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THE TAX COURT COMMITTEE ON OPINIONS
TAX COURT OF NEW JERSEY

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Re: Xpedite Systems, Inc. v. Director, Division of Taxation
Dkt. No. 018847-2010

Dear Counsel:

This opinion addresses plaintiff's motion for reconsideration in the above matter. As background, for tax years 1998-2000, and 2002, defendant ("Taxation") assessed plaintiff ("Xpedite") with Corporation Business Tax ("CBT") based on an audit of Xpedite's tax returns and business activities. Taxation re-apportioned receipts from services using the 25-50-25 formula (25% to the State of origination; 50% to the State where service is performed; and 25% to the State where the transaction terminated) in the pre-1997 version of N.J.A.C. 18:7-8.10(c). This changed the reported apportionment of 3% to 9%, which Xpedite had computed using the billing address of its customers under Example 2 of the post-1997 version of N.J.A.C. 18:7-8.10(a) (revenues from long distance toll calls to be allocated based on billings for calls originating in New Jersey).

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When Xpedite's administrative protest was heard in 2010, the Tax Court had just decided United Parcel Services Co. v. Director, Div. of Taxation, 25 N.J. Tax 1 (Tax 2009), aff'd, 430 N.J. Super. 1 (App. Div. 2013), aff'd, 220 N.J. 90 (2014). Because the taxpayer's data processing services were provided in New Jersey, the equipment performing those services, and personnel operating such equipment were in New Jersey, the court deemed the apportionment allowed by the pre-1997 version of N.J.A.C. 18:7-8.10(c) inapplicable, and that 100% of the receipts should be apportioned under the pre-1997 version of N.J.A.C. 18:7-8.10(a) which provided that "[r]eceipts from services performed within New Jersey are allocable to New Jersey."

Taxation's conferee held that since Xpedite's services originated and were performed from New Jersey, with New Jersey based equipment, 100% of Xpedite's receipts should be apportioned to New Jersey under United Parcel, supra, and thus under the first sentence of the post-1997 version of N.J.A.C. 18:7-8.10(a) ("[t]he numerator of the receipts fraction developed in accordance with this section includes receipts from services not otherwise apportioned under this section."). She disagreed with Xpedite that the methodology under Example 2 of N.J.A.C. 18:7-8.10(a) applied. She upheld the audit although it had applied the pre-1997 version of N.J.A.C. 18:7-8.10(c).

Both parties filed summary judgment motions. Xpedite contended that since Taxation's assessments were based on an inapplicable regulation they must be voided. Taxation argued that using N.J.A.C. 18:7-8.10(a) would actually require 100% of the receipts be apportioned to New Jersey per United Parcel, thus, its CBT assessments were not per se invalid.

The court denied the motions on August 25, 2015. It reasoned that both subsections (a) and (c) of N.J.A.C. 18:7-8.10 provide a methodology for apportionment of receipts from services. Since Xpedite did business in and out of the State it would have to apportion its receipts, thus, the main issue before the court was how much was properly apportionable to New Jersey. Therefore,

Taxation's apportionment methodology using N.J.A.C. 18:7-8.10(c) was not per se aberrant under the standards set forth in Yilmaz, Inc. v. Director, Div. of Taxation, 22 N.J. Tax 204 (Tax 2005), aff'd, 390 N.J. Super. 435 (App Div.), certif. denied, 192 N.J. 69 (2007). Even if deemed aberrant, it would not void the assessments ab initio but only overcome the presumptive correctness of Taxation's final determination. Since Taxation's final determinations are subject to a de novo review, the court would have to determine the appropriate apportionment based on credible evidence. Since discovery was incomplete, and the facts presented in the motions were insufficient to decide the apportionment ratio, the court denied summary judgment.

ANALYSIS

A motion for reconsideration is allowed "only for those cases which fall into that narrow corridor in which either, (1) the Court has expressed its decision based upon a palpably incorrect or irrational basis, or (2) it is obvious that the Court either did not consider, or failed to appreciate the significance of probative, competent evidence . . . ." D'Atria v. D'Atria, 242 N.J. Super. 392, 401 (Ch. Div. 1990). If a court's decision is not capable of drawing "a loud guffaw or involuntary gasp," then it is not "an overstatement to say that a decision is not arbitrary, capricious, or unreasonable." Ibid.

Xpedite seeks reconsideration claiming the issue presented is purely legal, to wit, whether the use of an inapplicable regulation is basis to void an assessment. Therefore, it claims, the court should have neither (1) analyzed the burden/standard of proof required for cases where facts are contested, nor, (2) applied the "heightened" standard of review and burden of proof articulated in Yilmaz as it was explicitly limited to sales tax audits of cash businesses. Xpedite also argues that Taxation's concession of the applicability of N.J.A.C. 18:7-8.10(a) is proof that its final determination is incorrect, therefore, the assessments must be nullified.

