



International Affiliate Transactions Involving Intangibles and Intellectual Property

TAM 2011-22 – Issued December 7, 2011
Tax: Corporation Business Tax

This technical advisory memorandum (TAM) concerns transactions between affiliate corporations involving charges and claimed deductions for intangible expenses and costs in which the recipient or payee affiliate is not a U.S. income taxpayer. Nothing herein shall constitute or be construed as a waiver of, or limitation upon, the Director's authority under N.J.S.A. 54:10A-8, N.J.S.A. 54:10A-10 or any other provision of the laws of the State of New Jersey.

DEFINITIONS: FOR PURPOSES OF THIS TAM

"Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the term "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

"Domestic affiliate" means a company or business entity that is: located in New Jersey or subject to New Jersey's tax laws; incorporated or organized under the laws of any state or commonwealth of the United States; and an "affiliate" of a "foreign parent company" or "foreign affiliate" as provided in these definitions.

"Domestic taxpayer" means "Domestic affiliate."

"Foreign affiliate" means a company or business entity that is:

- Located outside of the United States;
- Organized or incorporated under the laws of a foreign nation;
- Meets the definition of "affiliate" provided in these definitions; and
- Not a United States income taxpayer.

This definition also includes parent, subsidiary or brother-sister stock ownership and control relationships.

"Foreign parent company" means a "foreign affiliate" that is the parent company of a "domestic affiliate," in terms of stock ownership and control.

"Related entity," pursuant to N.J.S.A. 54:10A-4.4(a), means:

- A stockholder who is an individual, or a member of the stockholder's family enumerated in section 318 of the federal Internal Revenue Code of 1986, 26 U.S.C. §318, if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially or constructively, in the aggregate, at least 50% of the value of the taxpayer's outstanding stock; or
- A stockholder, or a stockholder's partnership, limited liability company, estate, trust or corporation, if the stockholder and the stockholder's partnerships, limited liability

companies, estates, trusts and corporations own directly, indirectly, beneficially or constructively, in the aggregate, at least 50% of the value of the taxpayer's outstanding stock; or

- A corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of the federal Internal Revenue Code of 1986, 26 U.S.C. §318, if the taxpayer owns, directly, indirectly, beneficially or constructively, at least 50% of the value of the corporation's outstanding stock. The attribution rules of the federal Internal Revenue Code of 1986, 26 U.S.C. §318, shall apply for purposes of determining whether the ownership requirements of this definition have been met.

"Related member," pursuant to [N.J.S.A. 54:10A-4.4 \(a\)](#), means a person that, with respect to the taxpayer during all or any portion of the privilege period, is:

- A related entity; or
- A component member as defined in subsection (b) of section 1563 of the federal Internal Revenue Code of 1986, 26 U.S.C. §1563; or
- A person to or from whom there is attribution of stock ownership in accordance with subsection (e) of section 1563 of the federal Internal Revenue Code of 1986, 26 U.S.C. §1563; or
- A person that, notwithstanding its form of organization, bears the same relationship to the taxpayer as a person described in any of the above definitions.

ADD-BACK RULE AND RELEVANT EXCEPTION(S)

Pursuant to [N.J.S.A. 54:10A-4.4](#), in computing entire net income for the Corporation Business Tax (CBT), corporate taxpayers are required to add back intangible expenses paid to related members or entities. However, [N.J.S.A. 54:10A-4.4](#) provides several exceptions to this add-back requirement including intangible expenses paid to a related member in a foreign nation that has in force a comprehensive income tax treaty with the United States. Further exceptions to the add-back requirement may be found in [N.J.A.C. 18:7-5.18](#) and also are addressed in [TAM-13](#).

ARM'S LENGTH PRICING IN RELEVANT CONTEXT

In circumstances in which a domestic affiliate pays royalties or expenses to a foreign affiliate or foreign parent company for the use of intangibles in New Jersey, the Division of Taxation intends to use existing authority afforded in [N.J.S.A. 54:10A-4\(k\)\(3\)](#)¹, [N.J.S.A. 54:10A-8](#)², [N.J.S.A. 54:10A-10](#)³, and [N.J.A.C. 18:7-5.10](#)⁴ to examine transactions between these affiliated

¹ Provides the authority to determine the period or year in which any item of income or deduction should be included in calculating a corporation's entire net income under the CBT.

² Provides the authority to adjust the allocation factor used in calculating a taxpayer's CBT liabilities if it appears that the allocation factor employed by the taxpayer does not accurately "reflect the activity, business, receipts, capital, entire net worth or entire net income" of the taxpayer "reasonably attributable to the State."

