

1. "Gross income" for purposes of this subsection and N.J.A.C. 18:7-5.2(a) 7iii means the result of adding the income amounts for gross receipts, or sales, dividends, interest, gross rents, gross royalties, capital gain, net income, net gain or loss from line 14(a), Part II, Federal Form 4797 and other income as adjusted for interest on Federal, state, municipal and other obligations not included in line 5 above and the dividend exclusion;

2. Gross income arrived at (f)1 above is the denominator;

3. The gross income included in (f)2 above resulting from the activities set forth in (a)1 through (a)7 above is the numerator; and

4. If the resulting percentage of (f)2 and 3 above is 75 percent or more, such corporation is a financial business corporation.

(g) A corporation that qualifies as a financial business corporation must file a Corporation Business Tax Return for Banking and Financial Corporations, Form BFC-1 and complete Schedule L apportioning the financial business conducted in New Jersey consistent with N.J.S.A. 54:10A-38 (Section 38 of the Corporation Business Tax Act).

Repealed by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Formerly entitled "Motion to report as investment company".

New Rule R.1987 d.335, effective August 17, 1987.

See: 19 N.J.R. 712(a), 19 N.J.R. 1568(b).

Amended by R.1993 d.364, effective July 19, 1993.

See: 25 N.J.R. 1841(a), 25 N.J.R. 3239(a).

18:7-1.17 Application of the tax to licensees under the Casino Control Act; casino business consolidated return

(a) Pursuant to N.J.S.A. 5:12-148(b), any business conducted by an individual, partnership, corporation, or any other entity, or any combination thereof, holding a license pursuant to the Casino Control Act shall, in addition to all other taxes imposed by that act, file a consolidated corporation business tax return pursuant to the Corporation Business Tax Act and pay the taxes indicated thereon.

(b) The consolidated return to be filed under the Casino Control Act is in addition to, and not in lieu of, any return due under the Corporation Business Tax Act. Provided, however, that where any corporation is a licensee under the Casino Control Act, it may exclude from the return due under the Corporation Business Tax any item of income, loss or deduction appearing on its consolidated return, but which would have been reported on its own separate return under the Corporation Business Tax Act for the year for which that item would otherwise have been reported. Provided further, that where any corporation is a partner in a licensee under the Casino Control Act, it may similarly exclude its share of distributable income or loss attributable to its partnership interest in the licensee which would otherwise have been reported by it on its own separate return under the Corporation Business Tax Act.

1. In no event may the tax reduction arising out of any such exclusion exceed the portion of the tax paid with the consolidated return which is clearly attributable to the net effect of the existence of the amount which is duplicated in entire net income on the separate return filed under the Corporation Business Tax Act.

2. The return filed under the Corporation Business Tax Act shall reflect taxable income before net operating loss deduction and special deductions which is required to be reported to the United States Treasury Department for the purposes of computing its Federal income tax. Claims for exclusion for any duplication shall be separately identified in computing entire net income and be documented and reconciled on the return due under the Corporation Business Tax Act.

3. The amount of net worth reported on the separate return filed under the Corporation Business Tax Act by a corporate member of a consolidated group may be reduced by an amount also reported on the consolidated corporation business tax return of the casino business to the extent that such net worth would have been duplicated on both returns.

(c) The principles of consolidation are determined by regarding each casino hotel as though it were a single corporation reporting in its own right under the Corporation Business Tax Act. The rules governing consolidation under the Internal Revenue Code do not apply. The business conducted by each casino hotel shall give rise to an obligation to file a separate consolidated corporation business tax return based on all the business activities conducted with respect to that casino hotel. All licensees and all other entities subject to common effective control, without respect to their form of organization or the form of license held, except for licenses issued to individuals in their capacity as employees, must join in filing the consolidated return. All transactions between or among them are to be eliminated in consolidation and shall not appear on the consolidated return. Accordingly, where the same licensee or entity subject to common effective control is a participant in the business conducted by more than one casino hotel, it must join in filing a consolidated return with each such business. A change in common effective control terminates the fiscal year for purposes of filing the consolidated return.

1. Common effective control is the power exercisable by any person or entity arising out of ownership or a contractual arrangement which joins more than one licensee or other entity or entities and permits domination in the management of more than one licensee or other entity or entities for the purpose of engaging in a single casino hotel business. Common effective control also occurs where a contractual arrangement permits more than one licensee or other entity or entities to operate jointly a single casino hotel business. For example, where the same persons or entities simultaneously control voting stock, boards of directors or serve as or nominate managing partners or are employed as managers or executives in more than one licensee or other entity or entities which participates in the business activities conducted by the

same casino hotel, or where a licensee or other entity or entities executes a sale and leaseback of its property with another licensee or other entity or entities and reserves by contract the option to recover its property, all such licensees or other entity or entities subject to common effective control shall join in filing the consolidated return. Notwithstanding an absence of common ownership, licensees and all other entities subject to common effective control joined in the operation of the business conducted by a casino hotel by management contract or partnership arrangement shall join in filing the return.

