No. 20-

IN THE

Supreme Court of the United States

XPEDITE SYSTEMS, INC.,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPERIOR COURT OF NEW JERSEY, APPELLATE DEVISION

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This Court has long held that State taxation of interstate commerce is only permissible where, among other factors, the tax is fairly apportioned to the entity's activities in the State. New Jersey, like many States, has a statute that allows its taxation authority to order the reapportionment of revenue attributable to the State where the taxpayer's method of apportionment does not properly reflect the revenue that is reasonably attributable to the State. Unlike other States, New Jersey applies a presumption of correctness to its Division of Taxation's decision to depart from the standard apportionment methodology, and requires the *taxpayer* to demonstrate that the Division's departure is improper instead of requiring the *Division of Taxation* to demonstrate why the taxpayer's apportionment was improper. This leads to a "heads I win, tails you lose" system in which the Division of Taxation can take different departure approaches to different taxpayers to maximize New Jersey's revenue, and the differing approaches will be affirmed in court challenges because of the deference afforded the Division of Taxation.

The question presented is: Whether granting unfettered deference to a State tax commissioner's decision to reapportion the revenues of an interstate business violates the Due Process Clause and Commerce Clause.

LIST OF PARTIES AND RULE 29.6 STATEMENT

Petitioner Xpedite Systems, Inc. (“Xpedite”) is the Plaintiff in the Tax Court of New Jersey and the Appellant in the Superior Court of New Jersey, Appellate Division. During the tax periods relevant to this petition, Xpedite was wholly owned by Premiere Global Services, Inc. (“PGi”). Open Text Corporation, a publicly-traded entity, is the current ultimate parent of Xpedite (which is now Xpedite Systems, LLC).

Respondent Director, Division of Taxation, State of New Jersey is the Defendant in the Tax Court of New Jersey and the Respondent in the Superior Court of New Jersey, Appellate Division.

RELATED CASES

Pursuant to Rule 14.1(b)(iii), a list of all proceedings in other courts that are directly related to this case are as follows:

- *Xpedite Systems, Inc. v. Director, Division of Taxation*, No. C-788, Supreme Court of New Jersey. Petition for certification denied on May 8, 2020.

- *Xpedite Systems, Inc. v. Director, Division of Taxation*, No. A-000789-18T3, Superior Court of New Jersey, Appellate Division. Judgment entered on January 9, 2020 and motion for reconsideration denied on January 23, 2020.

- *Xpedite Systems, Inc. v. Director, Division of Taxation*, No. 018847-2010, Tax Court of New Jersey. Judgment entered on September 5, 2018.

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CASES

Petitioner, Xpedite Systems, Inc. ("Xpedite"), respectfully petitions for a writ of certiorari to review the Superior Court of New Jersey, Appellate Division's holding that the Director of the Division of Taxation for the State of New Jersey was permitted to reject Xpedite's use of an apportionment formula codified in an administrative regulation and to reapportion Xpedite's revenues to substantially increase the amount of revenue attributable to New Jersey, without first finding that Xpedite's use of the standard apportionment formula did not reasonably reflect Xpedite's revenue attributable to New Jersey.[1]

OPINIONS BELOW

The Supreme Court of New Jersey's Order denying Xpedite's petition for certification (App. 1a) is unreported. The Superior Court of New Jersey, Appellate Division's Opinion (App. 2a) is unreported. The Tax Court of New Jersey's Opinion (App. 17a) is unreported.

JURISDICTION

The opinion of the Superior Court of New Jersey, Appellate Division was entered on January 9, 2020. Petitioner petitioned the Supreme Court of New Jersey

1. Though the New Jersey statute at issue here uses the term "allocation" to refer to the division of taxable revenues amongst the States, the more precise term is "apportionment." The term "allocation" is generally used in reference to non-business income. The term "apportionment" is typically used in reference to business income like the revenues at issue here. Thus, except where quoting from New Jersey authorities, this Petition uses the term "apportionment" to refer to the division of business income across multiple States for taxation purposes.

for certification of the Superior Court of New Jersey, Appellate Division's judgment, which would have allowed the Supreme Court of New Jersey to exercise its discretionary review authority. The court denied the petition for certification on May 8, 2020. On March 19, 2020, this Court entered an Order extending the deadline to file any petition for a writ of certiorari due on or after that date to 150 days from the date of the order denying discretionary review. Because this Petition is filed within 150 days of the date on which the Supreme Court of New Jersey denied Petitioner's request for discretionary review, this Court has jurisdiction pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS INVOLVED

Article I, Section 8, Clause 3 of the United States Constitution grants Congress the power "[t]o regulate commerce with foreign nations, and among the several states, and with the Indian tribes."

Section 1 of the Fourteenth Amendment to the United States Constitution states that "All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of cities of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

INTRODUCTION

This Petition presents the Court with an opportunity to resolve a split in the highest courts of the States about the level of deference that should be given to a tax commissioner's decision to reapportion the revenues of a company engaged in interstate commerce that are attributable to that State.

Xpedite is a company that engages in interstate commerce. For the years at issue, the vast majority of Xpedite's customers were located outside of the State of New Jersey. Xpedite apportioned its revenues to New Jersey for taxation purposes under an administrative regulation permitting the apportionment of revenues proportionately to the location of an entity's customers. The New Jersey Division of Taxation (the "Division" or the "Division of Taxation") rejected Xpedite's apportionment and concluded instead that Xpedite was required to apportion revenues based on a different methodology that weighted the location where Xpedite's services originated, where they were performed, and where they were terminated. This resulted in a much larger apportionment of Xpedite's revenues to New Jersey and, consequently, the amount of tax that Xpedite owed to New Jersey increased dramatically. Xpedite is now subject to that increase in New Jersey tax for the years 1998-2000 and 2002, with no ability to revise its apportionment in other States.

Xpedite sought review of the Division of Taxation's decision to reapportion its revenues in the Tax Court of New Jersey, but that court upheld the Division of Taxation's decision because it applied a presumption that the Division of Taxation's reapportionment decision was correct and improperly placed the burden on Xpedite to demonstrate that the decision was improper. Xpedite appealed to the Superior Court of New Jersey, Appellate Division, which also applied deference to the Division of Taxation's decision and rejected Xpedite's challenge. The Supreme Court of New Jersey denied review.

The deference that the New Jersey courts gave to the Division of Taxation's decision to reapportion Xpedite's revenues stands in stark contrast to the approach of the highest courts of several other States. Unlike New Jersey, those States require the tax commissioner to make two specific showings before rejecting a taxpayer's use of a statutory apportionment formula. First, the tax commissioner must demonstrate that the use of the apportionment formula selected by the taxpayer produces a result that is arbitrary or unreasonable. Second, the tax commissioner must demonstrate that the proposed reapportionment methodology produces a result that is fair and reasonable.

This split in the decisions of the States has significant constitutional implications. Both the Due Process Clause and the Commerce Clause require that a State's decision to impose a tax on interstate activity be fairly apportioned. To satisfy this requirement, the tax must be "internally consistent," which means that, if it were applied by every single State, it would result in no more than 100 percent of a company's revenues being taxed. The unfettered discretion that the New Jersey courts granted to the Division of Taxation to depart from the standard apportionment formula in this case violates that principle. If each State were permitted to depart from its standard apportionment formulas on a whim, without requiring any specific showing that the standard formula imposed an arbitrary or unfair result, companies would routinely be taxed on greater than 100 percent of their revenues, as tax commissioners in every State would apply whatever method of allocation maximizes their State's revenue at the taxpayer's expense, and that method of allocation would be presumed correct in any appeal.

As discussed below, this Court should grant certiorari to clarify that the Constitution only permits tax commissioners to unilaterally reallocate a taxpayer's revenues after a specific showing that the standard allocation methodology does not fairly and adequately represent the portion of the taxpayer's revenue that is attributable to a particular State. It is important that this Court decide this question because reallocation statutes like the one at issue in this case are commonplace and because States are increasingly becoming more aggressive in their attempts to use such statutes to generate additional revenue to taxpayers' detriment.

STATEMENT OF THE CASE

This Petition originates from an assessment of New Jersey Corporation Business Tax ("CBT") on Xpedite by the New Jersey Division of Taxation. Xpedite originally filed its CBT returns under the general rule of the Division's apportionment regulation to assign its receipts from business services to New Jersey. Through the assessment, the Division invoked its discretionary authority to reapportion the receipts under an alternative apportionment method that substantially increased Xpedite's New Jersey taxable income.

The CBT permits a multistate corporation to apportion income among the States in which it conducts business by applying an apportionment formula to determine its New Jersey taxable income. N.J.S.A. § 54:10A-6. The apportionment formula reflects business activity in New Jersey based on the proportion of the taxpayer's New Jersey property, payroll (i.e., wages paid to New Jersey employees), and receipts. *Id.* The Division's discretionary modification of Xpedite's apportionment formula was effected through an adjustment to its "receipts" factor.

Xpedite originally determined its CBT liability for the years 1998-2000 and 2002 (the "Tax Years") by apportioning receipts from its facsimile broadcast services based on the location of its customers under the general rule of the Division's apportionment regulation. N.J.A.C. § 18:7-8.10(a). App. 18a-19a. The Division audited Xpedite's CBT returns and reapportioned its receipts to New Jersey based on an alternative methodology that assigns receipts using a three-pronged method based on the location where a service originates, where the service is "performed," and where the service terminates. N.J.A.C. § 18:7-8.10(c). App. 23a. The Division cited its discretionary authority for reapportioning taxable income under N.J.S.A. § 54:10A-8 as the basis for making this adjustment. App. 6a-7a, 16a. The effect of the Division's discretionary adjustment was to deny Xpedite's use of the general rule for apportionment under the New Jersey regulations in favor of an alternative method that reassigned receipts to New Jersey and thus, significantly increased Xpedite's New Jersey taxable income.

