American Bankers Association
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Mr. Mitchell C. Smith
Administrative Practice Officer
Division of Taxation
50 Barrack Street
P.O. Box 269
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RE: PRN 2011-038

Dear Mr. Smith:

The American Bankers Association[1] (ABA) is pleased to submit this comment letter in response to the Notice of Proposed Amendment published in the New Jersey Register on February 7 regarding the proposed change in the rules relating to the taxation of foreign corporations by the State under N.J.A.C. 18:7-1.8. We believe that a broad application of the proposed rule may lead to unconstitutional results. Hence, we recommend that the Division of Taxation eliminate the references in the proposed rule change that would expand the contacts required to satisfy nexus for purposes of taxing an out-of-state financial business. Furthermore, because the proposed change in the rules represents a substantive change in policy, it should not be applied retroactively to 2002 as proposed.

Under current New Jersey law (*N.J.A.C. Section 18:7-1.8*), every "foreign" (non-New Jersey) corporation "which does business, employs or owns capital or property, or maintains an office in New Jersey in a corporate or organized capacity, regardless of whether it has formally qualified or is authorized to do business in New Jersey" is subject to State tax. The proposed rule seeks to change the current law by expanding the types of contacts that will subject a foreign corporation to New Jersey State tax. However, the proposed rule provides two separate standards for determining whether an out-of-state business has sufficient nexus with the State to be subject to tax. Under the first standard, a foreign corporation is subject to tax if it "**derives** receipts from sources within New Jersey or **engages in contacts** within New Jersey…provided that the taxpayer's business activity in New Jersey is sufficient to give this State jurisdiction to impose the tax under the Constitution and statutes of the United States." The second standard provides that "[a] financial business corporation, a banking corporation, a credit card company or similar business that has its commercial domicile in another State is subject to tax in this State if during any year it **obtains or solicits** business or **receives** gross receipts from sources within this State." Under the first standard, a general business corporation is subject to tax for the privilege of having or exercising its corporate franchise in the State or for the privilege of deriving receipts from sources within or

[1] The ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees.

maintaining an office in the State. Notwithstanding such contacts, there must be sufficient business activity to give the State jurisdiction to impose tax under the United States Constitution and laws. The second standard that applies to banking corporations does not contain the key language "or for the privilege of **deriving** receipts from sources within this State or for the privilege of engaging in contacts within the State," and does not contain the limitation requiring sufficient business activity to give the State jurisdiction under the U.S. Constitution or statutes.

The New Jersey legislature has made it clear that banks are different from other business corporations to the extent to which the State can subject them to tax. Banking corporations must do business, employ or own capital or property or maintain an office in the State. The proposal unfairly targets financial business corporations that receive gross receipts from sources within the State by its use of the term "receives" as opposed to "derives" which it uses with respect to general business corporations. Moreover, many of the State courts that have addressed the issue of nexus for the purposes of a State taxing an out-of-state business have agreed that there must be substantial nexus in order for a State to tax an out-of-state business. While "substantial nexus" has been defined in a variety of ways depending on the facts and circumstances of each case, the underlying question in many cases has always been focused on the frequency, quantity and systematic nature of a taxpayer's economic contacts with a State. Thus, the mere fact that a business derives receipts from sources within a State should not be determinative of the issue.

The ABA has a long history on the issue of State taxation of out-of-state businesses, has worked with the Multistate Tax Commission for many years on State tax initiatives and projects (including the current amendment project on the Model Uniform Financial Institutions Apportionment Rule), and has testified several times in Congress in hearings relating to State taxation of out-of state businesses (Business Activity Tax Bills Hearings). The issue of State taxation of out-of-state businesses is very important to the industry and we continue to support Congressional efforts to address the issue and create uniformity on State laws relating to this topic as more and more States are publishing "nexus" laws that are not only confusing and unfair, but also generally disrupt legitimate activities of financial business corporations by making it difficult to plan their tax payments on the basis of settled law. We strongly urge the New Jersey Division of Taxation to eliminate the standard applicable to foreign financial business corporations from its proposed rule as it essentially discriminates against such businesses by imposing more stringent standards on them and attempting to tax activities that do not create any form of "substantial nexus" with the State –as the term has been defined by many State courts.

Furthermore, we believe that the Division of Taxation's intent to retroactively apply the newly expanded regulatory interpretation of the State's subjectivity statute to tax years beginning on or after January 1, 2002 is unfair and extremely burdensome. Applying the rule retroactively will unfairly punish out-of-state businesses that have in good faith relied on the Division of Taxations' administrative guidance, which provides that the mere receipt of interest income absent some other connection did not create nexus for purposes of taxing an out-of-state business. Predictability and guidance relating to financial service companies' tax responsibilities, regardless of the State providing such guidance, is very important to the financial position of each company and the industry as a whole. Finally, these amendments may discourage financial services companies from knowingly engaging in any type of business transactions with New Jersey residents, even where such transaction would greatly benefit the resident and involve no contact between the company and the State. This would create a significant problem for many New Jersey residents, particularly

in the current economic climate when lending money and refinancing is critical to New Jersey and other States' ability to recover from the current economic conditions.

Please feel free to contact me at any time at fmordi@aba.com or 202.663.5317 to discuss these comments further or answer any questions you may have.

Sincerely,

Francisca N. Mordi

cc: Mr. Chris Jeter
Assistant State Treasurer
Division of Taxation

Mr. Michael Bryan
Acting Director
Division of Taxation