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INFOSYS LIMITED OF INDIA INC., Plaintiff, v. DIRECTOR, DIVISION OF TAXATION, Defendant.	TAX COURT OF NEW JERSEY DOCKET NO. 012060-2016 CIVIL ACTION

Decided: November 28, 2017

Margaret C. Wilson, Esquire, for plaintiff (Wilson Agosto, LLP, attorneys)

Michael J. Duffy, Deputy Attorney General, for defendant (Christopher S. Porrino, Attorney General of New Jersey, attorney)

BRENNAN, J.T.C.

This is the court's opinion with respect to the parties' cross-motions for partial summary judgment. Plaintiff is an international technology company with its largest presence in India. At issue is whether New Jersey can impose corporate business tax on Plaintiff's foreign source income even though that income is not taxable for Unites States federal income tax purposes. For the reasons explained more fully below, the court concludes that New Jersey cannot.

I. Findings of Fact and Procedural History

The court makes the following findings of fact based on the submissions of the parties pursuant to R. 1:7-4.

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Plaintiff, Infosys Limited of India, Inc. (“Infosys”), is a multinational corporation engaged in providing services and support in technology, business consulting, information technology, software engineering, and outsourcing. Headquartered and incorporated in India, it has 33 branches worldwide including one in the United States (“U.S.”). As such, it is a foreign corporation for U. S. Federal Income Tax (“FIT”) purposes.

At issue are four fiscal tax years covering April 1, 2007 through March 31, 2011 (“FYE 2008”, “FYE 2009”, “FYE 2010” and “FYE 2011”). Infosys reported and paid both FIT and New Jersey Corporate Business Tax (“CBT”) for these periods.

In December 2007, Infosys entered into a Pre-Filing Agreement (“PFA”) with the Internal Revenue Service (“IRS”) that set forth a methodology to determine the allocation of income to the U.S. Pursuant to the PFA, Infosys filed its FYE 2008 through FYE 2011 FIT returns and paid FIT only on U.S. source income as determined by §861 of the Internal Revenue Code. As a foreign corporation, Infosys reported its income on Line 29 of IRS Form 1120-F[1], which sets forth the federal taxable income before net operating loss deductions and special deductions.

Infosys also filed timely CBT returns with the New Jersey Division of Taxation (“Division”) for tax years FYE 2008 through FYE 2011. Schedule A of the CBT return reports the tax base, identified as entire net income (“ENI”). The ENI calculation is based on Line 28 of

[1] Domestic US corporations report their income to the IRS using Form 1120. While there are many similarities between the two forms, one difference in formatting is that a corporation reports its taxable income before operating loss (NOL) deductions and special deductions on line 28 of Form 1120, but on Line 29 of Form 1120-F.

the Unconsolidated Federal Form 1120 used by domestic corporations[2], which is the same as Line 29 of the Unconsolidated Federal Form 1120-F used by foreign corporations.

Infosys' FIT and CBT tax returns also included federal Form 8833 Treaty-Based Return Position Disclosure ("Form 8833") with an attachment that set forth Infosys' entitlement to benefits under the Convention for the Avoidance of Double Taxation between the United States and India ("U.S.-India treaty"). Infosys posits that the U.S.'s right to tax Infosys' business profits under Article 7 of the U.S.-India treaty is limited to profits that are attributable to business in the U.S. conducted through a permanent establishment ("PE") such as a branch office, or to similar business activities effected through the PE. The attachment to Form 8833 specifically states the following:

> The amount of business profits attributable to Infosys' U.S.P.E. has been computed consistent with the Pre Filing Agreement. Where there are business activities not explicitly addressed in the Pre Filing Agreement, those business activities are included in business profits of Section II of the branch consistent with Article 7 of the U.S.-India treaty. (which is reported on Line 29 of Section II of Form 1120-F), under Article 7.2 of the U.S.-India treaty, are those profits which the PE might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly at arm's length with Infosys (i.e. the home office). Furthermore, under Article 7.3 of the U.S.-India treaty, Infosys is entitled to deduct expenses incurred in connection with the business of the PE, such as an allocation of executive and general administrative, research and development, interest and other costs (which are reported on lines 12 through 27 of Section II of Form 1120-F) wherever they are incurred.