Xpedite's arguments are premised on a misplaced notion that determining allocation of receipts is not a methodology, and thus, involves no contested facts. The law is clear that Taxation's audit and ensuing final determination, is, in all instances, its interpretation and administration of the CBT Act. Therefore, the same must accord with the language and intent of the CBT Act, which supersedes even any implementing regulations. The CBT Act requires allocation of income, including receipts, of a taxpayer to New Jersey. N.J.S.A. 54:10A-6. The allocation factor is used to "determine fairly what percentage of the value of a multi-state corporation is generated in-state." Brunswick Corp. v. Director, Div. of Taxation, 11 N.J. Tax 530, 539 (Tax 1991), aff'd, 13 N.J. Tax 136 (App. Div.), certif. denied, 134 N.J. 476 (1993). The CBT Act grants Taxation the authority to re-determine an allocation factor if it not reflective of a taxpayer's receipts "reasonably attributable" to New Jersey. N.J.S.A. 54:10A-8. See also N.J.A.C. 18:7-8.3(a) (Taxation can independently, or at a taxpayer's request, compute a business allocation factor to properly reflect receipts and income to the State). Taxation has broad discretion to determine an allocation factor since the CBT's statutory scheme "recognizes that this is a highly specialized decision that entails considerable discretion." Metromedia, Inc. v. Director, Div. of Taxation, 97 N.J. 313, 324 (1984).

Thus, the language and intent of N.J.S.A. 54:10A-6, 10A-8, the implementing regulations, and precedent interpreting the same, amply show that determining apportionment is not a mechanical exercise by using predetermined finite formulae or numbers. Taxation has the responsibility for determining a fair and reasonable apportionment. This necessarily involves, predominantly, if not always, a fact sensitive analysis.

Since the consistent theme underlying the statutory scheme and precedent is the reasonableness of Taxation's determination of a taxpayer's allocable receipts to New Jersey,

Xpedite's contention that this court erred in using the burden of proof standards set forth in Yilmaz, supra, to CBT assessments is also misplaced. First, the same standard was applied in United Parcel, supra, a matter involving CBT assessments, including the issue of allocation. In initially laying out the "general legal principles," the court noted that even the assignment of a presumptive correctness to Taxation's final determinations was derived from local property tax cases. 25 N.J. Tax 12-13 (citing to Atlantic City Transportation Co. v. Director, Div. of Taxation, 12 N.J. 130, 146 (1953), a corporate franchise and gross receipts tax case which first incorporated the local property tax standards that tax assessments are presumptively correct). Subsequently, the burden of proof in local property tax cases set forth in Pantasote Co. v. City of Passaic, 100 N.J. 408, 413 (1985), namely that the proof to overcome the presumptive validity of an assessment should be "cogent . . . definite, positive and certain in quality and quantity," was "applied" in cash audit cases by Yilmaz. United Parcel, supra, 25 N.J. Tax at 13. Given such adoption and "evolution" of the standard of proof in local property tax matters into state tax cases, the court applied "the same standard in" the CBT assessments not involving "a cash business." Ibid.

Second, the underlying substance of an "aberrant" versus "imperfect" methodology vis-a-vis the presumptive correctness of Taxation's final determination, is the "reasonableness of the" data and methodology used by Taxation. Yilmaz, supra, 22 N.J. Tax at 236 (citing to a local property tax case, Ocean Pines, Ltd. v. Borough of Point Pleasant, 112 N.J. 1 (1988) which allowed a taxpayer to challenge an assessment if it could prove that the data and method used to set the assessment was unreasonable).[1] In United Parcel, the court noted that Yilmaz applied the "logic"

[1] The term "aberrant" also has its genesis in local property tax cases. See Pantasote, supra, 100 N.J. at 408 where the court stated that an assessment's presumptive correctness is overcome when "the quantum of the assessment was far wide of the mark of true value" or "is so far removed," or if "the method of assessment itself is so patently defective and aberrant." However, "inadequacies in the municipality's evidence or deficiencies in the assessment methodology will not impugn the presumption of validity." Ibid.

of the local property tax case, to a sales tax matter "so that [Taxation] was required only to use a reasonable methodology in imposing the assessments . . . ." United Parcel, supra, 22 N.J. Tax at 46. Since allocation of the statutory factors involves methodology implemented by Taxation, it is not erroneous to apply the Yilmaz' reasonableness standard, i.e., non-aberrant methodology, in this case.