Xpedite protested the Division's reapportionment to the Conference and Appeals branch of the Division. After an administrative conference, the Division upheld the adjustment through a Final Determination dated August 6, 2010. App. 17a-18a, 24a. The Final Determination increased Xpedite's CBT liability for the Tax Years, for a total assessment inclusive of penalty and interest of $6,160,570. App. 18a

Xpedite appealed the Final Determination to the New Jersey Tax Court. In an Opinion dated September 5, 2018, the Tax Court granted summary judgment to the Division. The Tax Court determined that "the issue in the case is the reasonableness of Taxation's allocation methodology as to which it has 'broad authority' to make adjustments." App. 44a. The Tax Court concluded that the Division's adjustment to Xpedite's receipts factor was reasonable given its broad discretionary authority, and that therefore, "Xpedite has not met its burden of overcoming the presumptive correctness of Taxation's CBT assessments." App. 48a.

Xpedite filed a notice of appeal to the Appellate Division of the New Jersey Superior Court on October 19, 2018. In a Decision dated January 9, 2020, the Appellate Division upheld the Tax Court below, stating that the Appellate Division's "review of a decision by the Tax Court is highly deferential" and that because "the Tax Court has 'special expertise', its findings will not be disturbed unless they are arbitrary." App. 13a. The Appellate Division upheld the Tax Court based on its conclusion that the Division of Taxation's reallocation was "well within the Director's discretion." App. 16a. Xpedite filed a motion for reconsideration, which the Appellate Division denied on January 23, 2020.

Xpedite filed its notice of petition for certification to the New Jersey Supreme Court on January 31, 2020, which was denied by Order of the court on May 8, 2020. App. 1a.

REASONS FOR GRANTING THE PETITION

I. THIS CASE PRESENTS AN IMPORTANT QUESTION REGARDING CONSTITUTIONAL LIMITS ON STATE TAXATION PROCEDURE.

This case presents an important question of the constitutional limits on a State's ability to formulate its own apportionment of a taxpayer's revenue for State income tax purposes. New Jersey allows its Division of Taxation to disagree with a taxpayer's apportionment, reassess a taxpayer's liability using the Division's own formulation for apportionment, then receive deference in any apportionment challenge, with the burden of proof resting with the taxpayer to prove that the Division's decision to reapportion was incorrect. If every State were to enact such a regime, interstate taxpayers would be subject to taxation on far more than their entire business revenue since each State's taxation authority would apply an apportionment that maximizes revenue in their own State, and that apportionment would be upheld under deferential review. Such a scheme violates the Commerce Clause and Due Process Clause.

A. The Constitution Limits States' Ability to Tax Interstate Commerce.

This Court is often asked to resolve constitutional challenges to State taxes and "has frequently had occasion to consider whether state taxes violate the

Commerce Clause." *Goldberg v. Sweet*, 488 U.S. 252, 259 (1989). This is because, "while the Constitution imposes no single formula on the States," it provides important limits on the States' ability to tax revenue that is not properly attributable to the State seeking to impose the tax. Specifically, "[u]nder both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983) (quoting *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982)); *see also Tenn. Wine & Spirits Retailers Ass'n v. Thomas*, 139 S. Ct. 2449, 2459 (2019) (recognizing that the Commerce Clause "prohibits state laws that unduly restrict interstate commerce" and "'prevents the States from adopting protectionist measures and thus preserves a national market for goods and services.'" (quoting *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273 (1988)).

Over 40 years ago, this Court articulated the framework for evaluating constitutional challenges to State taxes on interstate commerce. In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), the Court set forth the four criteria that a State tax must satisfy to pass constitutional muster. First, the tax must be "applied to an activity with a substantial nexus with the taxing State." *Id.* Second, it must be "fairly apportioned." *Id.* Third, it must not "discriminate against interstate commerce." *Id.* Fourth, it must be "fairly related to the services provided by the State." *Id.* This Court has recently reiterated these core constitutional requirements. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2091 (2018) ("The Court will sustain a tax so long as it (1) applies to an activity with a substantial nexus with the taxing

State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides.").

This case involves the second requirement – that the tax be fairly apportioned. "[T]he central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg*, 488 U.S. at 260-61. To be fairly apportioned, a tax must be both "internally and externally consistent." *Id.* at 261. "[T]o be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Id.* Put another way, the method of taxation "must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed."[2] *Container Corp. of Am.*, 463 U.S. at 169.

B. The Use of Revenue Apportionment Statutes Must Comply with the Constitutional Requirement of Internal Consistency.

Because the Constitution prohibits States from "tax[ing] value earned outside [their] borders," *Container Corp. of Am.*, 463 U.S. at 164 (internal quotation marks omitted), each State that imposes a tax on income has statutory or regulatory guidance containing formulas that explain how to apportion business revenues to that State. While these formulas often result in fair apportionment

2. External consistency, which is not at issue here, examines whether "the factor or factors used in the apportionment formula . . . actually reflect a reasonable sense of how income is generated." *Container Corp. of Am.*, 463 U.S. at 169.

of a company's revenues, sometimes they do not. *See, e.g.*, *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931) (striking down use of statutory method to apportion business revenues to North Carolina because it "attribut[ed] to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State"). To safeguard against unfair results produced by the standard apportionment formulas, many States have enacted statutes that allow departures from the standard formula where applying it would not properly reflect receipts that are reasonably attributable to the State. The New Jersey statute at issue here provides an illustrative example. It states, in relevant part: "If it shall appear to the commissioner that an allocation factor . . . does not properly reflect the activity, business, receipts, capital, entire net worth or entire net income of a taxpayer reasonably attributable to the State, he may adjust it . . . ." N.J. Stat. Ann. § 54:10A-8.

By safeguarding against unfair results, reapportionment statutes like New Jersey's serve an important role as a "constitutional 'circuit breaker.'" *Trinova Corp. v. Dep't of Treasury*, 445 N.W.2d 428, 434 (Mich. 1989), *aff'd*, 498 U.S. 358 (1991). This important purpose is also reflected in State court decisions examining the use of reapportionment statutes. For example, the Supreme Court of Michigan remarked that the purpose of a statute that allows reapportionment of revenues where the statutory apportionment formulas "do not fairly represent the extent of the taxpayer's business activity in this state" is to "ensure[] that each state taxes only its share of interstate transactions" by giving the State a mechanism to reject the statutory allocation where it would produce an unfair result. *See id.*; *see also*

City of Seattle v. KMS Fin. Servs., Inc., 459 P.3d 359, 366 (Wash. Ct. App. 2020) (holding that a statute that allows a taxation authority to "employ another method to allocate the taxpayer's income" "provides a safety net" to "avoid a constitutional violation"). In other words, where a method of allocation and apportionment does not fairly reflect the extent of a taxpayer's taxable activities in a jurisdiction, reapportionment statutes like the New Jersey statute at issue here can provide an important constitutional safeguard that can be used to foster "the central purpose behind the apportionment requirement," namely, "ensur[ing] that each State taxes only its fair share of an interstate transaction." *See Goldberg*, 488 U.S. at 260-61.

But because these statutes grant wide discretion to reapportion revenues, they are subject to abuse if their use is not carefully constrained. Indeed, as this Court has previously recognized, the use of a standard statutory apportionment formula is entitled to a great deal of deference. *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978) ("States have wide latitude in the selection of apportionment formulas and . . . a formula-produced assessment will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the State is in fact out of all appropriate proportions to the business transacted in that State or has led to a grossly distorted result."). Thus, departures from the standard apportionment formulas should be viewed with skepticism, and the use of reapportionment statutes should be limited to those narrow circumstances in which they are necessary to prevent "arbitrary or unreasonable results." William J. Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 781 (1957).

And a tax commissioner's use of a reapportionment statute, like any other method of taxation, must satisfy the four core constitutional requirements, including the internal consistency rule, to pass constitutional muster. *See Container Corp. of Am.*, 463 U.S. at 169.

C. New Jersey's Practice of Granting Unfettered Discretion to the Division of Taxation's Decision to Reapportion a Taxpayer's Revenues Violates the Commerce Clause and Due Process Clause.

Unlike the approach followed by other States, *see* Section II, *infra*, New Jersey grants "considerable discretion" to the Division's decision to impose an alternative apportionment, and New Jersey courts have held that the Division has "broad authority . . . to determine what income-producing activity . . . is reasonably referable to [the taxpayer's] business in New Jersey." *Metromedia, Inc. v. Dir., Div. of Taxation*, 478 A.2d 742, 747 (N.J. 1984). In this case, Xpedite calculated the amount of tax it owed to New Jersey by allocating its revenues based on the location of its customers under a New Jersey administrative regulation, N.J.A.C. § 18:7-8.10(a). App. 5a. But the Division of Taxation rejected Xpedite's reliance on this administrative regulation. The Tax Court found that the Division applied this "broad authority" to calculate the amount of tax Xpedite owed under an entirely different approach that computed the percentage of Xpedite's revenues attributable to New Jersey by weighting the location where Xpedite's services originated, the location where Xpedite's services were performed, and the location where Xpedite's services were terminated. App. 7a. This resulted in over 75 percent of Xpedite's revenues being taxed by New Jersey, even though less than 10 percent of

Xpedite's customers were located in New Jersey for each of the years in question. *Id.*; *see also* Br. for Pl.-Appellant at 7 (N.J. Super. Ct. App. Div.).

The New Jersey Superior Court, Appellate Division affirmed the Tax Court's decision and applied New Jersey's extremely deferential review of the Division of Taxation's apportionment methodology, expressly finding that its "review of a decision by the Tax Court is highly deferential" and "'limited [in] scope.'" App. 13a. The Appellate Division applied New Jersey law to place the burden on Xpedite to prove that the Division of Taxation's decision to apply an alternative method of apportionment was improper. *See* App. 13a, 16a. The court then concluded that Xpedite had not met that burden. *Id.* Like the Tax Court, the Appellate Division made no finding that the formula Xpedite used to determine the portion of its revenues to allocate to New Jersey produced an unreasonable or arbitrary result. Instead, it concluded that because the Division of Taxation's chosen allocation methodology "reasonably reflects the portion of Xpedite's services" performed in New Jersey, the Division of Taxation's decision to reject Xpedite's use of the statutory formula "was . . . well within the Director's discretion." App. 16a.

