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**Tax Policy**

Criss-crossing the country, Crowell & Moring's state tax team meets regularly with state tax commissioners and their counsel to bring Bloomberg BNA's readers candid and timely observations from the country's top state tax decision-makers. Nine stops into this 50-state journey, Walt Nagel, Don Griswold, and Jeremy Abrams spoke this month with Michael Bryan, Director at the New Jersey Division of Taxation. In this column, Bryan discusses a wide range of topics, including the Division's proposed market-based sourcing regulation, recent nexus litigation, and tax amnesty policy.

## **Crowell's Conversations: An Interview With Michael Bryan, Director of the New Jersey Division of Taxation**

MICHAEL BRYAN, INTERVIEWED BY WALT NAGEL,  
DON GRISWOLD, AND JEREMY ABRAMS

### **Sales Factor Trends**

**CROWELL:** It's great to be back home in New Jersey. (Jeremy and Walt grew up in Jersey and went to Rutgers.) We have a lot of questions for you, so let's get started. Like many states, New Jersey has gone down the path towards single sales factor apportionment. Have you seen any impact on revenue collections?

**BRYAN:** I don't think we anticipated this to really increase revenue. The administration and legislature enacted single sales factor because they heard the business community and agreed it was important. The Gov-

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ernor's office has been very clear about "no new taxes," and that's true without exception. Anything that even looks like a new tax or that will have a significant upward tax impact, putting more burden on taxpayers, is a reform idea that we don't even bring to the Governor. And the other thing to say is it's difficult to isolate that as one variable because we're at what we all hope is the end of an economic downturn. Companies are doing nominally better now. But corporation business tax revenue still tends to lag a little bit, and you can see that if you look at the state's financials. You'll also see that corporation business tax represents only 8 or 9 percent of the state's revenue. So it's not an enormous component but it's still one of the "Big 3" (sales & use tax; gross income tax; corporation business tax). We spend an inordinate amount of time talking about less than 9 percent of our revenue when so much time could be spent dealing with other important issues, like the tax gap in the sales and use tax area and the gross income tax area, and identity theft, and all those other topics that may have a much larger impact on revenue.

**CROWELL:** The proposed market-based sourcing rule for services set to go into effect in 2014 has been rather controversial. A lot of people in the taxpayer community think it's contrary to the statute.

**BRYAN:** Yeah, and that's indicative of the comments that we got in response to the publication of the regs earlier this year. We take those comments very seri-

ously. And we have the option to say “thank you very much” and move on, but what we’ve decided to do is do a pretty serious rewrite of that proposed reg and go out and re-propose. So we have drafts that we’ve circulated internally and the plan right now is to, at least internally, vet those with my advisory council. And I really thought we’d be done with that process by now, but we’ve had some delays in getting input and getting approvals and getting this stuff drafted. So I suspect we’ll see those re-proposed sometime early in 2014.

**CROWELL:** So this will really encourage people that comments matter, right?

**BRYAN:** Yes, that’s one thing. And the other is hopefully we’ll find a solution that really addresses some of those concerns about cost-of-performance and those sort of statutory issues that were raised in the comments.

## Transfer Pricing Audits

**CROWELL:** In September 2011, New Jersey opted not to continue its relationship with Chainbridge and to shut down its third-party transfer pricing audit program. Is the department still conducting transfer pricing audits?

**BRYAN:** Yes, we decided not to continue the contract. We are conducting section 482 audits within the Division of Taxation, but I think we all know that IRC § 482 is one of those rather arcane areas of the law that unless you work in that area constantly it’s very difficult to master the concepts and the issues. So the idea I had, I guess about a year ago, was to talk to Joe Huddleston at the MTC and see if they could support a desire on our part to create a centralized transfer pricing audit program because we just don’t have the resources to attract that kind of talent to the state of New Jersey. I thought if the MTC could centralize that effort with the support of some other states, maybe that would be a way to solve that problem for New Jersey and other states at the same time. I will say that the MTC has not had the level of commitment from as many states that are really necessary to move the program forward right now. There are lots of ways taxpayers can creatively manage their income through intercompany pricing. We’re going to try to do what we can at the state level [to ensure compliance], especially being a separate entity state.

## New Jersey Nexus

**CROWELL:** In *Village Super Market of PA*, the Tax Court seemed to apply a hybrid unitary business/sham analysis to determine that an out-of-state entity had nexus due to its ownership interest in a limited partnership doing business in New Jersey (contrary to 2011 case *BIS LP*). Do you see this as an expansion of New Jersey’s nexus jurisprudence?

