

MEMO# 25372

August 1, 2011

NJ Supreme CT Addresses Constitutionality of "Throw-Out" Rule

[25372]

August 1, 2011

TO: TAX MEMBERS No. 27-11

ADVISER DISTRIBUTOR TAX ISSUES TASK FORCE No. 9-11 RE: NJ SUPREME CT ADDRESSES
CONSTITUTIONALITY OF "THROW-OUT" RULE

The New Jersey Supreme Court has ruled that the state's "throw-out" rule may apply constitutionally only to untaxed receipts from states that lack jurisdiction to tax or due to congressional action. [\[1\]](#) Under the "throw-out" rule, receipts assigned to a jurisdiction in which the taxpayer is not subject to an income tax, profits tax, or other business activity tax are excluded from the denominator of the sales factor. Many states have adopted a "throw-out" rule to eliminate the apportionment of income from sales to states where the income is not subject to tax.

The Court held that New Jersey's "throw-out" rule violates the U.S. Constitution when applied to untaxed receipts from a state that chooses not to impose an income tax. The Court noted that a state's choice not to impose a tax is equivalent to taxing at a rate of 0%. New Jersey's apportioned share of income, the Court reasoned, should not increase because another state sets its tax rate at 0%. To find otherwise, the apportionment formula would not reflect reasonably how the income is generated in New Jersey.

The Court determined that the "throw-out" rule is constitutional when applied to untaxed receipts from states that lack jurisdiction to tax a corporation due to insufficient nexus or because of congressional action. Unlike where a state chooses not to impose a tax, a state's lack of jurisdiction could reflect the fact that the state has "contributed relatively little compared to New Jersey."

Pinank Desai
Assistant Counsel - Tax Law

endnotes

[\[1\]](#) Whirlpool Properties, Inc. v. Director, Division of Taxation, N.J. Dkt. No. A-25, (07/28/11).

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.