The Constitution does not permit that extraordinary deference. As discussed above, to comport with due process and to satisfy the requirements of the Commerce Clause, a rule of taxation must be internally consistent. The internal consistency test examines whether a rule of taxation, if applied hypothetically across all States, would result in greater than 100 percent of a taxpayer's income being taxed. *See, e.g.*, *Container Corp. of Am.*, 463

U.S. at 169 ("The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed."). If so, then the rule of taxation violates the Constitution. *See id.*

Granting a tax commissioner the unfettered authority to reject a taxpayer's use of the standard allocation methodology simply because he dislikes the result, as New Jersey does, violates the internal consistency test. If every State's tax commissioner were granted deference to reallocate taxpayer revenues however he wished, far greater than 100 percent of every interstate service provider's revenues would be taxed, as tax commissioners would apportion service providers' revenues based on their place of performance for those jurisdictions in which the service provider has property and payroll (as New Jersey did with Xpedite in this case), and would force those service providers to pay taxes based exclusively on the location of their customers in those jurisdictions in which the service provider has no or limited property and payroll (as New Jersey did in the *Bank of America* case, discussed below). If adopted by all States, this scheme of deference would cause all interstate service providers to pay tax on over 100 percent of their revenues, and would therefore violate the internal consistency rule. *See Container Corp. of Am.*, 463 U.S. at 169 (internal consistency rule requires that, if the method of taxation were "applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed").

The following hypothetical two-State scenario illustrates the reason that granting deference to tax commissioners' reapportionment decisions leads to internally inconsistent, and therefore unconstitutional, results. Assume that each of the two States in this scenario has a standard statutory allocation formula that permits a taxpayer to apportion revenues based on the location of its customers, and that a taxpayer has 90 percent of its operations in State A but 75 percent of its customers in State B. If the taxpayer applies the standard apportionment formula in each State and apportions its revenues between the two States based on the location of its customers, it will be taxed on 75 percent of its revenue in State B and 25 percent of its revenue in State A. But if State A follows the same approach that New Jersey did in this case, State A will require the taxpayer to pay taxes on 90 percent of its revenue and that decision will be upheld on appeal because of the great deal of deference given to the tax commissioner's reallocation decision. The taxpayer would still be on the hook for paying taxes on 75 percent of its revenue to State B under State B's standard apportionment formula, and the end result would be that the taxpayer is required to pay taxes on far greater than 100 percent of its revenue. The only way to prevent this result is to place the burden on the tax commissioner in State A to demonstrate that the use of the standard formula fails to fairly reflect the taxpayer's income and then—rather than simply defer to the State's assertion that it has done so—actually require the State to meet its evidentiary burden. New Jersey's system, as it stands, is a violation of constitutional standards, for the Division's determination is never independently reviewed, except by a court applying an extremely deferential standard of review.

Moreover, as this Court has previously recognized, it is impermissible to "allow apportionment where there is no practical or theoretical justification," because doing so "could provide the opportunity for a State to export tax burdens and import tax revenues." *Trinova Corp. v. Mich. Dep't of Treasury*, 498 U.S. 358, 374 (1991). But granting tax commissioners unfettered discretion to depart from statutory apportionment formulas by presuming that their decisions to do so are correct and requiring the taxpayer to bear the burden of overcoming them allows tax commissioners to do exactly that. The extreme deference that New Jersey gives to the Division of Taxation's apportionment methodology allows New Jersey to make taxation decisions based on whatever apportionment scheme will maximize the State's revenue, even if the State's positions are irreconcilable from case to case.

For example, in *Bank of America Consumer Card Holdings v. State Division of Taxation*, the New Jersey Tax Court explained that, in the modern technology-based service economy, revenues from services must be allocated to the location of the customer who receives the benefit of those services: "When it comes to services in a service-based economy, . . . *the service provider allocation should be based upon where the benefit of the service is derived or earned* . . . ." 29 N.J. Tax 427, 465 (Tax Ct. 2016) (emphasis added). In this case, however, the Tax Court reached the exact opposite conclusion, and refused to allow Xpedite to apportion its revenues based on the location of its customers. To return to the earlier hypothetical, because it does not impose a burden of proof on the Division to utilize alternative apportionment, New Jersey's reapportionment statute permits the Division to impose an apportionment formula as to each taxpayer that will benefit the State the most, and the highly deferential standard applied by the courts means that the Division never has to rationalize or justify the internally-inconsistent results that follow. This is exactly the kind of "competitive mischief" that the Commerce Clause bars. *See Trinova Corp.*, 498 U.S. at 374.

II. THIS CASE PRESENTS A QUESTION THAT HAS DIVIDED THE STATES. OTHER STATES – UNLIKE NEW JERSEY – PROVIDE PROCEDURAL GUARDRAILS ON THE POTENTIAL FOR TAX AUTHORITIES TO EXERCISE POWER IN AN UNCONSTITUTIONAL MANNER.

There is a split in the highest courts of the States about the appropriate level of deference the States must give to tax commissioners' use of an alternative apportionment mechanism. At one end of the spectrum, a party seeking to depart from a standard apportionment formula bears a heavy burden of showing that the departure is warranted. In California, for example, to justify departing from a taxpayer's use of the standard apportionment formula, the tax commissioner "has the burden of proving, by clear and convincing evidence that (1) the approximation provided by the standard formula is not a fair representation, and (2) its proposed alternative is reasonable." *Microsoft Corp. v. Franchise Tax Bd.*, 139 P.3d 1169, 1177 (Cal. 2006). Other States require a similarly specific showing before upholding a departure from the standard apportionment formula, but only require the tax commissioner to make that showing by a preponderance of the evidence. *See, e.g.*, *Twentieth-Century-Fox Film Corp. v. Dep't of Revenue*, 700 P.2d 1035, 1043-44 (Or. 1985) (tax commissioner must prove, by a preponderance of evidence, both (1) the standard statutory formula produces an unfair result; and (2) the "alternative method of allocating income is 'reasonable'"); *see also CarMax Auto Superstores West Coast, Inc. v. S.C. Dep't of Revenue*, 767 S.E.2d 195, 200 (S.C. 2014) ("[W]hen a party seeks to deviate from a statutory formula under section 12-6-2320(A), the proponent of the alternate formula bears the burden of proving by a preponderance of the evidence that: (1) the statutory formula does not fairly represent the taxpayer's business activity in South Carolina and (2) its alternative accounting method is reasonable.").

In States that follow these approaches, before reallocating a taxpayer's revenues, the tax commissioner must "state . . . findings of basic fact to support a conclusion that the statutory standard of unfair apportionment has been met." *St. Johnsbury Trucking Co. v. State*, 385 A.2d 215, 217 (N.H. 1978). In other words, the tax commissioner must explain why both of the prerequisites to departing from the standard statutory formula are satisfied. The reason specific factual findings are necessary is because, as explained by one State supreme court, "an alternative formula is the exception," not the rule. *Id.* Moreover, the mere fact that "the use of an alternative form of computation produces a higher business activity attributable to [the State] is not in and of itself a sufficient reason for deviating from the legislatively mandated formula." *Id.* Requiring a tax commissioner to demonstrate specific facts before departing from the standard statutory formula ensures that alternative reapportionment cannot be used for a nefarious purpose.

As discussed above, New Jersey's approach lies at the complete opposite end of the spectrum. New Jersey does not require the Division of Taxation to make any specific showings in order to justify its use of an alternative apportionment methodology. And it does not require the Division to prove that the taxpayer's use of the standard apportionment formula produced an arbitrary or unfair result. Instead, the Supreme Court of New Jersey has held that the Division of Taxation has the "broad authority to adjust the allocation factor in order to reflect more accurately and fairly the activity, business, receipts . . . or entire net income of a taxpayer reasonably referable to the state." *Metromedia, Inc.*, 478 A.2d at 747. Given this expansive authority, New Jersey's courts have held that the methodology selected by the Division of Taxation is presumptively correct, and they place the burden on the taxpayer to "overcom[e] the presumptive correctness" of the Division of Taxation's apportionment. *See* App. 48a.

New Jersey is not alone in rubber-stamping tax commissioners' decisions to depart from standard apportionment formulas. Indiana also applies a "presumption of validity" to its Department of Revenue's decision to deviate from a statutory apportionment formula. *See Ind. Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). And, like New Jersey, Indiana places the burden on the taxpayer to demonstrate that the Department of Revenue's alternative method of allocation is incorrect. *See id.* at 467.

As these decisions demonstrate, the level of deference that courts give to tax commissioners' use of alternative apportionment statutes varies significantly across the States – with massively disparate results. States like California, Oregon, and South Carolina require tax commissioners to specifically demonstrate that a taxpayer's use of a standard apportionment formula produces an unfair result in order to justify reapportioning a taxpayer's revenues. In States like New Jersey and Indiana, the tax commissioner's reapportionment decision is presumed correct, even if the commissioner has not demonstrated that there was anything wrong with the taxpayer's approach. In these jurisdictions, the burden rests with the taxpayer to prove that the commissioner's decision is wrong.

This Court should grant Xpedite's Petition to resolve this split and should hold that, before rejecting a taxpayer's use of a standard apportionment formula, tax commissioners bear the burden of demonstrating both that the use of the standard formula is unreasonable and that the tax commissioner's alternative apportionment methodology produces a reasonable result.

III. THIS CASE IS AN IDEAL VEHICLE FOR THE COURT TO ELUCIDATE PROCEDURAL SAFEGUARDS STATES MUST FOLLOW IN APPORTIONING REVENUE FOR PURPOSES OF TAXATION.

