

## New Jersey VDA Program—Attractive Terms for IHCs

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Authors: Kyle O. Sollie , David J. Gutowski

New Jersey has announced a new voluntary disclosure initiative for companies that own intangibles. If your intangible holding company (“IHC”) didn’t come forward previously, it should seriously consider coming forward now. The terms are significantly better than anything the New Jersey Division of Taxation has offered in years. Companies have until January 15, 2013 to take advantage of this program.

In 2006, the New Jersey Supreme Court issued its decision in *Lanco*, holding that physical presence was not required for corporate income tax nexus.<sup>1</sup> The court subsequently ruled that the Division could assert economic nexus even for tax years that pre-dated its 1996 regulation.<sup>2</sup> This broad nexus standard was compounded by New Jersey’s “throwout rule,” which required taxpayers to exclude non-sourced receipts from their sales-fraction denominator for tax years prior to 2011.<sup>3</sup> Although there are pending cases challenging the throwout rule,<sup>4</sup> it could be years before the courts issue a final decision.

In the meantime, the combination of economic nexus and throwout can mean significant assessments for IHCs. For example, in the pending *Whirlpool* case, the IHC’s throwout exposure for 2002 alone is over \$10 million including interest and penalties. IHCs that come forward voluntarily can avoid a significant part of their exposure.

### **Different Options for Throwout Relief and Shorter Look Back Period**

As explained in its notice, the Division will offer throwout relief based on averaging a throwout receipts fraction with a non-throwout receipts fraction. (During this period, New Jersey used a double-weighted sales fraction.) For the typical IHC, this method likely will provide only modest relief from throwout. But that does not mean IHCs should abandon the idea of coming forward. The Division will also consider a throwout remedy under which the IHC computes its tax by multiplying the IHC's New Jersey-source royalties by the statutory tax rate (9% for most taxpayers). To the extent an IHC has receipts besides royalties, the tax with respect to those receipts would be computed statutorily except that the IHC would be entitled to throwout relief using the “averaging” method.

Perhaps the most significant benefit of the new VDA program is the limited look back period. A participating IHC has to file returns only back to 2004, whereas the Division’s prior look back policy was much less generous. If your IHC is discovered on audit, it will have to file back to at least 1996. Another change from the Division’s prior policy for IHCs involves penalties. Under the new VDA program, the Division will abate all penalties except for the 5% amnesty penalty for returns due prior to February 1, 2009. By contrast, if your IHC is discovered on audit, it will face penalties of up to 35%.

## Affiliate May Qualify for Refund, But Claim Due by October 15

IHCs that want to come forward should do so soon. To the extent that an IHC pays tax under the program, any affiliate that paid royalties to the IHC may be entitled to a refund by qualifying for an exception to New Jersey's royalty addback.<sup>5</sup> The affiliate's refund could significantly offset the cost of coming forward. After taking into account the affiliate's refund, certain IHCs would pay the equivalent of only three years' worth of tax. But time is running out for the affiliated payor to claim a refund for the 2007 tax year. The limitations period for a calendar-year taxpayer will close by October 15 (four years from the date the return was filed on extension).

A taxpayer can negotiate VDA terms anonymously. So a company has little to lose by approaching the Division and getting a VDA number. To qualify for the program, the IHC must not be registered for New Jersey corporation business tax and cannot have been previously contacted by the Division about its activities.

A copy of the Division's notice, which includes the complete terms of the program, is available at: [www.reedsmith.com/njtax](http://www.reedsmith.com/njtax).

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<sup>1</sup> *Lanco Inc. v. New Jersey Director, Div. of Taxn.*, 908 A.2d 176 (N.J. 2006).

<sup>2</sup> *Praxair Technology, Inc. v. Director, Div. of Taxation*, 988 A.2d 92 (N.J. 2009).

<sup>3</sup> N.J.S.A. 54:10A-6(B) (repealed by L.2008, c. 120 for tax years beginning on or after July 1, 2010).

<sup>4</sup> See, e.g., *Whirlpool Properties, Inc. v. Director, Div. of Taxation*, N.J. Tax Court Docket No. 000066-2007. Although the New Jersey Supreme Court held that throwout was constitutional on its face, the case is currently before the New Jersey Tax Court with respect to the remaining as-applied and statutory issues.

<sup>5</sup> See N.J.S.A. 54:10A-4.4.

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