2. Consistent with N.J.A.C. 18:7-11.15(a), the separate return due under the Corporation Business Tax Act may not be consolidated. See also (c)(4) below.

3. Certain corporations that are members of affiliated or controlled groups may be required to file consolidated returns pursuant to N.J.S.A. 54:10A-10. See N.J.A.C. 18:7-5.11. See also (c)4 below.

4. For purposes of this section and notwithstanding any other provision, all divisions, components, or entities that comprise the casino hotel business are required to be included in the casino consolidated return. This includes, without limitation thereto, entities known as "qualifiers." The term "qualifiers" means entities that have officially qualified to participate in the casino industry in New Jersey pursuant to N.J.S.A. 5:12-84 or 5:12-85.c or similar statute, but that are not licensed under the Casino Control Act.

(d) Where a licensee is engaged in a business wholly unrelated to the casino hotel, or is engaged in the operation of more than one casino hotel, common costs must be apportioned in a reasonable manner consistently applied. The method of apportionment shall be disclosed on the consolidated return and may be adjusted by the Director where it shall appear to him to result in a distortion of tax liability.

(e) Where the licensees joining in filing the consolidated return do not have a common fiscal year, the return may be based upon the fiscal year of the casino operator as defined at N.J.A.C. 19:54-1.2 where all licensees join in making such an election. The other licensees may then include their respective financial condition and operations on the basis of their own fiscal years within which the consolidated year ends. Separate schedules reconciling timing differences in elimination of balance sheet items and items of entire net income attributable to the lack of a common fiscal year must be submitted as part of any such consolidated return. In the absence of this election, the return shall be based on a calendar year ending December 31. The reporting method, once adopted, is effective for all future returns unless the prior consent of the Director is obtained for a change.

(f) A legend shall be prominently displayed on the face of any return filed under this section identifying the return as a casino business consolidated return.

EXAMPLE

| | Hotel Entity 1 | | Management Co. Entity 2 | | Eliminations | | Consolidated | | Duplications | | | |
|--------------------|----------------|--------|-------------------------|------|--------------|-----|--------------|--------|--------------|--------|-----|-------|
| | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. |
| Gaming Revenue | \$ | \$1000 | \$ | \$0- | \$ | \$ | \$ | \$1000 | \$ | \$1000 | \$ | \$0- |
| Other Income | | 200 | | 0- | | | | 200 | | 200 | | 0- |
| Management Fees | | 0- | | 500 | 500 | | | 0- | | 0- | | 0- |
| Total Income | | 1200 | | 500 | | | | 1200 | | 1200 | | 0- |
| Management Fees | 500 | | 0- | | | 500 | 0- | | 0- | | 0- | |
| Payroll Deductions | 0- | | 200 | | | | 200 | | 0- | | 200 | |
| Other Deductions | 200 | | 0- | | | | 200 | | 200 | | 0- | |
| Total Deductions | 700 | | 200 | | | | 400 | | 200 | | 200 | |
| Net Income | 500 | | 300 | | | | 800 | | | | | |
| Duplications | | | | | | | | | 1000 | | | (200) |

Entity #1
 Net Income \$ 500
 Adjustment for duplication (1000)
 Tax Base \$ 0-

Entity #2
 Net Income \$ 300
 Adjustment for duplication (200)
 Tax Base \$ 300

Entity #2 may elect not to exclude duplications

New Rule, R.1985 d.453, effective September 3, 1985.
 See: 17 N.J.R. 901(a), 17 N.J.R. 2145(a).
 Special amendment, R.2003 d.135, effective February 27, 2003 (to expire August 26, 2003).

See: 35 N.J.R. 1573(a).
 Added (c)3.
 Adopted concurrent amendment, R.2003 d.370, effective August 22, 2003.

iv. In any privilege period or taxable year beginning on or after January 1, 2002, with respect to property acquired on or after January 1, 2002 and before September 11, 2004, any depreciation which was deducted in arriving at Federal taxable income and which was determined in accordance with Sections 168(k) and 1400L of the Federal Internal Revenue Code. Assets acquired before January 1, 2002 for which such depreciation was taken will continue for the entire life of the asset to follow Federal depreciation. Assets acquired in periods beginning before January 1, 2002 will continue to follow Federal depreciation even if the asset itself was acquired after January 1, 2002 but during such fiscal year. Upon early retirement a basis adjustment will be required to equalize Federal and State basis.