This case presents the ideal vehicle for resolving the split in the highest courts of the States about the level of deference that should be given to a tax commissioner's decision to reallocate revenues. As discussed above, New Jersey's approach to deciding challenges to the use of a reallocation statute is among the most deferential in the nation. Moreover, New Jersey's apportionment statute is unique in that it allows only the Division of Taxation, and not the taxpayer, to deviate from the statutory formula. Other States allow both the tax commissioner and the taxpayer to take advantage of the ability to reapportion where the statutory formula produces an unfair result. *See, e.g.*, O.C.G.A. § 48-7-31(d)(2)(C) ("If the allocation and apportionment provisions provided for in this paragraph do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition the commissioner for, or the commissioner may by regulation require . . . [t]he employment of any other method to effectuate an equitable allocation. . . ."); Tenn. Code Ann. § 67-4-2014(a)(5) ("If the tax computation, allocation or apportionment provisions . . . do not fairly represent the extent of the taxpayer's business activity in this state . . . the taxpayer may petition for, or the department through its delegates may require . . . [t]he employment of any other method to effectuate an equitable computation, allocation and apportionment of the taxpayer's net earnings or losses that fairly represents the extent of the business entity's activities in Tennessee.").

This unique feature of New Jersey's reapportionment statute makes it especially susceptible to the kind of unconstitutional results that Xpedite faced in this case. Because only the Division of Taxation, and not the taxpayer, has the authority to deviate from a standard allocation formula, New Jersey's apportionment statute functions as a one-way ratchet that can be used to increase the portion of the taxpayer's revenue that is subject to taxation by New Jersey, without allowing taxpayers to benefit from reapportionment where the standard apportionment methodology produces a result that is too high. The one-sided nature of New Jersey's apportionment statute makes it especially critical that the Division of

Taxation be required to make a specific showing that the taxpayer's use of the standard apportionment formula produces an unfair result and that the commissioner's chosen reallocation methodology is reasonable.

This case also presents an ideal vehicle for this Court's review because this Court's review of the level of deference that should be given to tax commissioners is urgently needed. Apportionment statutes like the New Jersey statute at issue in this case are common. In fact, the Uniform Division of Income for Tax Purposes Act ("UDITPA"), which includes such a reapportionment provision, has been enacted by 23 States and the District of Columbia. *See* Uniform Law Comm'n, Division of Income for Tax Purposes Act, *available at* https://bit.ly/30hsStD (last visited Oct. 2, 2020). And even States that have not adopted the UDITPA, like New Jersey, have statutes that grant tax commissioners the authority to reapportion revenues. Thus, this issue is likely to continue to arise until this Court resolves it.

Moreover, States are increasingly using apportionment statutes to extract additional revenue from taxpayers. As commenters have recognized, the recent trend is to "almost uniformly make it easier for states to use alternative apportionment" to increase their revenue, "while erecting obstacles for taxpayers." Christopher T. Lutz, Robert P. Merten III, and Nicholas J. Kump, *Trends and Developments in Alternative Apportionment of State Income*, State Tax Notes 559, 565 (May 8, 2017). This trend has been so pervasive that the Multistate Tax Commission has proposed amending the UDITPA's model statute to require a specific finding "(i) that the existing statutory allocation and apportionment provisions do not fairly represent the extent of the taxpayer's activity in the state, and (ii) that the alternative method proffered by the petitioning party is reasonable." *Id.* at 568. In other words, the professionals reviewing the UDITPA recognized the impropriety of deferring to taxation authorities on reallocation issues and proposed changes to the model statute to provide the constitutional guardrails already in place in States like California, Oregon, and South Carolina.

The proposed changes to the UDITPA alone, however, are not enough to safeguard against the unconstitutional use of reapportionment statutes. States are not required to enact the UDITPA's amendments into law, and are incentivized not to do so because, in those jurisdictions that presume a tax commissioner's reapportionment is reasonable, that discretion provides tax commissioners with a great deal of authority to use reapportionment statutes to maximize their State's revenue at the expense of taxpayers. Thus, until this Court resolves the split amongst the highest State courts about the showing tax commissioners must make before they are permitted to reject a taxpayer's use of a standard apportionment formula, taxpayers like Xpedite will remain at risk of being subjected to arbitrary, unfair, and unconstitutional taxation burdens.

CONCLUSION

For the above reasons, Xpedite's Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — ORDER OF THE SUPREME COURT OF NEW JERSEY, FILED MAY 12, 2020

SUPREME COURT OF NEW JERSEY

C-788 September Term 2019

084094

XPEDITE SYSTEMS, INC.,

Plaintiff-Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant-Respondent.

ORDER

A petition for certification of the judgment in A-000789-18 having been submitted to this Court, and the Court having considered the same;

It is ORDERED that the petition for certification is denied, with costs.

WITNESS, the Honorable Stuart Rabner, Chief Justice, at Trenton, this 8th day of May, 2020.

/s/
CLERK OF THE SUPREME COURT

APPENDIX B — OPINION OF THE SUPERIOR COURT OF NEW JERSEY, APPELLATE DIVISION, DATED JANUARY 9, 2020

SUPERIOR COURT OF NEW JERSEY,
APPELLATE DIVISION

DOCKET NO. A-0789-18T3

XPEDITE SYSTEMS, INC.,

Plaintiff-Appellant,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant-Respondent.

October 17, 2019, Argued
January 9, 2020, Decided

On appeal from the Tax Court of New Jersey,
Docket No. 018847-2010.

Before Judges Whipple, Gooden Brown and Mawla.

PER CURIAM

Plaintiff Xpedite Systems, Inc. (Xpedite) appeals from a September 5, 2018 Tax Court order denying its motion for summary judgment, granting defendant Director, Division of Taxation's (Division) cross-motion for summary judgment, and dismissing plaintiff's complaint. Xpedite argues the Tax Court judge erroneously calculated the portion of income, or "receipts," Xpedite earned from services performed in New Jersey between 1998 and 2002, that should have been allocated to New Jersey for tax purposes. We affirm primarily for the reasons stated in the thorough written opinion of Judge Mala Sundar.

Xpedite is a broadcast fax service incorporated in Delaware with headquarters in New Jersey. Users of Xpedite's services, generally businesses, send their customer lists, customer contact information, and documents to Xpedite's New Jersey headquarters via their own fax machines, telephone lines, or computer internet servers. Once the user's documents and customer lists are received at Xpedite's New Jersey headquarters, Xpedite uses its proprietary software, located on computers in its New Jersey headquarters, to quickly send out a large volume of faxes, e-mails, or voice messages. Xpedite's software can also add features such as message-opening tracking and links within the messages that allow its users' customers to forward the messages to their contacts.

The messages go out through a multi-state network made up of leased phone lines and some of Xpedite's own switching hardware. The messages are tracked to make sure delivery is successful, and Xpedite compiles reports at their New Jersey headquarters for its users so they can see the delivery status of their messages. Xpedite's mass e-mail and fax messaging services include a variety of formats and options. Users are charged per minute or per page for fax services, per file size for e-mail services, and per minute for other services.

Instead of sending faxes out individually to their customers, users send a single transmission through Xpedite's system to a list of fax addresses, which will be distributed to multiple recipients in a matter of minutes. Users can also upload customer lists and documents through Xpedite's website. After the user uploads their customer list file, the user then uploads the document file they would like to have sent to their customer list. For e-mails, Xpedite offers other add-on services.

From its New Jersey location, Xpedite distributes the document to the user's customer list by entering the destinations into its proprietary routing software program, contained in hardware located in New Jersey. For faxes, Xpedite's proprietary software then determines the "least cost route" (LCR) for fax delivery. The information is then sent by telephone line, to switches, called "remote fax delivery controllers" (RFDC), which are located both inside and outside of New Jersey. The RFDC then connects to phone lines, both in and out of New Jersey, to broadcast the messages. If the initial route is tied up, the broadcast message is re-routed to another line to facilitate a timely delivery. Intrastate broadcasts "almost always are done from an out of state []RFDC[] because interstate rates are usually less than intrastate rates."

For e-mails, after a job submission is uploaded to Xpedite's website, Xpedite's program runs checks to verify all required information is present; validates data; cancels invalid, duplicate, and blocked addresses; retrieves lists and profile specifications; creates a basic template for the message; and incorporates the user's additions. The program then creates an individual, customized message for every recipient and sends them by "forward[ing] each customized message to the [i]nternet mail server that handles domain mail for the destination. Once every message is on its way to its target address, a posting report is generated, if [the user] requested one." Once a connection is made to a carrier's phone lines, Xpedite monitors to ensure a successful transmission, then sends users reports on the results of both fax and e-mail broadcasts and deliveries.

For the years at issue herein, 1998 to 2002, Xpedite calculated its receipts and allocated them to New Jersey according to where it billed its customers, utilizing N.J.A.C. 18:7-8.10(a). While Xpedite receives all, or nearly all, orders at Tinton Falls and the orders are processed and sent out through the Tinton Falls "core platform," New Jersey users made up less than ten percent of Xpedite's total users in the years at issue.

Xpedite was audited by the State of New Jersey for Corporation Business Tax (CBT), Gross Income Tax (GIT), Sales Tax, and Use Tax for the years relevant to this inquiry. On May 11, 2007, the auditor issued an amended narrative finding Xpedite had been calculating its receipts for the period in question as per N.J.A.C. 18:7-8.10(a) Example Two, which describes a situation

> where a taxpayer earns income from long distance telephone calls. The taxpayer bills the originators of the long-distance calls. The

> example states that the appropriate method of allocating the long-distance [(LD)] revenue attributable to services performed in N[ew] J[ersey] is to base it upon billings for calls originating in N[ew] J[ersey].

The auditor stated that Xpedite was sourcing sales to the state where invoices were billed—the address where its customer's accounts payable are processed. The auditor determined that Xpedite is a telecommunication retailer and not a telecom provider because it does not originate the carrier signal service (dial tone), but rather uses the signal much like a freight company uses a toll road. Xpedite sends customers' information over the carrier signal.

