

TAX UPDATES FROM CONNECTICUT, NEW JERSEY AND NEW YORK CITY - OCTOBER 2021

Hodgson Russ Tristate Tax Alert
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In this installment of the Tristate Tax Alert we have news on New Jersey's CBT Schedule G-2 (Claims for Exceptions to Disallowed Interest and Intangible Expenses and Costs), guidance from New York City on Hurricane Ida penalty relief, as well as a guest appearance from the state of Maine, which recently considered Connecticut's pass-through entity tax regime.

Update from Connecticut

While technically not guidance from Connecticut, a recently released decision of the Maine Board of Tax Appeals considered the Connecticut pass-through entity tax (PTET) and held that a resident of Maine was not entitled to reduce his Maine personal income tax liability with a credit for PTET paid to Connecticut in 2018.

In the redacted Maine decision at docket no. BTA-2020-1 (Mar. 1, 2021), the resident owned a Connecticut limited liability company that elected to be treated as an S corporation. In 2018, the company was subject to Connecticut's mandatory PTET and the Maine resident received an offsetting credit against his Connecticut income tax liability. After the credit, the Maine resident had no income tax liability to Connecticut.

The resident filed a Maine income tax return, claiming a credit against his Maine income tax liability for the PTET that his company paid to Connecticut. While Maine statutes generally allow residents a credit for taxes paid to other states on income that is also taxed by Maine, Maine Revenue Services denied the credit. On appeal, the Board rejected the resident's argument that the Connecticut PTET was "functionally a tax upon his own personal income," finding that the Maine credit statute is limited by its terms to taxes imposed on individuals. The Board also reasoned that after application of all available credits in Connecticut, the Maine resident had no Connecticut individual income tax liability that would trigger the Maine resident credit.

Other states with PTET regimes, such as New York and New Jersey, have indicated they intend to provide resident credits for the PTET paid to certain states. The New Jersey Division of Taxation has advised it will allow a resident taxpayer to claim a credit for the Connecticut PTET. New York has announced that it plans to post a list of substantially similar PTETs that qualify for the New York resident tax credit.

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However, Maine, along with approximately 20 other states, have not enacted a PTET. This case highlights the importance of considering the impact of the PTET election on the resident credit because whether a state gives a resident credit for PTET paid to another state will depend on the provisions of each state's resident credit statute.

Update from New Jersey

The Lorillard Saga: Taxpayer Loses CBT Schedule G-2 Dispute on Appeal

Demonstrating that tax disputes can have long shelf lives, the New Jersey Appellate Division weighed in on the Division of Taxation's 2003 regulations and related CBT Schedule G-2 that interpret and apply the related party addback rules first enacted nearly 20 years ago.

In 2002, the New Jersey Legislature enacted a related party addback provision that required CBT taxpayers to add back to entire net income otherwise deductible royalty payments made to related members.

The Legislature also enacted several exceptions to the royalty addback, one of which was at issue in *Lorillard Tobacco Co. v. Division of Taxation*, Docket Nos. A-3444-18, A-0002-19 (Sept. 21, 2021). Lorillard argued that it was not required to add back royalty payments to its subsidiary because it qualified for the "unreasonable exception." The unreasonable exception to New Jersey's various related party addback provisions has been the subject of numerous New Jersey court decisions over the years as taxpayers and the Division have disagreed about what a taxpayer must prove in order to qualify for this exception.

The Division's regulations provided that the add back is not required if the taxpayer establishes, to the satisfaction of the Division, that the disallowance of a deduction is unreasonable by showing the extent the related party pays tax in New Jersey on the income stream. N.J.A.C. 18:7-5.18(b)(3).

On its original CBT returns Lorillard added back its royalty payments to its licensing subsidiary. The subsidiary was not a CBT filer because it claimed it did not have nexus with New Jersey. After audit the subsidiary filed CBT returns and paid CBT under New Jersey's 2009 Tax Amnesty program for the same years that Lorillard had added back royalty payments to the subsidiary.

Based on the subsidiary's payment of CBT, Lorillard argued that it qualified for the unreasonable exception and was entitled to a refund of the CBT attributable to the addback of the royalties paid to the subsidiary. However, the Division does not automatically allow a dollar-for-dollar exception to the addback when the payee of a royalty is a New Jersey CBT filer.

Instead, the Division created Schedule G-2 to the CBT return, which requires the royalty payor to compute the amount of the addback exception based on the allocation factors of the payor and payee. If the payor and payee have the same allocation factors, then the payor can take the full exception to the addback. But if the payor's allocation factor is larger than the payee's factor, then the payor will only have a partial exception to the addback.