Example: Federal bonus depreciation with respect to an asset acquired February 1, 2002 by a corporation which is a calendar year corporation will be disallowed for the corporation when filing its CBT-100 for 2002.

v. Gain or loss on property sold or exchanged is to be determined with reference to the amount properly to be recognized in determination of Federal taxable income. However, on the physical disposal of recovery property, whether or not a gain or loss is properly to be recognized under the Federal Internal Revenue Code, there shall be allowed as a deduction any excess or there must be restored as an item of income any deficiency of depreciation disallowed under (a)1x above over related depreciation claimed on that property under (a)2iv above. A statutory merger or consolidation shall not constitute a disposal of recovery property.

vi. In any year or short period ending after 1981, with respect to property placed in service on and after January 1, 1981, but prior to taxpayer fiscal or calendar accounting years beginning on or after July 7, 1993, any item of income included in arriving at Federal taxable income solely as a result of a "safe harbor leasing" election made under Section 168(f)(8) of the Federal Internal Revenue Code; provided, however, that for the accounting period which begins in 1981 and ends in 1982, such income which relates to property placed in service during 1981 is not to be excluded; and provided, further, that any such income which relates to a qualified mass commuting vehicle pursuant to Federal Internal Revenue Code Section 168(f)(8)(D)(v) (formerly 168(f)(8)(D)(iii)) shall be included in entire net income in any event.

(1) Where income relating to such safe harbor leasing election would have been included in Federal taxable income whether or not the election is made, no exclusion is permitted.

Example: A corporation which finances the acquisition of machinery and equipment is not permitted to exclude interest income merely because it is one of the parties to a "safe harbor lease" whereby it agreed that all parties to the trans-

action characterize it as a lease for Federal income tax purposes.

(2) For treatment of deductions relating to such safe harbor lease transactions, see (a)1xi above.

vii. Any banking corporation which is operating an international banking facility (IBF) as part of its business may exclude the eligible net income of the IBF, as herein described, from its entire net income, as follows:

(1) Any deductions under this section can only be claimed to the extent that they are not deductible in determining Federal taxable income, or not deductible under N.J.S.A. 54:10A-4(k)(1) through (3).

(2) The eligible net income of an IBF is the amount of income remaining after subtracting the applicable expenses, as defined by (a)2vii(4) below.

(3) Eligible gross income is the gross income derived from an IBF. This will include gross income derived from the following:

(A) Making, arranging for, placing or carrying loans to foreign persons, provided, however, that in the case of a foreign person which is an individual, or which is a foreign branch of a domestic corporation (other than a bank), or which is a foreign corporation or foreign partnership which is controlled, by one or more domestic corporations (other than banks), domestic partnerships or resident individuals, all the proceeds of the loan are for use outside of the United States;

(B) Making or placing deposits with foreign persons which are banks or foreign branches of banks (including foreign subsidiaries) or foreign branches of the taxpayers or with other international banking facilities; or

(C) Entering into foreign exchange or hedging transactions relating to any transactions under (a)2vii(3)(A) and (B) above or (D) below.

(D) Any other activities which an IBF may be, at any time, authorized to engage in by Federal or state law, the Board of Governors of the Federal Reserve, the Comptroller of the Currency, the New Jersey Banking Commission, or any other authority.

(4) Applicable expenses are any expenses or deductions which are directly or indirectly attributable to eligible gross income as defined in (a)2vii(3) above.

(See: N.J.A.C. 18:7-16 regarding international banking facilities.)

Amended by R.1983 d.62, effective March 7, 1983
See: 14 N.J.R. 1206(a), 15 N.J.R. 343(d).

Added new 10 and 11 to (a). Recodified old 10 as new 12 and added 4-6 to (b).

Amended by R.1984 d.453, effective October 15, 1984.
See: 16 N.J.R. 1327(a), 16 N.J.R. 2827(a).

(b)7 added.
Amended by R.1985 d.562, effective November 4, 1985.
See: 17 N.J.R. 1538(a), 17 N.J.R. 2678(a).
Substantially amended.
Amended by R.1987 d.335, effective August 17, 1987.
See: 19 N.J.R. 712(a), 19 N.J.R. 1568(b).
Substantially amended.
Amended by R.1992 d.289, effective July 20, 1992.
See: 24 N.J.R. 175(a), 24 N.J.R. 2628(b).
Revised text.
Amended by R.1994 d.186, effective April 18, 1994.
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).
Amended by R.1997 d.204, effective May 19, 1997.
See: 28 N.J.R. 5158(a), 29 N.J.R. 2467(a).
In (a)1vii, inserted "For accounting or privilege periods ending on or before January 10, 1996."
Special amendment, R.2003 d.135, effective February 27, 2003 (to expire August 26, 2003).
See: 35 N.J.R. 1573(a).
Rewrote the section.
Adopted concurrent amendment, R.2003 d.370, effective August 22, 2003.
See: 35 N.J.R. 1573(a), 35 N.J.R. 4310(a).
Provisions of R.2003 d.135 adopted without change.
Amended by R.2004 d.367, effective October 4, 2004.
See: 36 N.J.R. 1680(a), 36 N.J.R. 4484(a).
In (a), deleted iii, recodified former iv through viii as iii through vii in 2.
Amended by R.2006 d.61, effective February 6, 2006.
See: 37 N.J.R. 4195(a), 38 N.J.R. 1080(a).
In (a)2i, deleted "of this chapter"; added (a)2i(1) and (a)2ii(1).
Amended by R.2007 d.284, effective September 4, 2007.
See: 39 N.J.R. 844(a), 39 N.J.R. 3780(b).
In (a)1viii, updated the second N.J.A.C. reference; in (a)1xviii, deleted "and" from the end; in (a)1xix, substituted a semicolon for the period at the end; and added (a)1xx and (a)1xxi.