Although Xpedite calculated its receipts for the CBT according to where its customer's accounts payable are processed, the auditor found this method did not accurately calculate New Jersey receipts, did not reflect the trade, business practice, and economic realities underlying the generation of charges for the services, and did not reflect Xpedite's business activities in New Jersey. Pursuant to N.J.S.A.54:10A-8 and -10, the auditor suggested three alternate methods to determine Xpedite's New Jersey receipts, all "reflect[ing] a measurement of transmission origination." The auditor's suggested methods were:

> [Alternate method one:] Per Jeffrey Carter, Sales Tax Billing Manager (6/30/2004), New Jersey is the origination point of all transmissions, thus the service allocation would be 100%;

> [Alternate method two:] Per Gary Schwerdt, Manager of Network Cost & Routing (7/26/2004), approximately 98% of all telecom services originate in New Jersey, thus the service allocation would be 98%;
>
> [Alternate method three:] Per Gary Schwerdt, Manager of Network Cost & Routing (7/26/2004), 59.32% of the RFDC (switching devices) which receive the transmission from New Jersey are located in New Jersey. The remaining 40.68% of the devices are located outside of New Jersey but are directed by New Jersey. Transmissions destined for New Jersey are almost always routed through equipment located outside of New Jersey. Service allocation would be 89.83%.

Because sales of services originated and were performed in New Jersey and thus sourced to New Jersey, the auditor maintained that the receipts factor should be 100%.

However, the auditor was directed by the Division to instead allocate receipts to New Jersey in accordance with N.J.A.C. 18:7-8.10(c), which allocates twenty-five percent of receipts to the state of origin, fifty percent of receipts to the state where the service is performed, and twenty-five percent of receipts to the state of termination for "a total of 76.306% of receipts allocable to New Jersey." On September 28, 2007, the Division sent Xpedite a notice of assessment related to its final audit determination, stating that as a result of the audit, Xpedite was liable for $4,975,353.02, including penalty and interest, for CBT and Sales and Use Tax for the years 1998 to 2005. Xpedite contested the Division's assessment and the matter was reviewed.

On August 4, 2010, conferee Nita Vakharia (Conferee Vakharia) issued a conference report with her findings. Based on the fact that Xpedite had its main location in New Jersey, all the faxes and e-mails for mass mailing originated and were processed in New Jersey, the equipment was located in New Jersey, and the service was performed in New Jersey, Conferee Vakharia found that under *United Parcel Serv. Gen. Serv. Co. v. Director, Div. of Taxation*, 25 N.J. Tax 1 (Tax 2009), *aff'd*, 430 N.J Super. 1, 61 A.3d 160 (App. Div. 2013), *aff'd*, 220 N.J. 90, 103 A.3d 260 (2014), 100% of the receipts should be allocated to New Jersey under N.J.A.C. 18:7-8.10(a). Therefore, because the Division had only apportioned seventy-six percent of receipts to New Jersey, Conferee Vakharia upheld the audit assessment based on the twenty-five — fifty — twenty-five formula under N.J.A.C. 18:7-8.10(c). On August 6, 2010, the Division issued a final determination to Xpedite stating the audit assessment had been upheld, and that $6,160,570 was due.

On November 2, 2010, Xpedite filed a complaint in the Tax Court of New Jersey, contesting the final determination regarding the CBT tax allocation only. Both parties moved for summary judgment and the Tax Court denied both motions, holding that facts had not yet been sufficiently developed to decide the percentage of allocation of Xpedite's sales receipts properly allocable to New Jersey. To that end, the Division deposed Gary Schwerdt, Xpedite's manager for least-cost routing and network cost and routing. No one from Xpedite's current ownership group or management appeared at the deposition.

On June 2, 2017, Xpedite again moved for summary judgment, submitting its secondary public offering filing and Securities and Exchange Commission (SEC) filings as evidence of its business model. The Division cross-moved for summary judgment, providing Schwerdt's deposition to establish Xpedite's business model. Xpedite argued that it should be taxed under N.J.A.C. 18:7-8.10(a), but not 100% as the auditor originally determined and which Conferee Vakharia found would be appropriate. Rather, Xpedite asserted it should be taxed according to Example Two which demonstrates how a long-distance telecommunications company, which earns its income from "the sale of long distance telephone communications service" and bills the customers who initiate the call directly for all calls placed by them, should allocate the receipts to New Jersey based on "billings for calls originating in New Jersey."

Xpedite asserted the economic realities of the way it generates receipts are like a long-distance telephone service. Xpedite argued given those similarities, it should source receipts using the same methodology because the services are performed under the statute at the location the services are received by the customer. Xpedite contends the services are received by their users at the user's billing location. Xpedite further argued that the "origination" of the transmission is not in New Jersey, but at the user's location when and where the user faxes or sends their order to Xpedite. Xpedite also asserted that N.J.A.C. 18:7-8.10 subsection (c) does not apply to them under *United Parcel*, as that subsection is only meant for those businesses that are not located in New Jersey, but where transactions "barely touch[]" New Jersey.

On September 5, 2018, the Tax Court issued an order and opinion relying on the SEC filings, Schwerdt's deposition testimony, and the undisputed material facts recited by each party. The court made extensive factual findings and legal conclusions, denied Xpedite's motion for summary judgment, granted the Division's cross-motion for summary judgment, and dismissed Xpedite's complaint. The Tax Court affirmed the Division's assessments, stating that "the material facts are undisputed as are the documents in support of each party's summary judgment motion. Although parties may draw different conclusions from the undisputed facts and documents, the court is not bound by the differing interpretations as a reason to deny summary judgment."

The Tax Court further found that

> [The Division]'s audit determined that Xpedite's allocation based on its costs-of-performance inadequately represented the receipts allocable to New Jersey. Xpedite provides nothing to contradict this basis for the CBT assessments. Rather, it offers an alternate methodology, namely Example [Two]. An example cannot trump a statute or regulation. Further, the language and intent of Example [Two] shows that it is limited to regulated LD carriers, [and] thus would not apply to Xpedite. Even if Example [Two] is deemed to be ambiguous

> as to its intendment and reach, it will not apply to Xpedite because the clear intent of the controlling statutes and implementing regulation is an inclusion of all receipts, pursuant to which, and based on the facts presented to the court, would require 100% of Xpedite's receipts as allocable to New Jersey.

The court noted N.J.A.C. 18:7-8.10(a) is "broadly intended," providing that an allocation methodology for receipts for "services performed within the state" must "reflect the trade or business practice and economic realities underlying the generation of the compensation for services" so that receipts from services are subject to the CBT and must be allocated to New Jersey if they are not otherwise apportioned.

Relying on *United Parcel*, 25 N.J. Tax at 36, the Tax Court determined that even where users accessing a data processing service were out-of-state, 100% of receipts were taxable to New Jersey because the equipment that performed data processing, as well as the personnel operating, maintaining, and repairing the equipment, were all located in New Jersey.

Because Xpedite does have some switching devices located out-of-state, the court found it was not unreasonable or arbitrary for the Division to use the twenty-five – fifty – twenty-five methodology to allocate Xpedite's receipts.

The Tax Court rejected Xpedite's argument that it fits into Example Two of N.J.A.C. 18:7-8.10(a) because at the time Example Two was promulgated, telecommunications providers were subject to fees and tariffs, as well as Federal Communications Commission regulations, none of which apply to Xpedite. Rather, Xpedite is dependent on such carriers for its business, transmitting its users' calls, and for call origination and termination. Finally, the Tax Court noted that even if the terms in Example Two are vague, "an example or illustration cannot limit or expand the statute or the regulation . . . [m]oreover, the issue in this case is the reasonableness of [the Division's] allocation methodology as to which it has 'broad authority' to make adjustments which would 'accurately and fairly' represent a taxpayer's 'activity, business, receipts.'" (quoting *Metromedia, Inc. v. Dir., Div. of Taxation*, 97 N.J. 313, 323, 478 A.2d 742 (1984)). The Tax Court also resolved the apparent inconsistency of Xpedite's sales taxes, which are collected for "telecommunications services," in that the Sales and Use Tax Act "broadly defines telecommunications" and

> also because the issue here is the allocation of receipts to New Jersey, where consideration must be given not just to the nature of services, but also to the cost of performance and economic realities, and Example [Two] is limited to an LD telephone company, of LD telephone calls, and of toll revenues from LD calls.

The court noted that the "economic reality" of Xpedite's business is that

> almost everything to do with the fax blasts [(Xpedite's services)], occurs in New Jersey

> . . . the fact that it uses RFDC's or POPs [(point of presence)] located outside New Jersey is only to lower costs, and does not change the fact that the transmissions begin in New Jersey (the [user] is presumably using its own [local telephone lines] to send its order to Xpedite, thus, Xpedite cannot claim to be providing LD telephone services to its customer in this regard.).

The Tax Court found the Division's allocation of receipts was in line with the language and intent of the controlling statute and regulations, and that its adjustment to Xpedite's allocation factor was reasonable under *Metromedia*. The Tax Court also found that Xpedite had not met its burden of overcoming the presumptive correctness of the Division's CBT assessments. This appeal followed.

Our review of a decision by the Tax Court is highly deferential and "we have a limited scope of review following a determination of that court." *Estate of Taylor v. Dir., Div. of Taxation*, 422 N.J. Super. 336, 341, 28 A.3d 852 (App. Div. 2011). Because the Tax Court has "special expertise," its findings will not be disturbed unless they are arbitrary or lack substantial evidential support in the record. *Yilmaz, Inc. v. Dir., Div. of Taxation*, 390 N.J. Super. 435, 443, 23 N.J. Tax 361, 915 A.2d 1069 (App. Div. 2007). Conversely, we review the Tax Court's legal determinations de novo. *Alcatel-Lucent USA Inc. v. Twp. of Berkeley Heights*, 460 N.J. Super. 243, 249, 214 A.3d 201 (App. Div. 2019).