Lorillard claimed a refund for tax years 2002 through 2005 of \$4,297,701 but the computation required by Schedule G-2 reduced the refund to \$2,802,277 because the subsidiary had a lower allocation factor than Lorillard. While the Tax Court found Lorillard was entitled to the full refund because the allocation factors of the payor and payee should not be used to limit the addback exception, the appellate court did not agree.

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In reversing the Tax Court decision the appellate court found the Division's regulation and Schedule G-2 were an appropriate exercise of discretion, entitled to deference by the Tax Court, and consistent with the 2002 legislation. However the appellate court noted that *Lorillard* is not precluded from showing that it is unreasonable in some manner not to refund the balance of the remaining addback based on facts specific to its situation.

We will be keeping an eye on the developments in *Lorillard* as it has been remanded to the Tax Court to consider *Lorillard's* constitutional challenges to the addback statute. Given the nature of the claims and the long history of litigation between *Lorillard* and the Division, we expect the issues to make their way back to the appellate court after the remand and ultimately the New Jersey Supreme Court may have to weigh in on whether Schedule G-2 imposes an unreasonable limitation on the addback exception that is inconsistent with the addback statute.

Given the uncertainty in this area potential refund claims relating to Schedule G-2 computations should be preserved.

Update from New York City

Penalty Relief for Victims of Hurricane Ida

New York City issued [Finance Memorandum 21-03](#) (the "Memorandum") on September 15, 2021 prescribing penalty relief for victims of Hurricane Ida. The Commissioner of the NYC Department of Finance ("Finance") exercised his authority under the Administrative Code of the City of New York to allow waiver or abatement of penalties for certain Finance administered taxes due between September 15, 2021 and October 2, 2021. The Memorandum outlines the taxes for which the Commissioner has exercised his authority and the mechanisms to request the waiver/abatement of penalties, as well defining who is a "qualified taxpayer" eligible for penalty relief. Please be aware that interest continues to accrue and apply, notwithstanding the penalty relief. Accordingly, interest must be paid on all tax payments received after the original due date and the interest will be calculated from the original due date to the date of payment.

A "qualified taxpayer" is one who was directly affected by Hurricane Ida in counties specified by FEMA as eligible for individual assistance. The Memorandum provides that as of September 14, 2021, such counties include the Bronx, Kings, Nassau, New York, Queens, Richmond, Suffolk, Sullivan and Westchester. Also eligible are: (i) taxpayers directly affected by Hurricane Ida located in any additional counties in New York State that are declared disaster areas eligible for individual assistance and federal tax relief after the date of issuance of the Memorandum, (ii) taxpayers directly affected by Hurricane Ida in counties in other states meeting the above criteria. The Memorandum sets forth several categories of taxpayers who would be considered directly affected by Hurricane Ida and eligible for relief:

- Victims of the storm who reside in or have a principal place of business in the designated counties
- All workers assisting in the relief activities in the designated counties
- Any taxpayer whose records necessary to meet tax filing and payment deadlines because of disruptions in the designated counties in the transportation and delivery of documents by mail or private delivery services, or due to disruptions in the designated counties in communication services (for example, telephone, facsimile, or electronic mail), resulting from the storm

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- Taxpayers whose practitioners reside in or have their principal places of business in the designated counties and were unable to complete work to meet tax filing, payment, and other deadlines on behalf of their clients due to the storm.

For Business Corporation Tax returns, General Corporation Tax returns, Unincorporated Business Tax returns and Banking Corporation Tax returns due on or after September 15, 2021, and on or before October 2, 2021, qualified taxpayers who cannot meet these deadlines due to Hurricane Ida, may file and pay any tax due on or before December 14, 2021. The Memorandum makes clear that “[a]ny filings made on or before December 14, 2021, will be considered timely and no late filing or late payment penalties will be imposed” and “includes taxpayers who previously received extensions whose extended due dates fall within the period commencing September 15, 2021, and ending October 2, 2021.”

For Commercial Rent Tax and Hotel Room Occupancy Tax, qualified taxpayers whose quarterly returns are due on or after September 15, 2021, and on or before October 2, 2021, and who are unable to file on time due to Hurricane Ida, may file and pay on or before December 14, 2021, without the imposition of any late filing or late payment penalties. Similar relief is provided for qualified taxpayers whose Real Property Transfer Tax returns were due or are due on or after September 15, 2021, and on or before October 2, 2021—they may file and pay on or before December 14, 2021, without the imposition of any late filing or payment penalties.

The Memorandum also provides that qualified taxpayers whose monthly Utility Tax returns are due on or after September 15, 2021, and on or before October 2, 2021, and who are unable to file on time due to Hurricane Ida, may file on or before December 14, 2021, and such filings will be considered timely.

Contact [Open Weaver Banks](#) (646.218.7524), [Debra Herman](#) (646.218.7532), or [Elizabeth Pascal](#) (716.848.1622) if you have any questions about how these tax laws may impact you or your business.