Case Notes

Benefits from safe harbor leases do not constitute "real intangible personal property", for purposes of corporate tax. *Reuben H. Donnelley Corp. v. Director, Div. of Taxation*, 128 N.J. 218, 607 A.2d 1281 (1992).

Interpretation of amendment to corporate tax governing safe harbor leases was not an administrative rule. *Reuben H. Donnelley Corp. v. New Jersey Dept. of Treasury, Div. of Taxation*, 11 N.J.Tax 241 (1990), reversed 12 N.J.Tax 255, certification granted 127 N.J. 551, 606 A.2d 364, reversed 128 N.J. 218, 607 A.2d 1281.

Corporate owner of safe harbor leased property could not include it in owner's business allocation factor. *Reuben H. Donnelley Corp. v. New Jersey Dept. of Treasury, Div. of Taxation*, 11 N.J.Tax 241 (1990), reversed 12 N.J.Tax 255, certification granted 127 N.J. 551, 606 A.2d 364, reversed 128 N.J. 218, 607 A.2d 1281.

State's inclusion of Federal obligations in taxpayer bank's tax bases under the Corporation Business Tax Act complied with the Federal public debt statute since the tax was nondiscriminatory; taxpayer bank's net worth and net income bases appropriately included the value of and income from the bank's holdings of state and local obligations. *Garfield Trust Co. v. Director, Div. of Taxation*, 6 N.J.Tax 462 (Tax Ct.1984), affirmed per curiam 7 N.J.Tax 663 (App.Div.1984), affirmed 102 N.J. 420, 508 A.2d 1104 (1986), appeal dismissed 107 S.Ct. 390, 479 U.S. 925, 93 L.Ed.2d 345.

Federal minimum tax for tax preference was not properly excludable from the taxpayer's entire net income in the calculation of New Jersey corporation business tax, since the Federal minimum tax is on income and not an excise tax on capital. *Texaco, Inc. v. Director, Div. of Taxation*, 4 N.J.Tax 63 (Tax Ct.1982).

18:7-5.3 Tax paid to foreign country or United States possession; when deductible from net income

(a) With respect to foreign taxes required to be included in income as dividends received under Section 78 of the Internal Revenue Code, no deduction from Federal taxable income is permitted if 100 percent of the dividend received amount is deductible therefrom under N.J.A.C. 18:7-5.2(a) 2i.

1. However, if 100 percent of the foreign tax amount is not deductible from Federal taxable income as dividends received under N.J.A.C. 18:7-5.2(a) 2i, then the percentage which is taxed may be deducted from Federal taxable income. No other foreign taxes are deductible.

Amended by R.1999 d.116, effective April 5, 1999.
See: 31 N.J.R. 266(b), 31 N.J.R. 893(a).

In (b), changed N.J.A.C. references throughout.
Administrative change and correction.
See: 31 N.J.R. 1818(a).
Special amendment, R.2003 d.135, effective February 27, 2003 (to expire August 26, 2003).
See: 35 N.J.R. 1573(a).
Rewrote the section.
Adopted concurrent amendment, R.2003 d.370, effective August 22, 2003.
See: 35 N.J.R. 1573(a), 35 N.J.R. 4310(a).
Provisions of R.2003 d.135 adopted without change.

18:7-5.4 Factors not adjustable to Federal taxable income

(a) No adjustment to Federal taxable income is permitted under this rule for:

1. Gains or losses not recognized for Federal income tax purposes under Section 351 or similar sections of the Internal Revenue Code but only to the extent that recapture or other provisions of the Code are not paramount to these sections.

2. The general business credit allowed or allowable for Federal income tax purposes under Section 38 of the Internal Revenue Code.

i. This may not be taken as a deduction in computing the New Jersey net income tax base, nor as a credit, in any manner, in computing tax liability under the Act.

ii. Upon disposition of assets which qualified for a general business credit under Section 38 of the Internal Revenue Code, taxpayer must use the same basis for computing gain or loss for New Jersey net income tax purposes as employed for Federal income tax purposes.

3. Depreciation attributable to a decrease in the basis of depreciable property for Federal income tax purposes, as a result of the general business credit allowed or allowable under Section 38 of the Internal Revenue Code.

i. This depreciation may not be taken as a deduction in computing the New Jersey net income tax base.

ii. Depreciation taken for New Jersey net income tax purposes must be reported at the same amount as reported for Federal income tax purposes for the same period.

Amended by R.1985 d.562, effective November 4, 1985.

See: 17 N.J.R. 1538(a), 17 N.J.R. 2678(a).

(a)2 deleted; (a)1 amended; 3 and 4 renumbered as 2 and 3.

Amended by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

18:7-5.5 Entire net income; determining stock ownership

(a) The provisions of N.J.A.C. 18:7-4.5 and 4.6 relating to the manner or degree of direct or indirect stock ownership by a creditor are applicable in determining deductibility of interest paid or accrued to holders of 10 percent or more of the aggregate outstanding shares of the taxpayer's capital stock of all classes.