Third, while Taxation is "bound by standards of sound accounting principles" in determining the appropriate apportionment, thus, allocation factor, it still has "as broad" a discretion "as necessary" so that a fair apportionment of income to New Jersey is achieved. Metromedia, supra, 97 N.J. at 324 (citing to N.J.S.A. 54:10A-8(e) which permits Taxation to determine an allocation factor by "applying any other similar or different method calculated to effect a fair and proper allocation of . . . income . . . reasonably attributable to the State"). Thus, where Taxation determines an allocation factor which is based on a "reasonable" rationale, then the "factor measuring or attributing revenues . . . would not facially be unsound or arbitrary." Metromedia, supra, 97 N.J. at 325. Cf. Oberhand v. Director, Div. of Taxation, 193 N.J. 558, 568 (2008) (an agency's interpretation of law that is "plainly at odds" with the statute will not be upheld). See also Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 133 (1931) (recognizing that there is an inherent "difficulty of making an exact apportionment [of a multistate corporation's income] . . . hence, when the state has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases" in connection with constitutional challenges to the apportionment formula).[2]

[2] In deciding the validity of the 3-factor apportionment formula (similar to New Jersey, see N.J.S.A. 54:10A-6), the Oregon Supreme Court noted: "It is a judicially recognized fact that as a matter of practical tax administration, no method of allocation can precisely determine the exact amount of income attributable either to any given geographic area or to any given part of a series of business transactions . . . , and any honest effort in that regard must be more or less arbitrary and fictitious." A. C. Dutton Lumber Corp. v. State Tax Comm'n, 228 P.2d 867, 872-73 (Or. 1961).

In sum, the inquiry here is whether the audit and final determination is reasonable, i.e., not outside the bounds of the enabling statute and legislative directive, and whether Taxation's use of the 25-50-25 formula found in the pre-1997 version of N.J.A.C. 18:7-8.10(c) reasonably reflects a fair apportionment of Xpedite's business receipts to New Jersey. In doing so, the court must consider the scheme of the CBT Act's apportionment requirement and the interpretive regulations as a whole, so that there is a fair and reasonable construction and implementation of the CBT Act. Thus, although Yilmaz noted the "inappropriate[ness]" of applying the burden of proof required in local property tax cases to Taxation's final determinations involving the "administrative construction given a statute," 22 N.J. Tax at 236, for the above stated reasons, the court finds that its application of the reasonableness, i.e., non-aberrant, standard of Yilmaz, is not irrational. Since the pre or post version of N.J.A.C. 18:7-8.10(c) also implements an apportionment methodology, the court's conclusion that use of this regulation is not per se "aberrant," i.e., unreasonable or plainly inconsistent with N.J.S.A. 54:10A-6, is also not baseless or irrational.

Xpedite has not presented a case for summary judgment to show that Taxation's assessments included or excluded some factor which is plainly erroneous as a matter of law. See e.g. International Business Machines Corp. v. Director, Div. of Taxation, 26 N.J. Tax 102 (Tax 2011). There, as a matter of law pursuant to a partial summary judgment motion, the court reversed Taxation's final determinations because the CBT Act, which computes entire income based on federal income with few exceptions, did not specifically add back federally excludable

Thus, no "one formula of apportionment [is] superior to another. The only limitation imposed upon a given state seeking to levy an excise tax against a foreign corporation doing business in that state is . . . that the formula of apportionment will fairly and accurately . . . reflect the net income of the business done within the state." Id. at 873 (citing and quoting Butler Bros. v. McColgan, 315 U.S. 501 (1942)). The observations by the Oregon Supreme Court are pertinent to the issues raised here, not only because they were based on the United States Supreme Court's holdings, but also because they echo the similar substantive holding in Metromedia, supra.

extraterritorial income for CBT purposes. The court found that Taxation "acted outside [the] statutory authority" in including such income for CBT purposes. Id. at 104.

Here, there is no such claim or issue. Expedite desires that an apportionment of its receipts be based on a formula or methodology used for long distance telephone companies. Taxation disagrees. Xpedite's implicit premise is that when Taxation agreed United Parcel was factually similar to Xpedite, thus 100% of receipts was allocable under N.J.A.C. 18:7-8.10(a), by extension Taxation also conceded that Example 2 of N.J.A.C. 18:7-8.10(a) applies. This is unfounded since the conferee specifically rejected an apportionment under this example on grounds it would not appropriately reflect the economic realities of Xpedite's business activities.

Whether or not Example 2's methodology is appropriate is for the court to decide after examining the nature and extent of Xpedite's business and receipts in and out of New Jersey. This cannot be determined in a summary fashion.[3] Xpedite does not contest that this court reviews a final determination on a de novo basis. Thus, if the facts establish that Taxation's "interpretation is inconsistent" with the statute, the court can reverse the CBT assessments.

CONCLUSION

For the aforementioned reasons, the court does not find its earlier opinion and order were based on palpably incorrect or irrational bases. Therefore, Xpedite's motion for reconsideration is denied. An Order reflecting this conclusion will be entered with this opinion.

Very truly yours,

Mala Sundar

Mala Sundar, J.T.C.

[3] As noted above, an adjustment under N.J.S.A. 54:10A-8 is tempered by "sound accounting principles." Metromedia, supra, 97 N.J. at 384. Whether Taxation's determination accords with sound accounting principles cannot be decided as a matter of law. See e.g. United Mortgage Co. v. Director, Div. of Taxation, 3 N.J. Tax 287, 295-96 (Tax 1980).