³ Provides the authority to adjust items of income, expenses, allocation factors, and tax returns or reports to accurately reflect "a fair and reasonable determination of the amount of tax payable" in accordance with CBT laws and regulations. The section also affords the Director the ability to examine payments and compensation between affiliates (as defined in this TAM) and members of an affiliated group or a controlled group pursuant to section 1504 or 1563 of the IRC, in addition to compelling these entities to file a consolidated return.

⁴ Provides further explanations and guidance relating to the authority described in [N.J.S.A. 54:10A-10](#).

companies or taxpayers to ensure that the domestic taxpayer “doing business” or “exercising its corporate franchise”⁵ in New Jersey reports the appropriate amount of expenses and deductions arising from these transactions.

This analysis is similar to that with respect to arm’s length pricing requirements provided in the Internal Revenue Code (IRC) §482 and also is consistent with [N.J.A.C. 18:7-5.10](#). Subsequently, the Director may make appropriate adjustments to the domestic taxpayer’s entire net income that reflect true income earned and expenses incurred in the State to reach “a fair and reasonable determination” of tax liabilities. A “fair and reasonable tax” is defined as one “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.” [N.J.A.C. 18:7-5.10\(a\)\(3\)](#).

DOCUMENTATION

To determine whether the domestic affiliate’s intangible expense deductions meet the arm’s length standards of IRC §482 and [N.J.A.C. 18:7-5.10](#), the Division may request certain documentation from the domestic taxpayer pursuant to [N.J.A.C. 18:7-5.10\(g\)](#). This may include the following: an overview of the domestic taxpayer’s business; description of its organizational structure; identification of the transfer pricing methodology selected and why such methodology was determined to be the most appropriate for transfer pricing purposes; and an explanation of the economic analysis relied upon in making the determination. Documentation satisfying the requirements of Internal Revenue Code §6662, a third party transfer pricing study, or an advanced pricing agreement (APA) approved by the Internal Revenue Service will be deemed to satisfy the documentation requirements associated with this analysis. However, pursuant to [N.J.A.C. 18:7-5.10](#) and [TAM-2012-1](#) approved APAs may be reviewed by the Division to examine the payments made between the domestic affiliate and foreign affiliate under arm’s length standards referenced earlier in this TAM.

DIRECTOR’S AUTHORITY

Under authority provided in [N.J.S.A. 54:10A-10](#), the Director may use the requested information to adjust the intangible expense deductions of the domestic taxpayer relating to payments made to a foreign affiliate or foreign parent company if a determination is made that the items as reported do not accurately reflect true income or expenses, and the economic realities of the transaction(s) in question.

Once the Division has received the requested documentation from the domestic taxpayer, it may undertake its own arm’s length analysis of the transactions at issue as provided in IRC § 482 and [N.J.A.C. 18:7-5.10](#). If the Division determines that a subsequent adjustment must be made to reach “a fair and reasonable determination” of tax liabilities in New Jersey pursuant to [N.J.S.A. 54:10A-10](#), it shall do so by making said adjustments to the entire net income of the domestic

⁵ These terms are included in the state’s CBT nexus standard as found in [N.J.S.A. 54:10A-2](#) and [N.J.A.C. 18:7-1.8](#). “Doing business” in the state is further defined in [N.J.A.C. 18:7-1.9](#).

taxpayer, including potential disallowance of up to 100 percent of the deduction arising from the payment of royalties to the foreign affiliate or foreign parent company.

POTENTIAL DISALLOWANCE UPON FAILURE TO PROVIDE DOCUMENTATION

In the event that the domestic affiliate fails to provide the documentation referenced above to support its intangible expense deductions relating to payments made to a foreign affiliate or foreign parent company, the Director may, in determining the entire net income of the domestic taxpayer, choose to disallow up to 100 percent of the deduction. In determining the entire net income of the domestic taxpayer that has failed to provide the requested documentation, the Division may contact and commence an audit of the foreign affiliate or foreign parent company to arrive at a "fair and reasonable tax."

The domestic taxpayer has 90 days from the time of request from the Division to provide documentation to substantiate its intangible expense deduction, which can be extended for good cause or agreement between the domestic taxpayer and the Division. The Division intends to codify the contents of this TAM in a regulation, pursuant to the Administrative Procedure Act, N.J.S.A. 52:14B-1 et seq.

Note: A Technical Advisory Memorandum ("TAM") is an informational statement of the law, regulations, or Division policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions or changes in Division policies could affect the validity of the information presented in a TAM.