(b) In determining the percent ownership of investment for purposes of computing the dividend exclusion, a taxpayer can aggregate its ownership of stock by basing its computation on its ownership equity in the payor. No part of such investment may be determined with reference to loans or advances but must be based upon investment in capital stock.

Example 1: Corporation A received a dividend from Corporation B and a dividend from Corporation C. Corporation A owns 90 percent of Corporation B. Corporation A owns 20 percent of Corporation C. Corporation B owns 70 percent of Corporation C. The remaining shares of Corporation B and Corporation C are owned by unrelated persons.

By literal terms of the Act, the dividend received by Corporation A from its 90 percent owned Corporation B is excludible from entire net income.

Since the equity of Corporation A in Corporation C is 80 percent or more ownership, it may also exclude the dividends received from Corporation C from entire net income.

Ownership equity of Corporation A in Corporation C:

| | | |
|--|-------------|------------|
| Direct investment in Corporation C | | 20% |
| Investment in Corporation B | 90% | |
| Investment of Corporation B in Corporation C | <u>70%</u> | |
| Indirect investment in Corporation C | .90 × .70 = | <u>63%</u> |
| Aggregate ownership by Corporation A of the stock of Corporation C | | <u>83%</u> |

Example 2: Corporation D received a dividend from Corporation E and a dividend from Corporation F. Corporation D

owns 90 percent of Corporation E. Corporation D owns 20 percent of Corporation F. Corporation E owns 60 percent of Corporation F. The remaining shares of Corporation E and Corporation F are owned by unrelated persons.

By literal terms of the Act, the dividend received by Corporation D from its 90 percent owned Corporation E is excludible from entire net income.

Since the equity of Corporation D in Corporation F is less than 80 percent ownership, it may only exclude 50 percent of the dividend received from Corporation F from entire net income.

Ownership equity of Corporation D in Corporation F:

| | | |
|--|-------------|------------|
| Direct investment in Corporation F | | 20% |
| Investment in Corporation E | 90% | |
| Investment of Corporation E in Corporation F | <u>60%</u> | |
| Indirect investment in Corporation F | .90 × .60 = | <u>54%</u> |
| Aggregate ownership by Corporation D of the stock of Corporation F | | <u>74%</u> |

New Rule, R.1987 d.118, effective March 2, 1987.

See: 18 N.J.R. 2004(b), 19 N.J.R. 410(c).

Old rule repealed.

Cross References

See N.J.A.C. 18:7-4.5 (Net worth; indebtedness includible) and 18:7-4.6 (Receivables offset against includible indebtedness) as to computing net worth.

18:7-5.6 Adjustment of entire net income to period covered by return; how computed

(a) If the entire net income required to be reported is for a period other than a period covered by the taxpayer's Federal income tax return, the taxpayer shall compute its net income as follows:

1. Its Federal taxable income is first adjusted in the manner set forth on N.J.A.C. 18:7-5.1 through 5.4;
2. The result is then divided by the number of calendar months or parts thereof covered by the Federal income tax return;
3. The result is then multiplied by the number of the calendar months or parts thereof covered by the return under the Act. A part of a month shall be deemed to be a month.

Amended by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Statutory References

N.J.S.A. 54:10A-17.

18:7-5.7 Right of Director to independently determine net income

If in the opinion of the Director the method employed in N.J.A.C. 18:7-5.6 does not properly reflect the taxpayer's net income properly apportionable to New Jersey under the Act for the period covered by its New Jersey return, the Director may determine entire net income solely on the basis of the taxpayer's income during such period.

Amended by R.1994 d.186, effective April 18, 1994.
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Statutory References

N.J.S.A. 54:10A-17(a).

18:7-5.8 Calculation of gain in certain instances

(a) A selling parent corporation in a Federal I.R.C. 338(h)(10) transaction does not recognize gain on the sale of target stock for New Jersey purposes for acquisition dates occurring on or after January 14, 1992.

(b) Where a target corporation recognizes gain as the result of an I.R.C. 338(h)(10) election, the target reports and pays tax on such gain pursuant to N.J.A.C. 18:7-5.1(a).

Repealed by R.1994 d.186, effective April 18, 1994.
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Procedure for computing short period return".
New Rule, R.1996 d.378, effective August 5, 1996.
See: 28 N.J.R. 2515(a), 28 N.J.R. 3810(a).

18:7-5.9 (Reserved)

Repealed by R.1979 d.45, effective February 6, 1979.
See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Formerly entitled "Procedure for computing when taxpayer alters corporate identity".

