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Passthrough Entities

Tax Practitioner: Court Rulings Provide Nexus Relief for Corporate Investors in Partnerships

The general nexus rule for a corporation with an interest in a partnership is that the activity of the underlying partnership creates nexus in that state, triggering filing requirements, a tax expert said.

But a recent court ruling in Louisiana and two in New Jersey provide indications that some fact patterns allow a corporation investing in a partnership to avoid certain taxes, Todd Hyman, a partner with Deloitte Tax LLP in Philadelphia, told a webinar audience March 1.

The Louisiana ruling in *UTELCOM, Inc. v. Bridges* was a dispute over the applicability of the state's franchise tax to a corporation whose sole connection to Louisiana was a limited partnership interest in a partnership doing business in Louisiana, Hyman said. As a result, the taxpayer argued that it wasn't subject to the state's franchise tax. (191 DTR K-2, 10/3/11).

The state argued that capital contributions made by the corporation to the partnership and that were deployed in Louisiana gave the corporation nexus in the state. The state also argued that the general partner was acting as an agent on behalf of the limited partners, creating nexus, he said.

But the court disagreed with the state in a taxpayer-friendly ruling, Hyman said. "The court felt that the capital contributions of the corporation were really the partnership's to deploy however they wanted to," he said. "They also felt that the general partner was not acting as an agent on behalf of the limited partners, but rather was acting in their own interest as a general partner."

The *UTELECOM* ruling has given rise to significant refund claims that have been filed over the past several years, he said. "If you have a corporation that meets this fact pattern, it may be worth filing a refund claim if you've paid significant tax to Louisiana," he said.

New Jersey Rulings. Two recent cases in New Jersey have yielded contrary results, again based on differences in the underlying fact patterns, Hyman said. The first was a 2011 case, *BIS LP, Inc. v. New Jersey Div. of Taxation*, which involved a corporation whose only connection to the state was a limited partnership interest in a partnership doing business there (169 DTR K-3, 8/31/11).

In *BIS*, the court found that the corporation was not unitary with the underlying partnership, Hyman said. "The corporation and the partnership weren't in the

same line of business, and there was no substantial overlapping of officers," he said.

The resulting decision was favorable to the taxpayer, but the state tried to argue that the underlying refund should be paid to the partnership, which was barred under the statute, Hyman said. The court disagreed, ruling that the refund should be paid to the corporation.

"New Jersey's rules are pretty specific when it comes to withholding," he said. "So if you have a corporation that meets the rules under *BIS*, and isn't unitary with the underlying partnership that it invests in, that underlying partnership is still required to withhold in New Jersey on behalf of the corporation. And it is then the corporation that has to go and claim that it is not unitary."

Village Supermarket. Another recent New Jersey case was less taxpayer-friendly and illustrates the importance of the underlying fact patterns in determining nexus, Hyman said. In *Village Super Market of PA, Inc. v. New Jersey Div. of Taxation*, 27 N.J. Tax 394 (N.J. Tax Ct. 2013), the plaintiff was a Pennsylvania corporation that invested in a limited partnership that operated grocery stores in New Jersey.

But there were important factors that pointed toward treating the corporation as unitary with the partnership, Hyman said. The corporation operated a grocery store in Pennsylvania, and there was a significant overlapping of officers, he said. In addition, there was a cash management agreement that included the corporation and the partnership.

"The court in this case found the relationship to be clearly unitary, and thus, the corporation really needed to pick up the activity of the partnership and apportion it to New Jersey," Hyman said. "So, there was a very different result, and one that depends on the fact patterns."

Hyman said that, in New Jersey, there is a regulation covering the issue of when a corporation's interest in a partnership is unitary or not unitary. "You really need to look to that reg to figure out whether you meet the facts of *BIS*, and really aren't subject to tax on your underlying interest," he said.

Hyman added that New Jersey has taken a different approach from that of Louisiana in responding to refund claims based on these cases, insisting that taxpayers prove their case. "In New Jersey, they initially paid out significant refunds to taxpayers that filed refund claims," he said. "But it seems more recently, maybe due to the amount they've paid out, they've dug their heels in and pushed taxpayers to prove that their corporation was truly not unitary with the partnership they invest in."

But despite the resistance, the cases are “worth keeping an eye on,” he said. “If you meet the fact pattern, it’s worth pursuing a refund if it’s applicable.”

Also speaking on the webcast were Greg Bergmann, a partner with Deloitte Tax in Chicago, and Scott Frishman, a principal with Deloitte Tax in Washington.

BY CHRISTOPHER BROWN

To contact the reporter on this story: Christopher Brown in St. Louis at chrisbrown@bna.com

To contact the editor responsible for this story: Ryan Tuck at rtuck@bna.com