**BRYAN:** We were pleased with the result in *Village Super Market of PA*. It had a lot to do with the *BIS* case before it, and I think everybody in a well-informed position knows the *BIS* case went up as an investment company case and we didn’t have the opportunity to argue the issues that we did in the case of *Village Super Market of PA*. So while we don’t view this as an expansion from New Jersey’s perspective, we do view it as a rollback, at least a partial rollback, of the result that we

got in the *BIS* case. New Jersey still points to *Lanco* as the leading nexus case that we tend to rely on.<sup>1</sup>

**CROWELL:** Has New Jersey’s view on nexus evolved at all in the years since *Lanco*, and if so, how?

**BRYAN:** I don’t think it really has. I think in the director’s office, and counsel’s office and the folks in audit that tend to deal with that, we still view *Lanco* as the law of the land and we’ve not softened that position. Until we have a different result – maybe how *Whirlpool* comes out in the end will redefine that.<sup>2</sup>

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**CROWELL:** So what’s your view on *Whirlpool*?

**BRYAN:** I’m not going to speculate as to what I’d like to see as the outcome. I will say we’re all aware that the three motions have been denied by Judge Bianco. That’s recent news, I think as early as the beginning of November. And there is a short amount of time to make some decisions on that. But the way we think this is going to end up is back as a nexus case and sometime in 2014, it will be back on the court’s docket. So we think we’ll be back in the trial court on that one.

## Revenue Collection Policy

**CROWELL:** New Jersey recently had a Voluntary Disclosure program for intangible holding companies. Can you share with us the results of that program?

**BRYAN:** Well I will say that when I went out and spoke to practitioner groups and industry groups, I did get this question fairly frequently, that being – “is New Jersey going to offer an opportunity to deal with some of the IHC issues that companies are facing?” So I worked with folks here at the Division of Taxation to give taxpayers an opportunity that we thought was really as generous as we thought we could be, given the fairly consistent pressure that I was getting from the practitioner and industry communities. And in the end the [taxpayer] participation in the program was disappointing. I do think some folks were counting on it being a lot more generous than it ended up being. So that was unfortunate.

**CROWELL:** An issue related to voluntary disclosure is amnesty. You have the *UPS* litigation in the New Jersey Supreme Court regarding New Jersey’s post-amnesty penalty. Do you think it’s fair to increase penalties for those that don’t participate in amnesty?

**BRYAN:** The way I look at it is at the outset; tax amnesty is bad policy. Because in a lot of cases what it does is it steals a lot of revenue from the Division’s near

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<sup>1</sup> EDITOR’S NOTE: See *Lanco Inc. v. New Jersey Dir., Div. of Taxn.*, 188 N.J. 380 (2006), cert. denied, 551 U.S. 1131 (2007) (New Jersey may constitutionally impose tax on foreign corporation that lacks physical presence in the state where the foreign corporation receives royalties for use of its intellectual property through a licensing agreement with an in-state retailer).

<sup>2</sup> See *Whirlpool Properties Inc. v. New Jersey Dir., Div. of Taxn.*, N.J. Tax Ct., No. 000066-2007, 10/22/13.

future. Those are cases we in a lot of situations would have identified anyway, it enables taxpayers to bring that money in at some significant discount. And when these things come up so frequently, and frequently might be every five to seven years, you set an expectation that taxpayers and practitioners are just going to wait for the next one to come up and take advantage of it and manage those reserves on their balance sheets when they have that opportunity to do it with some certainty and at a significant discount. And those programs never typically originate within the Division of Taxation, they'll typically originate within the Legislature.

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**“I don’t necessarily disagree with the notion of a [post-amnesty] penalty.”**

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**CROWELL:** Kind of a revenue shot in the arm?

**BRYAN:** Yeah, and that’s exactly what happened in 2009. That amnesty really originated in the Legislature. We have input but we don’t necessarily drive the process. There has to be some incentive for taxpayers to show up. So I don’t necessarily disagree with the notion of a penalty in that aspect. I think that’s the intent of the Legislature, to put some incentive in there in the form of “if you don’t show up and we do find you, it’s going to cost you a little more.”

### **E-Access Is Not Delivery**

**CROWELL:** Let’s talk about electronic commerce. How is the Division treating digital downloads of books, music, and the like under New Jersey law?

**BRYAN:** Well, some aspects of e-commerce are taxable in New Jersey. We did put up Tech Advice which we’ve gotten some compliments on with regard to cloud computing and a lot of those related issues.<sup>3</sup> From our perspective in New Jersey, those transactions are largely not taxable. It’s our view that access is not delivery. Until there is legislation that changes that, you know, we don’t view that as an opportunity to attempt to create nexus or to create new sources of revenue for sales or use tax. We’re dealing with the statute as it’s written today and until the Legislature provides something that changes that significantly we don’t view these [cloud computing] transactions largely as taxable.