18:7-5.10 Right of Director to correct distortions of net income allocation factors; adjustments and redeterminations

(a) Whenever it shall appear to the Director that any taxpayer fails to maintain its records in accordance with sound accounting principles or conducts its business or maintains its records in a manner so as either directly or indirectly to distort its true entire net income or the proportion thereof properly allocable to this State, or whenever any taxpayer maintains a place of business outside this State, or whenever any agreement, understanding or arrangement exists between a taxpayer and any other corporation or any person or firm, for the purpose of evading tax under the Act, or whereby the activity, business, receipts, expenses, assets, liabilities, or net income of the taxpayer are improperly or inaccurately reflected, the Director is authorized and empowered, in his or her discretion and in whatever manner he or she may determine, to adjust and redetermine such items, and to adjust items of gross receipts, tangible or

intangible property and payrolls within and without the State and the allocation of entire net income or to make any other adjustments in any tax report or tax return as may be necessary to make a fair and reasonable determination of the amount of tax payable under the Act.

1. Where any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor; or

2. Any taxpayer, a substantial portion of whose capital stock is owned either directly or indirectly by or through another corporation, enters into any transaction with such other corporation on such terms as to create an improper loss or net income, the Director may include in the entire net income of the taxpayer the fair profits which, but for such agreement, arrangement or understanding, the taxpayer might have derived from the transaction.

3. For purposes of this section, "fair and reasonable tax" is the tax that would have been payable by a taxpayer reporting the same transaction(s) on a separate entity basis where the parties to the transaction(s) had independent economic interests.

4. For purposes of this section, "substantial portion of stock" is the direct or indirect ownership of 20 percent or more of the outstanding shares of any class of stock. For purposes of arriving at this level of ownership the stock attribution rules of IRC section 318 will be used.

5. Under N.J.S.A. 54:10A-10(b) interest should be charged on loans or advances made by one related party to another from the day after the debt arises until the debt is satisfied. With respect to intercompany trade receivables of related taxpayers, interest is not required to be charged on an intercompany trade receivable before the first day of the third calendar month.

i. If the creditor is regularly engaged in the business of making loans or advances, the arm's length interest rate should be charged. Upon failure to do so, the Division of Taxation can determine what interest should have been charged. Where the creditor is not in the business of loaning money or making advances, either an arm's length rate based on the facts and circumstances or a safe haven rate is acceptable. However, the safe haven rule does not apply to any loan or advance in which the interest or principal amount is expressed in a currency other than U.S. dollars.

ii. For interest paid or accrued on a loan or advance, a safe haven rate is one that is between 100 percent and 130 percent of the Applicable Federal Rate (AFR) as determined under Internal Revenue Code Section 1274(d) in effect on the date that the loan or advance is

made. Adjustments for inadequate interest would be made at 100 percent of the AFR and adjustments for excessive interest would be made at 130 percent of the AFR. In the case of a sale-leaseback transaction, the lower limit would be 110 percent of the AFR. In determining the rate of interest actually charged on a written loan or advance, any original issue discount included in income by the lender or any bond premium deducted by the lender is to be taken into account.

6. Where a service by one member of a group to another member is rendered for less than an arm's length charge, the Division of Taxation may make appropriate allocations to reflect an arm's length charge for that service. The arm's length charge is equal to the costs or deductions incurred by the member performing the service, except in cases where the service is an integral part of the business activity of either member.

7. If tangible property is made available by one member of the group to another, the latter should be charged the arm's length rental charge.

8. Where one member of a group of controlled entities sells or otherwise disposes of tangible property to another at other than an arm's length price, a proper allocation will be made between the seller and the buyer using the following methods.

i. Comparable uncontrolled price method: This method must be used if there are comparable uncontrolled sales (sales between outsiders or a member and an outsider where the property sold and the circumstances involved are identical, or nearly identical, to those in the controlled sale). To the extent they are not identical, adjustments are made.

ii. Resale price method: If there are not comparable uncontrolled sales, the resale price method must be used if the standards for its application are met. A typical situation where this method is required is where a manufacturer sells products to a related distributor which, without further processing, resells the products to unrelated parties.

iii. Cost plus method: If the standards for application of the resale price method are not satisfied, either that method or the cost plus method is used, depending on which is more feasible and will produce a more accurate arm's length price. Normally, the cost plus method is appropriate where a manufacturer sells products to a related entity which performs substantial manufacturing, assembly, or other processing of the product or adds significant value by use of its intangible property (trademark, for example) before resale.

iv. Comparable profits method: In general, the comparable profits method evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar instances.

v. Profit split method: In general, the profit split method evaluates whether the application of the combined operating profit or loss attributable to one or more controlled transactions is arm's length by reference to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss. The combined operating profit or loss must be derived from the most narrowly identifiable business activity of the controlled taxpayers for which data is available that includes the controlled transactions (relevant business activity).

vi. Unspecified methods: In general, methods not specified in (a)8i, ii, iii, iv, and v above may be used to evaluate whether the amount charged in a controlled transaction is arm's length. Any method used under this paragraph should be applied in accordance with the provisions of U.S. Treas. Reg. § 1.482-1.