In 2011, the IRS audited Infosys' tax returns for years FYE 2008 through FYE 2011, and made changes to the FYE 2008 and FYE 2009 returns through a Revenue Agents Report dated

[2] CBT Schedule A instructs taxpayers to report "Taxable income before net operating loss deductions and special deductions (line 11 less line 27 must agree with Line 28, page 1 of the Unconsolidated Federal Form 1120, or the appropriate line item from the Federal Forms 1120-IC-DISC, 1120 FSC or 1120-A, whichever is applicable. See instructions 8(b) and 16(c)).

December 21, 2011 ("RAR"). The changes increased U.S. taxable income for FYE 2008 and FYE 2009. The RAR did not make any changes to the FYE 2010 and FYE 2011 returns.

During the audit, Infosys realized that it had made a mistake on its FYE 2008 through FYE 2011 New Jersey CBT returns. Infosys' original CBT returns incorrectly included its worldwide income on Line 33b. As such, the ENI reported on the original CBT returns did not match the federal taxable income before net operating loss deductions and special deductions as reported on Line 29 of its Form 1120-F returns.

On June 21, 2012, Infosys filed amended CBT returns with the Division based on the RAR adjustments for FYE 2008 and FYE 2009, and it recalculated ENI for FYE 2008 through FYE 2011 by removing the worldwide income previously reported on Line 33b. The amended CBT returns requested refunds of CBT previously paid (plus interest) based upon calculated overpayments as indicated in the following chart:

FYE	Original Return NJ CBT Page 1 Total Tax	Amended Return NJ CBT 100 Total Tax	NJ CBT (Amended return) Overpayment
2008	$1,723,926	$308,887	$1,425,538
2009	$2,043,157	$565,380	$1,804,820
2010	$2,139,178	$814,124	$1,637,219
2011	$2,399,216	$795,814	$2,552,351

Thereafter the Division audited the FYE 2008 through FYE 2011 tax periods and made adjustments resulting in the assessment of additional CBT. Those assessments are unrelated to

the CBT refund request and are not part of this summary judgment motion. The Division denied the CBT refunds requested by Infosys.

On December 4, 2014, Infosys filed an administrative appeal with the Division's Conference and Appeals Branch ("DCAP") protesting the assessment of additional CBT and the denial of a $5,831,788 CBT refund based on the amended CBT returns. On May 20, 2016, the DCAP upheld a portion of the contested assessment and confirmed the denial of a CBT refund. The Division issued a Final Determination letter on May 20, 2016, which stated that their "office has determined that N.J.S.A. 54:10A-4(k)(2)(A) supports Audit's conclusion that the "worldwide income adjustment" reported on line 33b of the CBT returns is correct under N.J.A.C. 18:7-5.2(a)(1)(xi), and N.J.A.C. 18:7-5.1(a) and (b)."

On August 16, 2016, Infosys timely filed a Complaint with the Tax Court. The court heard oral argument on the motions on September 1, 2017.

II. Legal Analysis

A. Summary Judgment

Summary judgment should be granted where "the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to a judgment or order as a matter of law." R. 4:46-2 (c). In Brill v. Guardian Life Ins. Co., 142 N.J. 520, 523 (1995), our Supreme Court established the standard for summary judgment as follows:

> [W]hen deciding a motion for summary judgment under Rule 4:46-2, the determination whether there exists a genuine issue with respect to a material fact challenged requires the motion judge to consider whether the competent evidential materials presented, when viewed in the light most favorable to the non-moving party in consideration of the applicable evidentiary standard, are sufficient to permit a rational factfinder to resolve the alleged disputed issue in favor of the non-moving party.

"The express import of the Brill decision was to 'encourage trial courts not to refrain from granting summary judgment when the proper circumstances present themselves.'" Township of Howell v. Monmouth County Bd. of Taxation, 18 N.J. Tax 149, 153 (Tax 1999) (quoting Brill, supra, 142 N.J. at 541).

