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SALT Alert

New Jersey Appellate Court Reverses *Lanco*

State Tax Alert

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On August 24, 2005, the Appellate Division of the Superior Court of New Jersey overturned one of the few decisions upholding the use of so-called Delaware holding companies. *Lanco, Inc. v. Director, Division of Revenue*, Docket No. A-3285-03T1 (N.J. Sup. Ct., App. Div, Aug. 24, 2005), *rev'g* 21 N.J. Tax 200 (N.J. Tax. Ct., 2003).

Lanco is a Delaware corporation that licenses certain intangible property to Lane Bryant, an affiliate, in the conduct of Lane Bryant's retail operations, including those in New Jersey in exchange for a royalty fee. Lanco itself did not have offices, employees or property in New Jersey. The New Jersey Tax Court ruled that the Division of Taxation could not subject Lanco to the New Jersey Corporation Business Tax (CBT) based solely on Lanco's licensing activities in the state. In particular, the Tax Court ruled that the "physical presence" standard upheld by the U.S. Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) in the context of use tax collection obligation applied to the CBT.

The Appellate Division reversed the Tax Court's decision, finding that New Jersey could tax Lanco's income from licensing fees even in the absence of physical presence. The Appellate Division relied heavily on decisions issued by other jurisdictions limiting *Quill's* physical presence test to the use tax collection obligation, including a recent North Carolina decision that criticized the New Jersey Tax Court's decision in *Lanco*. See *A & F Trademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. Ct. App. 2004).

What the Appellate Court's Reversal Means to Corporate Taxpayers

- Refund claims filed based on the Tax Court's decision will presumably be denied.
- The financial statement impact of the decision, including state tax reserves, should be re-evaluated for companies that have taken benefit for New Jersey tax purposes for the Delaware holding company or similar structure.
- The Appellate Court's decision could negatively impact future constitutional attacks against the nexus provisions contained in the New Jersey Alternative Minimum Assessment.
- Other state taxes that contain economic nexus provisions, such as the recently enacted Ohio Commercial Activity Tax, may be viewed in a more positive light.
- New Jersey may now challenge the Delaware holding company structure using either the *Lanco* decision or by applying the add-back provisions (effective 1/1/02).
- It is unclear whether the decision will be applied outside the context of Delaware holding companies, such as other out-of-state businesses with customers or contracts in New Jersey.
- The decision may be appealed to the New Jersey Supreme Court, and ultimately, to the U.S. Supreme Court.

FOR MORE INFORMATION
PLEASE CONTACT:
Glenn McCoy or
Robert Zonenshein at
(212) 885-8000.

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