9. Under both the comparable uncontrolled price method and the resale price method, market conditions faced by the affiliate are taken into account. Thus, goods may be sold, for a period, at a price which is below the full cost of manufacture in order to establish or maintain a market.

i. Assuming that the requirements of one of the methods in (a)8 above are met, it must be used unless the taxpayer can show that some other method is clearly more appropriate. Where none of the first five methods listed can reasonably be applied, some other appropriate method can be used.

ii. Where a taxpayer makes controlled sales of many different products or many sales of the same product and it is impractical to calculate an arm's length price for each product or sale, it is permissible to apply the proper method of pricing to product lines or other groupings. Also, the Division of Taxation may use statistical sampling techniques to verify or determine the arm's length price of all sales to a related entity.

10. The Division will apply equitable principles to prevent unjust situations from occurring.

(d) If the amount of the taxable income for any year of any taxpayer as returned to the United States Treasury Department is changed or corrected by the Commissioner of Internal Revenue or other officer of the United States or other competent authority, or if a renegotiation of a contract or subcontract with the United States results in a change in the taxable income, or if a recovery of a war loss results in a computation or recomputation of any tax imposed by the United States, the taxpayer shall file a report of the change or correction or an amended return within 90 days after the final determination of any change, correction, renegotiation, computation, or recomputation.

(e) For reports or returns filed prior to July 1, 1993, and within five years from the date of filing the report of change or correction or an amended return, the Director may reexamine the return, recompute and reassess the tax, but without changing the allocation of entire net income within and without New Jersey as previously computed, and shall so notify the taxpayer. For tax liabilities accruing on and after July 1, 1993, the period of limitation to make a deficiency assessment runs for an additional four year period from the date of filing the report of change or correction or an amended return. The additional period of limitation will only be applicable to the increase or decrease in tax attributable to the adjustments in the changed or corrected income.

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Amended by R.1988 d.407, effective September 6, 1988.

See: 19 N.J.R. 2255(b), 20 N.J.R. 2310(c).

Added text in (a)3 "December 8, 1987. On . . ."; changed percentage points in (a)4 from "three quarters of one percent per month" to "three percentage points above the prime rate, compounded daily." Administrative Correction: Incorporated (d)1 into (d) and deleted (d)2-3.

See: 22 N.J.R. 3504(a).

Amended by R.1992 d.404, effective October 19, 1992.

See: 24 N.J.R. 3275(a), 24 N.J.R. 3733(a).

Revised (a)4.

Amended by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Amended by R.1995 d.499, effective September 5, 1995.

See: 27 N.J.R. 645(a), 27 N.J.R. 3379(b).

Cross References

See Additional tax; change in Federal tax, N.J.A.C. 18:7-11.2, 18:7-11.3, 18:7-11.4, 18:7-11.6, 18:7-13.7.

Statutory References

See N.J.S.A. 54:10A-13 as to requirements and time limits for filing amended tax returns under the Act should a change, correction, or recomputation of Federally taxable income occur, and 49-6 as to Director's right to recompute and reassess any such deficiency assessment filed by taxpayer.

Case Notes

Computation of interest mitigated by absence of fraud. General Trading Co., Inc. v. Director, Div. of Taxation, 83 N.J. 122, 416 A.2d 37 (1980).

Taxpayer who sought corporate business tax refund while assessment periods for relevant tax years remained open was entitled to offset prior year deficiency against its overpayment. *Sharps, Pixley, Inc. v. Director, Div. Of Taxation*, 16 N.J.Tax 626 (1997.)

18:7-13.2 Hearing; protest

(a) Rules concerning the right of taxpayer to a hearing are:

1. Any taxpayer aggrieved by any finding or assessment of the Director may, within 90 days of the date of the notice of assessment or finding, file a protest in writing, in the form and manner described in N.J.A.C. 18:1-1.8, and may request a hearing;

2. Thereafter the Director shall grant an informal hearing to the taxpayer, if requested.

(b) Hearings before the Division of Taxation are to be conducted on an informal basis, with or without representation on behalf of the taxpayer or other party in interest.

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Amended by R.1991 d.23, effective January 22, 1991.

See: 22 N.J.R. 1995(a), 23 N.J.R. 219(a).

Reference to N.J.A.C. 18:1-1.8 added; (b), regarding powers of Director, deleted; (c) recodified to (b).

Amended by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Statutory References

See N.J.S.A. 54:49-18 as to procedures and time limits for filing a protest against any assessment under the Act, and taxpayer's right to a hearing thereon.

18:7-13.3 Appeal

(a) Any aggrieved taxpayer may, within 90 days after any final decision, order, finding, assessment or action of the Director made pursuant to the provisions of the Act, appeal therefrom to the Tax Court in accordance with pertinent provisions of the State Tax Uniform Procedure Law (see N.J.S.A. 54:51A-13 et seq.).

(b) The filing of a complaint by a taxpayer in the Tax Court shall suspend the running of the statute of limitations for the contested issue or issues for all subsequent privilege periods.

Amended by R.1989 d.508, effective October 2, 1989.

See: 21 N.J.R. 1503(b), 21 N.J.R. 3177(a).

Reference to State Tax Uniform Procedure Law added. Text at (b) and (c) deleted in entirety.