There are no material facts in dispute between the parties relevant to Infosys' income for the relevant fiscal years. The sole question is one of statutory interpretation concerning the calculation of the tax base, which can be determined by application of the law to the undisputed facts. Infosys contends that N.J.S.A. 10A-4(k) unambiguously adopts federal taxable income (Federal 1120-F Line 29) as the tax base, subject only to expressly enumerated adjustments that are not applicable here. The Director, Division of Taxation ("Director") takes the contrary position and argues that N.J.S.A. 10A-4(k) is not absolute and it allows for the add-back of world-wide income to the taxpayer's federal tax base. The court concludes that this matter is ripe for partial summary judgment.

B. Discussion

1. CBT and the Add-Back Statute

New Jersey's CBT Act taxes each non-exempt domestic corporation and foreign corporation:

> [F]or the privilege of having or exercising its corporate franchise in this State, or for the privilege of deriving receipts from sources within this State, or for the privilege of engaging in contacts with this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State.
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> [N.J.S.A. 54:10A-2.]

The determination of the CBT tax base is a two-step process. Step one is the determination of a corporation's ENI and step two is the application of an allocation factor[3]. Only step one, the determination of the ENI, is at issue in this motion.

A corporation's ENI is determined under N.J.S.A. 54:10A-4(k), which defines ENI as the "total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets." This broad definition of ENI is further limited in the following paragraph of the statute:

> For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report . . . to the United States Treasury Department for the purpose of computing its federal income tax . . .
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> [Ibid.]

This provision of the statute couples ENI under the CBT Act to Line 28 of the FIT return for domestic corporations, and Line 29 of the FIT return for foreign corporations, entitled "Taxable income before net operating loss deduction and special deductions."

After linking ENI to the federal return, the statute provides that "[e]ntire net income shall be determined without the exclusion, deduction or credit of" and lists more than a dozen exceptions – both additions and subtractions – to federal tax statutes that define federal taxable income. See N.J.S.A. 54:10A-4(k)(2)(A) through (J). The statute also contains various subsections refining the calculation of an entity's ENI for CBT purposes.

[3] New Jersey may only tax its state-specific share of the total ENI, and therefore must apply an allocation factor pursuant to N.J.S.A. 54:10A-6, which provides that the "portion of its entire net income to be used as a measure of the tax imposed…shall be determined by multiplying such…entire net income…by an allocation factor…."

The add-back exceptions listed in N.J.S.A. 54:10A-4(k)(2)(A) through (J) do not include the world-wide income that is excluded from federal taxable income.

2. Impact of the IBM and Toyota Decisions

The Director, Division of Taxation ("Director") argues that the first sentence of N.J.S.A. 54:10A-4(k), which states "[e]ntire net income shall mean total net income from all sources, whether within or without the United States…." supports its position that world-wide income should be added back to the federal tax base when calculating NJ CBT. In 2011, the Division unsuccessfully made the same argument to the Tax Court in International Business Machines Corp. v. Director, Division of Taxation, 26 N.J. Tax 102 (Tax 2011).

In that case, the court found in favor of taxpayers, concluding that N.J.S.A. 54:10A-4(k) unequivocally coupled a corporation's ENI for CBT purposes to its federal taxable income, with limited exceptions set forth at N.J.S.A. 54:10A-4(k)(2)(A).[4] This court adopts in full the analysis and conclusions of law as so thoroughly and thoughtfully set forth by Judge DeAlmeida in his opinion.

In arriving at a decision, Judge DeAlmeida addressed the introductory language in N.J.S.A. 54:10A-4(k). He concluded that the second paragraph of the statute deemed ENI "prima

[4] The decision involved two separate matters, International Business Machines Corporation v. Director, Division of Taxation, Docket No.: 011630-2008 and Creston Electronics, Inc. v. Director, Division of Taxation, Docket No: 011795-2009, that were consolidated into one motion for partial summary judgment.

IBM had received income from 2002-2004, some of which qualified as extraterritorial income ("ETI") under I.R.C. §114(e). IBM included ETI where appropriate on the federal filing, but excluded it for purposes of the CBT, and same was reflected in the filings. The Director audited IBM's returns and determined that ETI must be added back for CBT calculations.

Crestron Electronics timely filed 2004 and 2005 CBT returns, but after an audit of its federal returns, it filed amended CBT returns for 2004 and 2005. Crestron excluded ETI on the amended returns. The Director denied Crestron's amended return and rejected the proposed reduction.

facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report… to the United States Treasury Department for the purpose of computing its federal income tax…" See IBM, supra, 26 N.J. Tax at 109.

