New Jersey Supreme Court's July 28 decision in *Whirlpool Properties, Inc. v. Director, Div. of Taxation*, \_\_\_ A.3d \_\_\_ (N.J. 2011).

As expected, the Division announced that there will be no significant change to its prior throwout policy. The only change is that the Division will no longer throw out receipts that are sourced to Nevada, Wyoming, or South Dakota. Otherwise, the Division will continue to exclude receipts from the sales-fraction denominator unless the taxpayer can show that those sales are sourced to a state in which the taxpayer is filing a business-activity tax return. (To listen to a more detailed discussion of *Whirlpool*, and the Division's reaction to it, you can access an audio file of our recent teleseminar at the following link: [www.reedsmith.com/njtax](http://www.reedsmith.com/njtax).)

Specifically, the Division's guidance provides:<sup>1</sup>

The New Jersey Supreme Court has affirmed, as modified, the facial constitutionality of the Corporation Business Tax "throw-out rule" at N.J.S.A. 54:10A-6(B) (which has since been repealed, effective 7/1/10).

In accordance with the Court's ruling in *Whirlpool Properties*, the Division has revised its audit policy concerning the application of throwout to receipts assigned to Nevada, Wyoming, and South Dakota. As discussed by the Court, since these three states do not impose a corporate income tax or a similar business activity tax, the Division will not throw out receipts assigned to these states.

For receipts assigned to states other than Nevada, Wyoming, and South Dakota, the *Whirlpool* decision "will not result in a change to the Division's throw out policy and its application."

If no further appeal is taken regarding the facial constitutionality of the throw-out rule, the *Whirlpool Properties* matter will be decided by the Tax Court based on an "as applied" analysis.

In our view, the Division's guidance misapplies the rationale of *Whirlpool*. The court held that the throwout rule is unconstitutional to the extent it is applied to receipts that are not taxed by another state because a state chooses not to impose an income or business activity tax. The court reasoned that "[w]hether another state chooses to tax a receipt has no bearing on how much income is attributable to New Jersey." After *Whirlpool*, therefore, throwout applies only to receipts that are not taxed because the other state lacks jurisdiction to tax.

By essentially maintaining the status quo on throwout, the Division's throwout guidance misconstrues the significance of *Whirlpool*.

Under *Whirlpool*, another state's policy choices can have no effect on the application of throwout. As a result, if a state has jurisdiction to tax a receipt, throwout cannot apply even if a state chooses not to exercise that taxing authority. This is significant in light of the Division's broad nexus policy. The Division's view, which so far has been accepted by the New Jersey appellate courts,<sup>2</sup> is that a taxpayer has sufficient contacts to be subject to tax under the Constitution if it derives receipts from the state-regardless of physical presence. Applying this nexus principle to the court's analysis in *Whirlpool*, a taxpayer is subject to tax in *every state* and throwout can never apply.

Although the court in *Whirlpool* stated that receipts can be thrown out if sourced to a state in which the taxpayer is immune from income tax because of P.L. 86-272, this portion of the court's decision should be viewed as dicta. Whirlpool Properties licensed intangibles, so P.L. 86-272 was not an issue that was before the court. In any case, if a state wants to tax companies that are P.L. 86-272 protected, it can always choose to impose a non-income tax (like New Jersey does with its Alternative Minimum Assessment<sup>3</sup>). The Division recognizes that throwout does not apply to receipts sourced to states that impose business activity taxes on net worth or gross receipts.<sup>4</sup> A state's decision to not impose such a tax is a policy choice. And just like the choice to not impose an income tax, another state's choice to not impose a non-income tax should have no bearing on the application of New Jersey's throwout rule.

Accordingly, based on the court's rationale in *Whirlpool* and the Division's broad nexus policy, throwout should no longer apply to *any receipts*. Taxpayers should consider taking this position on their upcoming 2010 return, which is the last tax year for which throwout is in effect.<sup>5</sup> Further, taxpayers that paid more tax in prior years because of throwout should file refund claims. (For calendar-year taxpayers that filed on the last day on extension, the statute of limitations for the 2006 tax year closes by October 17. The statute of limitations is the fourth anniversary of the filing of that return.)

For more information on *Whirlpool* and the Division's reaction to it, contact the authors of this *Alert* or another member of the Reed Smith State Tax Group. For more information on Reed Smith's New Jersey tax practice, visit [www.reedsmith.com/njtax](http://www.reedsmith.com/njtax).

1. See N.J. Div. of Taxation, NOTICE, New Jersey Supreme Court Decision in *Whirlpool Properties Inc. v. Director*, available at: <http://reedsmithupdate.com/ve/74L717968Cu31ac935/stype=click/OID=61198221833561/VT=0>.
2. See, e.g., *Lanco, Inc. v. Director, Div. of Taxation*, 188 N.J. 380 (2006), cert denied, 127 S.Ct. 2974 (2007). But see *AccuZIP, Inc. v. Director, Div. of Taxation*, 25 N.J. Tax 158, 186 (Tax 2009) (holding that a taxpayer with no physical presence who sold less than \$65,000 of tangible personal property into New Jersey lacked substantial nexus with the state). Since the Division chose not to appeal *AccuZIP* to the appellate courts, it is not bound by the Tax Court's decision.
3. See N.J.S.A. 54:10A-5ae. (imposing a gross receipts tax on taxpayers exempt from corporation net income tax pursuant to P.L. 86-272).
4. N.J.A.C. 18:7-8.7(f).
5. L.2008, c.120 (repealing throwout for privilege periods beginning on or after July 1, 2010).

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