Special amendment, R.2003 d.135, effective February 27, 2003 (to expire August 26, 2003).

See: 35 N.J.R. 1573(a).

Designated existing paragraph as (a) and added (b).

Adopted concurrent amendment, R.2003 d.370, effective August 22, 2003.

See: 35 N.J.R. 1573(a), 35 N.J.R. 4310(a).

Provisions of R.2003 d.135 adopted without change.

Case Notes

Time and security requirements for Corporation Business Tax Act appeal (citing former rule as N.J.A.C. 17:18-1.23); failure to post security did not deprive Division of Tax Appeals of jurisdiction. *General Trading Co., Inc. v. Director, Div. of Taxation*, 83 N.J. 122, 416 A.2d 37 (1980).

18:7-13.4 Service of notice on taxpayers

(a) Any notice required to be given by the director pursuant to the State Tax Uniform Procedure Law, N.J.S.A. 54:48-1 et seq., may be served personally or by mailing the same to the person for whom it is intended, addressed to such person at the address given in the last report filed by that person pursuant to the provisions of the State Tax Uniform Procedure Law, or of any State tax law, or if no report has been filed, then to such address as may be obtainable. The mailing of such notice shall be presumptive evidence of the receipt of the same by the person to whom it was addressed. A notice may at the prescription of the director include on its face a designation which shall identify the notice for purposes of communication.

(b) An assessment notice pursuant to N.J.S.A. 54:49-5, N.J.S.A. 54:49-6 or N.J.S.A. 54:49-7 shall contain the statements required pursuant to subsections a, b, and f of N.J.S.A. 54:48-6.

(c) An assessment notice pursuant to N.J.S.A. 54:49-5, 54:49-6 or 54:49-7 shall include a statement of the reason for the assessment sufficient to inform a reasonable lay person of the statutory requirements which in the opinion of the Director require the assessment, the actions or omissions of the taxpayer which require the assessment, or the nature of the insufficient documentary evidence, if any, which has prompted the assessment, including:

1. In the case of an underpayment or failure of payment, a statement of the corresponding alleged correct amount and correct date of payment; and
2. In the case of a failure to file a return, a statement of the alleged required filing date.

(d) A refund determination notice pursuant to N.J.S.A. 54:49-15 shall include the statements required pursuant to subsections b, d and f of N.J.S.A. 54:49-6.

(e) A final determination notice pursuant to N.J.S.A. 54:48-18 shall include the statements required pursuant to subsections c and f of N.J.S.A. 54:48-6.

(f) The lack of any statement otherwise required to be included with a notice pursuant to this section or the lack of any description otherwise required pursuant to (c) of above shall not invalidate such notice.

(g) All notices of assessment related to final audit determination and "Notice and Demand for Payment of Tax" letters will be sent by registered or certified mail.

Repeal and New Rule, R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Statutory References

See N.J.S.A. 54:50-6 as to form of service of notice required of the Director to be given to the taxpayer.

18:7-13.5 Closing agreements

(a) The Director is authorized to enter into a written agreement with any taxpayer relating to the liability of such taxpayer in respect to any tax, fee, penalty or interest imposed by the Act, which agreement shall be final and conclusive, and except upon a showing of fraud, malfeasance, or misrepresentation of a material fact:

1. The case shall not be reopened as to the matters agreed upon or the agreement modified, by any officer, employee, or agent of this State; and
2. In any suit, action or proceeding, the above agreement, or any determination, assessment, collection, payment, cancellation, refund, abatement or credit made in accordance with it shall not be annulled, modified, set aside or disregarded.

Amended by R.1994 d.186, effective April 18, 1994.
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Statutory References

See N.J.S.A. 54:53-1 through 54:53-6 as to effect of closing agreements between Director and taxpayer.

18:7-13.6 Time for payment of tax

(a) The annual franchise tax must be paid to the Director in full on or before the due date of the return. For accounting periods ending on or after December 31, 1980, the annual franchise tax, including any estimated or installment payments required to be made pursuant to N.J.A.C. 18:7-3.13 must be paid to the Director in full on or before the due date of the return.

1. For due dates of returns see N.J.A.C. 18:7-11.7;
2. For penalties upon failure to file returns or pay taxes when due, see N.J.A.C. 18:7-14.1 and 2.

(b) Installment payments are due on or before the respective due dates as set forth in N.J.A.C. 18:7-3.13.

(c) A taxpayer which ceases to be subject to tax under the Act must pay the entire tax for each fiscal or calendar accounting period or part of a period during which it had a taxable status. See N.J.A.C. 18:7-11.11.

Amended by R.1982 d.6, effective January 18, 1982.
See: 13 N.J.R. 688(a), 14 N.J.R. 105(d).

(a) Added "on and after"; deleted "and thereafter"; added "but before December 31, 1980"; added "For accounting periods ending on or after December 31, 1980 ... return".

(b) added.

Amended by R.1994 d.186, effective April 18, 1994.
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Statutory References

See N.J.S.A. 54:10A-15 as to requirements for use of fiscal or calendar year accounting periods and due dates thereunder.