

## Proposed New Jersey Regulations Address Market-Based Sourcing

### Overview

On March 16, 2020, the New Jersey Division of Taxation released proposed amendments and a new rule to address the market-based sourcing provisions under the Corporation Business Act. The proposed regulations include the following:

- A rule amendment to limit allowance of cost of performance, time spent or other reasonable methods sourcing to privilege periods prior to July 31, 2019;
- A new rule to provide a method of allocating receipts from certain services using market-based sourcing for privilege periods ending on or after July 31, 2019;
- A method for allocating certain lump sum payments; and
- Examples to illustrate certain services and industries.

This Tax Alert summarizes these proposed regulations.

### Amendment to the existing rule for the allowance of cost of performance sourcing

Pursuant to the New Jersey tax reforms enacted in 2018, market-based sourcing is required for sales of services for purposes of computing the state corporation business tax sales factor, applicable for privilege periods ending on and after July 31, 2019.<sup>1</sup> In accordance with this new law, the allowance for cost of performance, time spent or other reasonable methods of sourcing under the existing rule is amended to limit the application to privilege periods ending prior to July 31, 2019.<sup>2</sup>

### New rule to provide a method of allocating receipts using market-based sourcing

The proposed rule requires taxpayers to include receipts from services in the numerator of the sales fraction if the benefit of the service is received by the customer at a location within New Jersey.<sup>3</sup> The customer is considered within the state if the customer is engaged in a trade or business and maintains a regular place of business in New Jersey or is an individual located within the state.<sup>4</sup> If the taxpayer provides services to customers engaged in a trade or business located in New Jersey and another state(s), the receipts included in the numerator of the sales factor should be based on the proportionate amount of the total value of the benefit of the services within and outside the state.<sup>5</sup> The proposed rule provides that in order to determine the extent to which a customer receives the benefits of a service within the state, a taxpayer may look to the terms of a contract, the taxpayer's books and records, or the nature of the taxpayer's or recipient's business and/or the service(s) at issue.<sup>6</sup>

The taxpayer may use reasonable approximation to determine the receipts attributable to the customer's operations within the state.<sup>7</sup> A reasonable approximation means that "the location where the benefit of the service(s) is received is determined in a manner that is consistent with the activities of the recipient" based on the available information to

<sup>1</sup> NJ A.N. 4202 (July 1, 2018) A copy of the adopted law is accessible [here](#).

<sup>2</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10(a)).

<sup>3</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(1)).

<sup>4</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(2)(i)).

<sup>5</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(3)).

<sup>6</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(3)(iii)).

<sup>7</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(3)(iv)).

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the taxpayer.<sup>8</sup> Reasonable approximations should, to the extent possible, be based on information that is “verifiable and specific in nature.”<sup>9</sup>

All receipts from sales for services provided in the regular course of business are allocable, regardless of whether services are performed by “employees or agents of the taxpayer, by subcontractors, or by any other persons and regardless of whether the taxpayer reports the receipt as an item of income or a reduction in expense.”<sup>10</sup>

### Method for allocating certain lump sum payments

The proposed regulations provide a method for allocating airline revenues and truck transportation industry revenues to illustrate the proper treatment of lump sum payments. Lump sum payments received for services where the benefit is received both inside and outside of New Jersey must be apportioned in a manner consistent with the methods provided for airline and truck company revenues.<sup>11</sup> For the airline industry, the transportation revenues from the services in New Jersey are “based on the ratio of an airline’s revenue miles in New Jersey divided by an airline’s total revenue miles.”<sup>12</sup> For trucking companies, “[t]he taxpayer’s receipts are multiplied by a fraction, the numerator of which is the number of miles in New Jersey and the denominator of which is the mileage in all jurisdictions.”<sup>13</sup>

### Examples provided for certain services and industry-specific transactions

The proposed regulations include a set of examples to illustrate market-based sourcing for specific services, including real estate surveying services, engineering services, computer software services, advertising services, prescription services, market analysis services, GPS services, legal information services, and payroll processing services. The proposed regulations also include specialized rules for certain industries for the allocation of the related service income. For asset management services, the receipts for services provided to an individual are allocated to New Jersey if the individual is a New Jersey resident.<sup>14</sup> If the asset management services are provided to a pension plan, retirement account or institutional investor, the receipts are sourced to New Jersey to the extent the beneficiaries are domiciled within the state.<sup>15</sup> Asset management services provided to a regulated investment company are allocated to New Jersey to the extent that shareholders are domiciled within the state.<sup>16</sup> For a registered securities or commodities broker or dealer, taxpayers are required to source the receipts to New Jersey if the customer is located within the state.<sup>17</sup> Additionally, for a broadcaster’s licensing of film programming, the taxpayers are required to source the receipts to New Jersey “based on the broadcast customer’s viewing audience in New Jersey in proportion to the viewing audience in all states.”<sup>18</sup>

### Considerations

Taxpayers should consider the impact of these regulations when filing their New Jersey corporate business tax returns for tax years 2019 and beyond.

<sup>8</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(3)(iv)(1)).

<sup>9</sup> *Id.*

<sup>10</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(4)).

<sup>11</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(6)).

<sup>12</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(6)(i)).

<sup>13</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(6)(ii)).

<sup>14</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(8)(i)).

<sup>15</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(8)(ii)).

<sup>16</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(8)(iii)).

<sup>17</sup> 52 N.J.R. Sec. 508(a)(N.J.A.C. 18:7-8.10A(a)(9)).

<sup>18</sup> 52 N.J.R. Sec. 508(a) (N.J.A.C. 18:7-8.10A(a)(10)).

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