After an analysis of the established legal precedents involved, Judge DeAlmeida noted that first, the Legislature is capable of amending the CBT Act to create an exception to an exclusion from federal taxable income if it so chooses. Second, if the first sentence of N.J.S.A. 54:10A-4(k) incudes in ENI all foreign source income, amendment of the CBT Act in 2005 in response to the enactment of Internal Revenue Code §199 would not have been necessary.[5] Id. at 114.

The crux of the Court's reasoning in IBM hung on the plain language of N.J.S.A. 54:10A-4(k) and the enumerated exceptions. Where no specific exception is identified, the controlling statutory language is that which establishes ENI to be prima facie equal to taxable income, before NOL deductions and special deductions, reported for purposes of computing federal taxable income.

The court in IBM also rejected the Director's argument that because ENI is considered an exclusion under federal law, and not a deduction, world-wide income is properly included in ENI for CBT purposes. The court disagreed and observed that N.J.S.A. 54:10A-4(k) does not vest any significance in the distinction between exclusions and deductions under federal law.

Judge DeAlmeida also rejected the Director's reliance on N.J.A.C. 18:7-5.2(a)(1)(xi), finding that the plain language of the does not apply to the taxpayer's extraterritorial income ("ETI".) The regulation specifically identifies "all income from sources outside of the United States which has not been included in computing taxable income…" and ETI was, in fact,

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[5] In 2004, Congress repealed the extraterritorial exclusion found in §61 and enacted §199 in its place, which allows for the exclusion of foreign source income from federal taxable income.

included in the computation of federal taxable income. Further, Judge DeAlmeida argued that the regulation is invalid insofar as the Legislature has the exclusive constitutional authority to impose a tax.

Judge DeAlmeida, in addressing the interplay of N.J.A.C. 18:7-5.2(a)(1)(xi) with N.J.S.A. 54:10A-4(k)(1), concluded that although Director is authorized to interpret the CBT Act so as to give itself the broadest reach constitutionally permissible, he may not extend the tax to income not within the fair contemplation of the Legislature as derived from the text of the statute imposing the tax. The clear intent of the Legislature was to couple ENI to federal taxable income (with limited exceptions). N.J.S.A. 54:10A-4(k)(1) works as a limiting factor to the reach of Director's relied-upon regulations.

The Director however argues that the IBM decision is undercut by a more recent Tax Court decision – Toyota Motor Credit Corp. v Director, Division of Taxation 28 N.J. Tax 96 (Tax 2014), aff'd., ____ N.J. Tax ____ (App. Div. 2017), also written by Judge DeAlmeida. The Director asserts that the court in Toyota, supra, departed from the holding in IBM by allowing a taxpayer to deviate from federal line 28 without an "expressly enumerated" adjustment.

In Toyota, the taxpayer sought to adjust its federal basis in sold property for purposes of reducing the gain realized from the sale for CBT purposes. The court recognized that none of the provisions in N.J.S.A. 54:10A-4(k) entitled the taxpayer to the favorable adjustment and expressly acknowledged its prior decision in IBM. Notwithstanding this, the court found that there are provisions of the CBT Act, in particular N.J.S.A. 54:10A-4, that suggest that the Legislature intended to tax only an entity's *actual* economic gains- the accessions to its wealth –

from the sale of property and not artificial gains resulting from unused depreciation deductions.

Specifically the court found:

> Standing alone, these provisions [N.J.S.A. 54:10A-4(k) and N.J.A.C. 18:7-5.2(a)] might not be sufficient to depart from the holding in International Business Machines, supra, and the well-recognized concept that an entity's entire net income for CBT purposes equates to its federal taxable income absent an express statutory provision authorizing a deduction or addition to the entity's federal taxable income.
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> [Id at 115.]

