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New Jersey Still Wrestles with Unity, but Don't Forget the Rules

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As the New Jersey Division of Taxation changes leadership and issues guidance regarding legislative changes, including for unity, it is time to recall some fundamentals of unity and put the unity statute change in context. First, we wish outgoing Acting Director of the Division of Taxation John Ficara well and congratulate Marita Sciarrotta as the new Acting Director.

New Jersey modified its statutory definition of unity by changing an "and" to an "or" (enacted along with many other Corporation Business Tax changes). Summarizing the new unity statute language, commonly owned businesses have statutory unity when they are sufficiently "interdependent, integrated, ***or*** interrelated" so as to provide a synergy and mutual benefit, a sharing or exchange of value among them, and a significant flow of value among the separate parts. P.L. 2023, c. 96 (NJSA 54:10A-4(gg)) (emphasis added to show the change). The guidance explains that while the language changed, the tests remain the same. TB-93(R) (Revised August 14, 2023).

The statute's instruction that "unity" shall be construed to the broadest extent permitted under the Constitution of the United States is a peculiar statement because the statutory definition of "unity" contains 300 words. Yet, inasmuch as "unity" is also a constitutional concept, if the statutory word "unity" is to be construed as broadly as constitutionally permitted, then why not state that statutory unity "will be synonymous with constitutional unity" (six words), for which there is much case law in existence. Because those 300 words must mean something, and words matter, there are opportunities in the language.

The statute, however worded, cannot reach beyond constitutional unity. The U.S. Supreme Court stated:

As we indicated in [Mobil Oil]: "Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business." The constitutional question becomes whether the income "derive[s] from 'unrelated business activity' which constitutes a 'discrete business enterprise.'"

Allied-Signal v. NJ Division of Taxation, 504 US 768, 780 (1992) (referring to *Mobil Oil v. Vermont*, 445 U.S. 425, 442 (1980)). In *Allied-Signal*, the U.S. Supreme Court recognized that in one of its prior

decisions it “reaffirmed that the constitutional test focuses on functional integration, centralization of management, and economies of scale.” *Id. at* 783 (referring to *Container Corp. of Am v. CA FTB*, 463 U.S. 159, 179 (1983)). The question in *Allied-Signal* was unity within the legal entity confines. The U.S. Supreme Court’s *Container* decision held that the unity concept can cross legal lines, thus allowing for California’s then-new unitary combined reporting methodology and finding unity under the facts in that case.

In *Container*, the U.S. Supreme Court gave us important conditions for unity, two of which I highlight here. First, to have a unitary business, you must have “a flow of *value*, not a flow of goods.” *Container Corp.*, 463 U.S. at 178 (1983) (emphasis in original). Second, arm’s length transactions do not constitute flows of value. *Id. at* 180 n.19 (1983). That is, the mere existence of related-party transactions between two entities does not make two entities unitary.

These important concepts are overlooked in New Jersey’s guidance. New Jersey states its view that: “Existence of arm’s length pricing between entities, however, does not indicate a lack of unity.” TB-93(R). Many auditors believe that they do not have to consider, and can ignore, transfer pricing reports, which is wrong and is subject to challenge. When auditors assert unity by related-party transactions and the transactions are at arm’s length, stand up and fight!

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