### **Measured Success**

**CROWELL:** We’ve heard you say publicly that there’s been a bit of a brain drain here in the Division as there is at the IRS, due to the large number of retirements. Have you been able to backfill the brain drain? How is that process going?

**BRYAN:** It’s difficult. I spend a lot of time talking to my senior staff about succession planning and 2014 is going to be a difficult year. Health benefits get more expensive for retirees in New Jersey after June 30, 2014, so we anticipate a significant number of retirements. We are empowered to hire an awful lot to replace our retirements, but we’re often hiring trainee positions. So

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<sup>3</sup> EDITOR’S NOTE: See N.J. Div. of Taxn., Technical Bulletin No. TAM 4-2013 (July 3, 2013).

we’re bringing folks in that are new to the Division, not in every case inexperienced. There are lots of people that come in with experience, but what we’re losing is at the senior staff level. Those folks with 30, 35, 40 years of experience and those are significant resources that are going to be difficult, if not impossible, to replace in the short term. So we’re doing our best to anticipate that. There are lots of managers that give us plenty of notice that they intend to retire so we can begin to develop people to fill those positions and take on that responsibility in those roles. But I think anybody in my position nationwide is going to face this in a big way over the next couple of years. And it’s going to present significant challenges. And there are other jurisdictions that aren’t empowered to hire so they have that outflow without the corresponding inflow. We’ve at least had the opportunity to bring people in. Since I’ve started here in July of 2010 we’ve brought in about 330 individuals to the Division of Taxation and we’re planning another 80-100 early next year.

**CROWELL:** You spent a good portion of your career in the private sector with a very large company; Comcast. Do you approach these issues with a different perspective now as Director?

**BRYAN:** I left the private sector and industry and I guess I had been somewhat of a student of that notion never expecting ever to be sitting in this chair today. But I always found it fascinating to look at the Internal Revenue Service where it wasn’t uncommon to see people come out of law firms, or the Big 4, or economists, or out of industry, and move into the Internal Revenue Service in very senior roles, in chief counsel’s office and places like that. I always wondered how difficult it would be to spin the table around and sit on the other side. And it is surprisingly easy to see it from the other side when you understand the job that you need to do and how it needs to get done. You certainly bring a different perspective to the position, but it’s easy to see the priorities and what’s important to the Division, and what needs to get done, and what kind of decisions need to be made and how to deal with those things. And my position is a little different in that I’m only the second director to come to the Division from the outside in the history of the organization. So I don’t know that I’ll ever be viewed as anything but an outsider with some of the senior staff here. I hope I’ve broken down some of those barriers but most directors in the past have grown up in the organization and really have been insiders from the beginning of their careers.

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**“[T]he two biggest ideas I brought to the table here were accountability and transparency.”**

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**CROWELL:** Well Comcast’s loss is certainly New Jersey’s gain. It must certainly be a breath of fresh air for the career folks to get another perspective as well.

**BRYAN:** Yeah, and that’s what I’ve hoped for. I ran audits in multiple states and the IRS at Comcast. And you know I attended Hal [Heltzer]’s seminar at Crowell & Moring whenever I could; I keep a copy of *Coping With IRS Audits* right here on my credenza. And so I had a fairly broad perspective on how the IRS and certain jurisdictions ran audits; some were better than others and

I always viewed New Jersey as somewhere in the middle of the pack.

And the two biggest ideas I brought to the table here were accountability and transparency; to try to improve accountability within the Division, to set some goals and some targets, and hold people responsible for those. And transparency in the form of better communications with taxpayers, for example the technical advisory memoranda that we started publishing, we're working on an audit manual and some other aspects of accessing the Division and senior staff within the Division. I think we've had some measured success in both of these areas.

I encourage practitioners, if you feel you have an auditor or an investigator that's running somewhat rogue,

to escalate those cases and have those conversations with the supervisors and assistant chiefs, chiefs and assistant directors to try to bring those problematic cases to our attention. We've also created an office of the taxpayer advocate here in New Jersey. We don't want that to be another avenue for appeal, but we do want it to be an opportunity for those taxpayers that feel like they're just not being heard to solve some really, really difficult problems. There are lots of cases where the advocate's office has done an awful lot of good whether it's on a specific taxpayer matter or systemic issues that we find within the Division.

**CROWELL:** You're doing a great job Mike. Thanks for sitting down with us today.