Toyota was decided under a "broad principle that State tax policy prohibits the assessment of a tax on 'phantom income' resulting from depreciation deductions used by the taxpayer for federal purposes, but which resulted in no New Jersey Tax benefit." Id. at 115-116. This principle was established in Koch v. Director, Division of Taxation 157 N.J. 1 (1999)[6], and applied in Moroney v. Director, Division of Taxation, 376 N.J. Super. 1 (App. Div. 2005)[7]. Although both Koch and Moroney involved New Jersey Gross Income tax cases, the court's recognition of benefits that

[6] At issue in the Koch case was the method to be used to calculate a partner's gain from the disposition of his partnership interest for purpose of New Jersey's Gross Income tax. Although the Tax Court and the Appellate Division agreed with the Director that the zero basis on the federal return resulting from the use of prior losses to offset gains should result in a zero basis on New Jersey's Gross Income Tax return, the Supreme Court reversed. The Supreme Court concluded that where the taxpayer's federal adjusted basis in a partnership interest reflects benefits obtained by the taxpayer under federal law, but not available under New Jersey law, the Director cannot use the federal adjusted basis to calculate gain from the sale of that partnership interest.

[7] Moroney concerned related appeals regarding the manner in which net gain from the sale or disposition of rental property should be determined under the New Jersey Gross Income Tax Act. Relying upon the Supreme Court's decision in Koch, the Tax Court held, and the Appellate Division affirmed, that the federal adjusted basis must be increased by the cumulative amount of the allowed and allowable depreciation deductions that were not utilized by the taxpayers in computing net income from the respective properties in the years of their ownership.

are available under federal tax law, but are not available under New Jersey tax law, is the same. In such cases, where it is evident that the federal adjusted basis is artificially manipulated and not reflective of true gain (income), a correction is necessary in order to accurately calculate and thereby tax only true gain (income) as opposed to false or "phantom income."

Specifically in Toyota, the taxpayer had taken certain federal depreciation deductions on a fleet of vehicles, and thereby increased its net operating losses; but "[b]ecause of limitations in the CBT Act, [Toyota] could not use these losses for New Jersey CBT purposes." 28 Id. at 104. The federal adjusted basis of the fleet of vehicles reflected those losses, and resulted in more federal income tax being due (as depreciation recovery gain). The question in Toyota was whether the federal tax basis should also apply for New Jersey tax purposes even though Toyota had not received any New Jersey tax benefit for those losses that were reflected in the federal tax basis. The Tax Court agreed with Toyota that in order to avoid the New Jersey taxation of "phantom income", Toyota should be "entitled to increase its basis in the vehicles it sold…by the amount of depreciation that was unused for CBT purposes." 28 Id. at 105.

The Director argues that IBM and Toyota are at odds, as they currently allow a taxpayer to reduce its state tax base without a specific statutory adjustment, while Taxation would not be permitted to increase a taxpayer's state tax base to include excluded income. The Director argues that "IBM is no longer settled law" and summary judgment should be denied on that ground.

This court disagrees and finds that IBM and Toyota represent two separate and distinct legislative intents as expressed in the language of the statute. In IBM, the focus was on the language stating that New Jersey EIN "shall be" deemed prima facie to be equal to federal taxable income. Toyota on the other hand, did not focus on the federal taxable income language but rather on the more narrow language regarding the taxation of sale of assets. Specifically, the

court in Toyota focused on the Legislature's expressed intent to tax "profit" from the sale of assets. As such, both decisions are distinguishable and reconcilable.

This court finds that the facts in Infosys more closely parallel the facts in IBM. The issue here is not "phantom income" as was the concern in Toyota, but rather the tax base. For this reason, the court finds that pursuant to the Legislature's directive in N.J.S.A. 54:10A-4(k), Infosys's tax base should match the federal taxable income as indicated on Line 29 of the Unconsolidated Federal Form 1120-F.

Finally the Director argues that Line 29 is obscured by the fact that it is influenced by the terms of the US-India Treaty. The Director believes that he should be able to pierce the protection provided to the taxpayer through the treaty when establishing a tax base for CBT purposes. The court does not find this argument persuasive in light of the expressed intent of the Legislature in N.J.S.A. 54:10A-4(k).

III. Conclusion

The court grants Infosys' motion for partial summary judgment and denies the Director, Division of Taxation's Motion for Partial Summary Judgment. The Director having not objected to the Infosys' calculation of the amount of the tax refund due by matching ENI to Line 29 of the Federal Form 1120, the court orders the Director to issue a CBT refund to Infosys in the amount of $5,831,788 plus interest.