To understand the receipts allocation factor that is at issue, it is helpful to understand what the CBT is. Under the 1998 version of N.J.S.A. 54:10A-2, which was the audit period at issue in this matter, "[e]very domestic or foreign corporation" must pay an annual tax "for the privilege of doing business, employing or owning capital or property, or maintaining an office, in [New Jersey]." N.J.S.A. 54:10A-2 (1998). A corporation doing business in New Jersey that also "maintains a regular place of business outside [New Jersey] 'is obligated to pay tax only on that portion of its entire net income which is allocable to [New Jersey].'" *Flagstar Bank v. Dir., Div. of Taxation*, 29 N.J. Tax 130, 147 (Tax 2016) (quoting *Stryker Corp. v. Dir., Div. of Taxation*, 18 N.J. Tax 270, 272-73 (Tax 1999) (citing N.J.S.A. 54:10A-6)).

What is allocable to New Jersey is ordinarily computed using a formula that multiplies a corporation's entire net income by a portion of the corporation's property value within New Jersey, a portion of the sales, or "receipts" from "services performed within [New Jersey]," and the payroll of the corporation. *See* N.J.S.A. 54:10A-6(A)-(C); *see also Flagstar Bank*, 29 N.J. Tax at 147. This formula "[limits] taxation under the CBT to only that income that has a sufficient nexus to New Jersey to satisfy constitutional constraints on State taxation." *Flagstar Bank*, 29 N.J. Tax at 147 (citing *Cent. Nat'l-Gottesman, Inc. v. Dir., Div. of Taxation*, 14 N.J. Tax 545, 552 (Tax 1995)).

When the three-factor allocation formula under N.J.S.A. 54:10A-6 does not fit in a situation, because it "does not properly reflect the activity, business, receipts, capital, entire net worth or entire net income of a taxpayer reasonably attributable to [New Jersey]," the commissioner "may adjust it by . . . (e) applying any other similar or different method calculated to effect a fair and proper allocation of the entire net income and the entire net worth reasonably attributable to [New Jersey]." N.J.S.A. 54:10A-8(e) (1998).

This section "invest[s] the Director with broad authority to adjust a [N.J.S.A. 54:10A-6] allocation factor if it does not properly reflect a taxpayer's business activity reasonably attributable to [New Jersey]." *Hess Realty Corp. v. Dir., Div. of Taxation*, 10 N.J. Tax 63, 81 (Tax 1988). Here, the record reflects that Xpedite's users received the benefit of the service at Xpedite's New Jersey headquarters, where the users' messages were processed, the users' messages were monitored, and the reports on the success or failure of the message deliveries were compiled and then sent to the users, all using the proprietary software located on hardware in Xpedite's New Jersey headquarters. Xpedite's users had to send their customer lists and documents to Xpedite's New Jersey headquarters, using local telephone lines or internet service to which they were personally subscribed, to be processed before they were sent out.

Xpedite's services, and the revenues generated from them, are performed at its headquarters in New Jersey using its hardware and proprietary software, and given the holding under *United Parcel*, 100% of its receipts could be sourced to New Jersey under subsection (a). However, unlike the taxpayer in *United Parcel*, Xpedite does utilize some out-of-state phone lines and switches in performing its services, some of which it maintains and owns. Consequently, even if the New Jersey headquarters is directing and monitoring the transmission throughout the entire message delivery, the messages are traveling through that out-of-state equipment. Therefore, 100% receipt allocation to New Jersey may not reflect the realities of its business, and the seventy-six percent allocation reached by the Division using the twenty-five – fifty – twenty-five method under subsection (c), even though it can be inferred that (c) only applies to those out-of-state businesses with mere contact with New Jersey, may more accurately reflect the way Xpedite earns receipts from its services. Under N.J.S.A. 54:10A-8, the Director exercised broad discretion to adjust a receipts allocation to reflect the economic realities of Xpedite's business.

Therefore, the resulting seventy-six percent allocation from the Division's use of the twenty-five – fifty – twenty-five formula under (c), instead of 100% under *United Parcel*, reasonably reflects the portion of Xpedite's services performed in New Jersey and was therefore well within the Director's discretion.

The Tax Court's findings are supported by adequate facts in the record. Further, after a de novo review, we discern no error. We do not address Xpedite's remaining arguments as they lack sufficient merit to warrant discussion in a written opinion. R. 2:11-3(e)(1)(E).

Affirmed.

APPENDIX C — OPINION OF THE TAX COURT COMMITTEE ON OPINIONS TAX COURT OF NEW JERSEY, DATED SEPTEMBER 5, 2018

NOT FOR PUBLICATION WITHOUT APPROVAL OF THE TAX COURT COMMITTEE ON OPINIONS
TAX COURT OF NEW JERSEY

September 5, 2018

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Re: Xpedite Systems, Inc. v. Director, Division of Taxation *Dkt. No. 018847-2010*

Dear Counsel:

This is the court's opinion as to the parties' second round of summary judgment motions. The issue is how much of plaintiff's income from fax blast services should be allocated to New Jersey. After an audit, defendant ("Taxation") determined that a 76% allocation is appropriate under a "25-50-25" methodology prescribed in N.J.A.C. 18:7-8.10(c) (25% of receipts allocated to the State in which costs originate; 50% of receipts allocated to the State in which the service is performed; and 25% of the receipts allocated to the State in which the transaction terminates). Taxation accordingly assessed plaintiff with Corporation Business Tax ("CBT"), plus interest and penalties, of $6,160,750 for fiscal years 1998-2000, and 2002.

Plaintiff ("Xpedite") had initially moved for summary judgement claiming N.J.A.C. 18:7-18(c) was inapplicable, and the controlling regulation was N.J.A.C. 18:7-8.10(a) pursuant to the ruling in *United Parcel Serv. Gen. Serv. Co. v. Dir., Div. of Taxation*, 25 N.J. Tax 1 (Tax 2009), *aff'd*, 430 N.J. Super. 1 (App. Div. 2013), *aff'd*, 220 N.J. 90 (2014), specifically, Example 2 therein ("Example 2"), therefore, the assessments were void as a matter of law.[1] N.J.A.C. 18:7-8.10(a) explains how the numerator portion of the receipts fraction (for purposes of computing the allocation percentage to New Jersey) is to be calculated, and states that where services are performed inside and outside New Jersey, the receipts are determined "based upon the cost of performance or amount of time spent in the performance of such services or by some other reasonable method that should reflect the trade or business practice

1. In *United Parcel*, the court had applied the pre-1997 version of N.J.A.C. 18:7-8.10(a) which provided that "[r]eceipts from services performed within New Jersey are allocable to New Jersey." Pre-1997 amendment, there was no 25-50-25 formula in N.J.A.C. 18:7-8.10(c), and Example 2 was contained in this subsection.

and economic realities underlying the generation of the compensation for services." Example 2 states that where a taxpayer earns income from the "sale of long distance telephone communications service," it should allocate its "long distance toll revenues attributable to services performed in New Jersey . . . based upon billings for calls originating in New Jersey." *Ibid.*

Taxation cross-moved for summary judgment contending that its assessments are presumptively correct, and that Xpedite's receipts would be allocatable 100% to New Jersey even under N.J.A.C. 18:7-8.10 (a) and *United Parcel.*

The court denied both motions holding that Taxation's assessments are presumptively correct and cannot be voided, unless it is proven to be aberrant and unreasonable. Since it was undisputed that Xpedite had in-State and out-of-State customers, and facts were needed to decide the percentage of allocation of Xpedite's sales receipts properly allocable to New Jersey, which facts were yet to be developed, the court denied summary judgment to both parties.

These instant second round of summary judgments then followed. Both parties claimed discovery is complete, no further facts are needed, and per Taxation, no more facts can be elicited since Xpedite claims that it has no employees with knowledge relevant to the issues herein for the tax years involved. Xpedite argues that its income should be allocated to New Jersey under Example 2, and its filings with the Securities and Exchange

Commission ("SEC"), along with its parent's such filings, proves that it competes with common carriers such as AT&T or MCI, therefore, it is providing long distance ("LD") telephone communications services illustrated in Example 2. Taxation disagrees on grounds Xpedite is not a LD telephone company such as AT&T, and thus, is not a provider of LD telephone calls/services, which earns income from LD telephone calls. Without credible non-hearsay proof to the contrary, Taxation argues, its presumptively correct assessments must stand.

For the reasons following, the court affirms the assessments. Taxation's audit determined that Xpedite's allocation based on its costs-of-performance inadequately represented the receipts allocable to New Jersey. Xpedite provides nothing to contradict this basis for the CBT assessments. Rather, it offers an alternate methodology, namely Example 2. An example cannot trump a statute or regulation. Further, the language and intent of Example 2 shows that it is limited to regulated LD carriers, thus would not apply to Xpedite. Even if Example 2 is deemed to be ambiguous as to its intendment and reach, it will not apply to Xpedite because the clear intent of the controlling statutes and implementing regulation is an inclusion of all receipts, pursuant to which, and based on the facts presented to the court, would require 100% of Xpedite's receipts as allocable to New Jersey.

FACTS

In May 2007, Taxation completed an audit of Xpedite for tax years 1998 through 2005, for CBT, and for Sales & Use tax ("SUT"). The auditor examined records and had discussions with Xpedite's accountants (PricewaterhouseCoopers, LLP, "PwC"), and Xpedite's employees, Jeffrey Carter (Manager, Sales Tax Billing) and Gary Schwerdt (Manager, Network Cost & Routing).

Based on such information, the auditor described Xpedite as a telecommunications retailer which used carrier signals to send information on behalf of its customers, "much like a freight company uses a toll road," thus was not a "telecom provider," which originated carrier signals (the dial tone). Xpedite's business was providing "mass messaging services via fax, e-mail and voice," with the mass faxing being the source of the "vast majority of sales." Its New Jersey headquarters was the "hub for the application of the software and the location for most of the hardware," and was also "the origination and/or destination point of all telecommunication services." All transmissions originate in New Jersey, and then are transmitted, using telephone lines, via the least cost route, which is determined by Xpedite's software after the destination is entered into the software program. The transmission is sent to a remote fax delivery controller ("RFDC"), which is located in or out of State, and connects to another telephone line, in or out of State. If the first choice of the route has a long queue, the broadcast would be routed to the next best least cost route. Interstate and intrastate broadcasts are done from an out-of-state located RFDC since interstate rates are lower. The auditor also noted that the out-of-State locations were "mainly sales offices," and about 50% of Xpedite's payroll were New Jersey employees.

In examining the allocation of receipts, the auditor found that Xpedite apportioned sales based on payroll, with most of the out-of-State wages for sales persons, but then, as to New Jersey sales, Xpedite reallocated them to other States and about $75 million to a category "other." He noted that if the sales were to be allocated based on Xpedite's cost of performance (i.e. wages), then it would result in about $58 million "of NJ sales and not the $4,786,072 as reported" on the CBT returns. He thus deemed Xpedite's apportionment of its sales receipts to New Jersey as unrealistic since its cost-of-performance computation did not "accurately reflect New Jersey receipts," or "the trade, business practice and economic realities underlying the generation of charges for the services," or Xpedite's "business activities" in New Jersey. As permitted by N.J.S.A. 54:10A-8, and -10, he rejected Xpedite's receipts allocation method.

His discussions with Mr. Carter and Mr. Schwerdt revealed that New Jersey was the origination point of all transmissions; 60% of the switching devices were located in New Jersey; the switching devices located outside New Jersey are nonetheless "directed by" New Jersey; and transmissions destined for New Jersey are routed through equipment located out-of-State. He therefore concluded that 98%-100% of Xpedite's sales receipts are allocable to New Jersey because, (1) Xpedite had significant property in New Jersey used in performance of the services; (2) New Jersey was the origination of all transmissions, i.e. sent out from New Jersey "via telephone lines;" and, (3) the "hardware and software that determines the least cost route, directs, controls and originates the transmissions," are in New Jersey. If, however, the out-of-State location of the switching devices were considered, then 89.8% would be allocable to New Jersey.

However, pursuant to a meeting between PwC and Taxation's upper management, the auditor was directed to allocate receipts based on the 25-50-25 formula contained in N.J.A.C. 18:7-8.10(c). This resulted in 76.36% of Xpedite's sales receipts being allocated to New Jersey (25% of receipts allocated to State of origination which was New Jersey, plus 50% of receipts allocated to the State where the service is performed, which was also New Jersey, plus 1.306% of the 25% of receipts allocated to the State of termination, *i.e.* to New Jersey). The consequent CBT assessment was $495,288 (1998); $848,170 (1999); $1,006,898 (2000); and $35,176 (2002), totaling $4,923,285 inclusive of interest and penalty.[2]

2. As to SUT, the auditor found that the amounts reported on Xpedite's SUT returns as compared to the CBT returns differed "by several million dollars" because Xpedite only reported what it deemed to be New Jersey taxable sales, which was determined using a "2 out of 3 rule," *i.e.*, if two of the following three conditions were met, it made the sale taxable: (1) origination of a call (default is New Jersey); (2) customer's billing address; and (3) call destination. If (1) and (3) were in New Jersey, it was a taxable sale; if (2) and (3) were "same," tax was collected based on the rate of the "destination State;" if (1) and (2) were the "same," all sales were taxable at for New Jersey customers at the New Jersey sales tax rate. The auditor essentially accepted this methodology and imposed $39,040 as SUT for sales which either were untaxed, or taxed by other States at a lower rate. Xpedite did not contest this assessment.

Xpedite protested the audit's CBT assessment contending that N.J.A.C. 18:7-8.10 did not apply to it, except maybe Example 2 of subsection (a) because that was "similar to [its] business model." Taxation's conferee rejected Xpedite's reported allocation (i.e. 5%-7%) as not reflective of the underlying economic reality. She found that since most faxes originate in this State, where all the services are performed, and the equipment is located, the allocation should be 100% under N.J.A.C. 18:7-8.10(a), and *United Parcel*. She upheld the auditor's allocation.

In the instant motions, neither party disputes the factual assertions in the audit and conference reports. Xpedite disagrees with Taxation's conclusions, and provided its 1995 IPO (initial public offering) filing, 1996 annual filing with the SEC, as well as the SEC filings of its parent Premier Technologies, Inc. ("PTI") (for 1998), and of PTEK Holdings, Inc. (for 1999-2002), as evidence of its business model. Taxation claims that the SEC filings were un-authenticated and inadmissible hearsay. Taxation provided the deposition testimony transcript of Mr. Schwerdt, as evidence of Xpedite's business.[3] Xpedite claimed that Mr. Schwerdt was merely a financial analyst, thus was not qualified as an expert, and lacked knowledge, as to the nature of Xpedite's business, which rendered his deposition testimony unreliable because it is lay opinion.

The court rejects both these positions. The SEC filings are publicly available documents, and need not be

3. In response to Taxation's subpoena, Xpedite claimed it could not locate Mr. Schwerdt. Taxation then independently located the individual and procured his deposition.

rejected due to lack of formal authentication. *See* N.J.R.E. 201 (facts which may be judicially noticed include "specific facts and propositions of generalized knowledge which are capable of immediate determination by resort to sources whose accuracy cannot reasonably be questioned."); *Oran v. Stafford*, 226 F.3d 275, 289 (3d Cir. 2000) ("'[T]he documents are required by law to be filed with the SEC, and no serious questions as to their authenticity can exist," especially if they are used to "determine what the documents stated.'") (quoting *Kramer v. Time Warner, Inc.*, 937 F.2d 767, 774 (2d Cir. 1991)[4]); *In re Rockefeller Ctr. Properties Sec. Litig.*, 184 F.3d 280, 293 (3d Cir. 1999) (court is authorized "to take judicial notice of all public disclosure documents which are either required to be filed with the SEC or are actually filed with the SEC.") (Nygaard, J, concurring in part and dissenting in part).[5] Additionally, *R.* 1:6-6 does not apply since the documents produced in support of its summary judgment motion were discovery materials. While it is true that the management's statements in the SEC filings are being offered for the truth of the matter, viz. as evidence as to the nature of Xpedite's business, the essence of the descriptions in those documents are almost identical to the representations made by Xpedite to Taxation during

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4. The ruling applied only "to public disclosure documents required by law to be filed, and actually filed, with the SEC, and not to other forms of disclosure such as press releases or announcements at shareholder meetings." *Kramer*, 937 F.2d at 774.

5. In that case, the counsel for the party submitted an affidavit authenticating copies of the annual reports filed with the SEC. *In re Rockefeller Ctr. Properties Sec. Litig.*, 184 F.3d at 293.

audit, and in the course of this litigation, and recited in the audit and conference report, both of which documents are undisputed. Similarly, Mr. Schwerdt's deposition testimony as to Xpedite's business operations largely conforms to Xpedite's management's statements in the SEC filings. That he does not consider Xpedite as a LD telephone provider is not germane, because the court is not using his views in this regard to decide the matter.

Based on these documents, as well as the undisputed material facts recited by each party, the court finds the following facts as to Xpedite's business. Xpedite is a Delaware-incorporated entity and headquartered in New Jersey. Its stock is publicly traded. Its Data Center, a large operations center, is in Tinton Falls, and it also uses a facility in Piscataway as an operations or backup center. It was acquired in February 1998 by PTI, a Georgia-based company, which changed its name to PTEK Holdings, Inc.

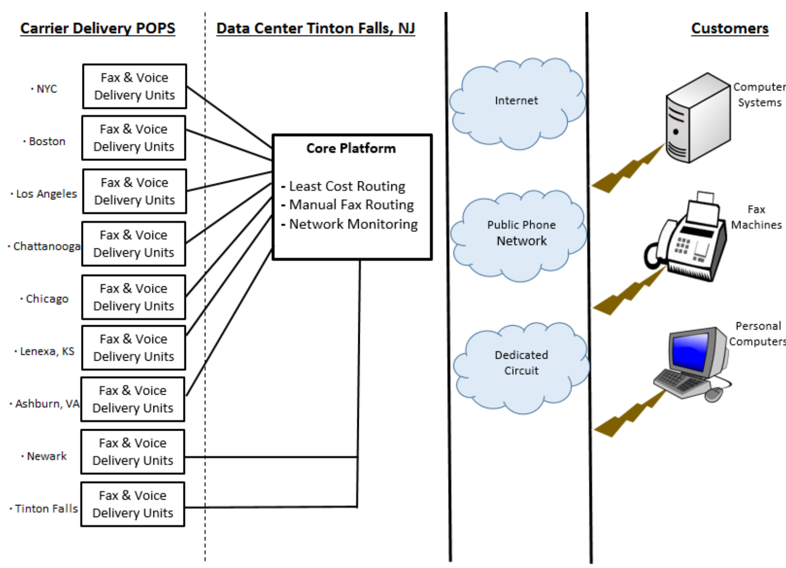
Xpedite delivers business advertisements/messages/information on behalf of its customers who/which are predominantly financial service companies and travel agencies. It provides basic and enhanced fax services. A customer sends the information to Xpedite, with a list of fax addresses, which Xpedite then blasts to multiple recipients. The customer can electronically send its order to Xpedite from the customer's location, using either the customer's fax machine or computer, using local or long distance phone company lines that it subscribes to. It can also upload the desired list of targets with the targets' fax numbers on Xpedite's webpage (after logging in as Xpedite's customer). Xpedite's system would either store and then forward the fax, or would connect the customer's fax to the recipient's fax, for immediate delivery. A customer could also send a message from its computer, which will be routed through Xpedite to the recipient.

All orders are received in New Jersey, at Tinton Falls. Xpedite then ensures its delivery electronically, through the quickest and cheapest means, from the Tinton Falls Data Center. After a fax blast, Xpedite's computer systems track the transmission and delivery to ensure delivery was complete. Thus, what would normally take hours for a customer in sending multiple faxes, can be done within minutes by Xpedite, and saves customers time and money, with the added benefit of knowing that the document was delivered.

Xpedite charges its customers based on per domestic minute or per page for a broadcast fax, or based on file size, or per domestic minute for voicemail. Separate rates are charged for international transmissions. Xpedite's revenues are thus from broadcast deliveries, and based on time (per-minute) of LD service usage, and upon volume for e-mail distributions. The contract also showed an additional "minimum commitment" fee or charge, and services such as "fax response, FOD, VR Hokey Transfer, BANNERfx, etc." was at a certain dollar amount not based on per-minute or per-page. Xpedite negotiates "lower rates with its primary telecommunications service providers," to increase its profit margins, and uses "least cost routing to reduce its telecommunications costs, including direct interconnections with local exchange carriers," which allows Xpedite to provide its high-volume customers discounts or better pricing.

Xpedite performs its services using computers, software, servers, routers, switches, third party communication equipment and switching centers, and leased telecommunication lines connecting these systems using nodes (equipment which allows access to or egress via a local telephone call, a.k.a. a point-of-presence or POP). The nodes allow for faxes to be sent and terminated using inexpensive local calls, instead of more expensive LD or international calls as the leased telecommunications lines "provide the reliable, continuous, high-speed throughout required for delivery" of the immediate or "real time" faxes. Outbound faxes are delivered through the POPs for transmission by an LD carrier.

A sketch (provided by Xpedite to Taxation during the audit) depicted Xpedite's business as follows:



So that the transmissions are not interrupted (due to power outages or other issues), Xpedite uses a variety of carriers to transmit its telecommunication traffic, and uses a variety of telecommunications routing technology, including using a fiber-optic connection with Bell Atlantic, which allows immediate re-routing of traffic. Thus, in a power outage affecting a "terminating carrier," Xpedite would switch the calls to another terminating carrier.

Xpedite does not own any of the telephonic cable or electronic transmission lines. Rather, it uses third-party communications and network equipment such as telephone lines, servers, routers, and third party switching centers, which are located throughout the country, to transmit the fax-blasts or e-mail blasts. Neither Xpedite (nor PTI or PTEK) own a transmission network, and therefore, depend on common carriers such as MCI, AT&T, and other "facilities-based carriers" for transmitting the LD calls, and depend upon Local Exchange Carriers ("LECs") or Competitive LECs ("CLECs") for "call origination and termination."[6] The telecommunications lines are leased from a several major "telecommunications carriers"

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6. LECs are "local telephone companies that provide traditional land-line phone service," and "typically serve a small local service area covering a few local 'exchanges,' which are designated by the first three numbers of a seven-digit phone number." *Sw. Bell Tel. Co. v. V247 Telecom L.L.C.*, 207 F. Supp. 3d 688, 690-91 (N.D. Tex. 2016). The Telecommunications Act of 1996 created CLECs by "open[ing] the market to competition, allowing different carriers to serve the same exchange area." *Ibid*. The prior monopolies are the Incumbent Local Exchange Carriers ("ILECs").

on a short term or multi-year basis pursuant to supply agreements, sometimes "with an option to upgrade to higher speed lines, and generally billed on a monthly basis." Such leased "capacity" on a common carrier's "backbone" enabled Xpedite and its sister companies to provide connectivity and data transmission within its "private data network," and its "hub equipment is co-located at various MCI WorldCom sites." PTEK also relied "primarily upon leased network facilities of other telephone companies," did not "own a transmission network," and depended on LECs and CLECs "for call origination and termination."[7]

All the SEC filings cautioned that the business' success depended not only upon obtaining telecommunication services on favorable terms from LD carriers for the transmission of the customers LD calls, but also upon the "cooperation of both interexchange and LECs or CLECs in originating and terminating service" for the customers "in a timely manner." Loss of the "ability to receive or terminate calls would" produce a significant revenue loss to Xpedite's corporate family. Similarly, the ability "to maintain network connectivity" depended on "access to transmission facilities provided MCI WorldCom or an alternative provider," and thus, inability to continue the agreement with MCI, including the co-location, could lead to revenue loss.

7. The SEC filings also stated that the company or sister companies, including Xpedite, purchase LD services from MCI, Cable & Wireless Communications, Inc., Worldcom, and other "national post, telephone and telegraph" ("PTT") companies, "to carry fax traffic that is routed to destinations where" Xpedite did not have nodes.

The SEC documents claim that AT&T, MCI WorldCom, Sprint, and other PTT companies are competitors because they provide certain enhanced fax communication services. They also describe only Premiere Communications, Inc. ("PCI"), one of the subsidiaries, as being a LD telecommunications/operator services, regulated by the Federal Communications Commission ("FCC"). PCI was initially reported as having either "applied for and received . . . all necessary certificates or authorizations to provide intrastate, [LD] services," subject to the State public utility commission control. In later years' SEC filings, it was reported as being authorized to provide such service in 46 states.

Mr. Schwerdt, who analyzed rates charged by various "telecom companies," stated that Xpedite was a

> broadcast and transactional fax delivery company for documents . . . . [M]y dealings was trying to keep the costs under control, the lowest – again, referring to the least-cost routing system which is in existence since what I've more or less managed. In other words . . . the business model is such where we obtain rates from larger – predominantly the large carriers, and rates vary across those carriers, and my job was to find the least-cost route for a particular dialed number to determine . . . where we wanted to use that carrier in our system.

If a customer needed immediate fax delivery, and since Xpedite had only "so much capacity at various locations across the nation," the fax would "go into a queue, and if that queue is filled up and it's taking too long, it would need to be jumped to a different carrier or a different route" through POPs or nodes (typically owned by the LD carrier), so that the fax is delivered immediately. This could be costly due to higher rates attributable to dealings with various carriers, including local carriers, however, Xpedite "predominantly dealt with" LD carriers, or regional carriers (if cheaper). The "last mile" of the message's delivery path (*i.e.* closest to the fax's destination) was "always [a] local carrier." Xpedite rented connections from such carriers, and was billed per minute. Thus, its costs were the billed minutes plus the cost of leasing the lines from a carrier such as Bell Atlantic or any other out-of-country carrier, plus equipment such as computer servers.[8]

ANALYSIS

Summary judgment will be granted only "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to a judgment or order as a matter of law." *R.* 4:46-2(c). The court finds that summary judgment is an appropriate mechanism because the material facts are undisputed as

8. In his deposition, Mr. Schwerdt claimed not to have recollected speaking with the auditor or anyone from Taxation during the audit. However, the auditor's report contained almost an identical description of Xpedite's business based on information from Mr. Schwerdt. *See supra* p.4.

are the documents in support of each party's summary judgment motion. Although parties may draw different conclusions from the undisputed facts and documents, the court is not bound by the differing interpretations as a reason to deny summary judgment.

The CBT is imposed on the income allocable to (*i.e.* sourced to) New Jersey. N.J.S.A. 54:10A-6.[9] The allocation is achieved by dividing the "New Jersey property, receipts, and payroll, respectively," with the entity's "total (real and tangible) property, business receipts, and payroll, respectively," as averaged. *Stryker v. Dir., Div. of Taxation*, 168 N.J. 138, 148 (2011). The "combined fraction is then applied to the" entity's entire net income, so that the "the percentage or portion of" the income is "properly attributable, and thus taxable, to New Jersey." *Metromedia, Inc. v. Dir., Div. of Taxation*, 97 N.J. 313, 323 (1984). Taxation has the "broad authority to adjust the allocation factor in order to reflect more accurately and fairly the activity, business, receipts . . . or entire net income of a taxpayer reasonably referable to the state." *Ibid.*

The receipts portion of the numerator is to include receipts from, among others, "services performed within the state." N.J.S.A. 54:10A-6(B)(4). For the tax periods at issue here, the interpretive regulation provided as follows:

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9. A corporation's income was 100% allocable to New Jersey if it did not maintain a "regular place of business" outside New Jersey. This provision was abrogated in 2008. *L.* 2008, *c.* 120 §2.

> The numerator of the receipts fraction developed in accordance with this section includes receipts from services not otherwise apportioned under this section. If the service is performed both within and outside this State, the numerator of the receipts fraction includes receipts from services based upon the cost of performance or amount of time spent in the performance of such services or by some other reasonable method which should reflect the trade or business practice and economic realities underlying the generation of the compensation for services. "Cost of performance" is defined as all direct costs incurred in the performance of the service, including direct costs of subcontractors.
>
> [N.J.A.C. 18:7-8.10(a).]

For instance,

> Taxpayer earns income from the sale of [LD] telephone communications service. It bills the originators of [LD] telephone calls directly and for all calls placed by them. The appropriate method of allocating its [LD] toll revenues attributable to services performed in New Jersey is based upon billings for calls originating in New Jersey.
>
> [N.J.A.C. 18:7-8.10(a), Example 2.]

Prior to 1997, Example 2 used to be contained in subsection (c) of N.J.A.C. 18:7-8.10. It was inserted in 1984 in connection with regulatory amendments due to the ruling in Metromedia, Inc. which had voided a CBT allocation based on an audience share on grounds that Taxation's determination was invalid rule-making. *See* 16 N.J.R. 3420(b) (Dec. 17, 1984). Taxation explained that in "adding a rule regarding the radio and television industry, . . . [it] also decided to add additional rules that dealt with services performed partially within this State and partially outside this State," for purposes of N.J.S.A. 54:10A-6(B)(4) (the numerator portion of the allocation factor). 16 N.J.R. 3420(b). In this process of "putting into rule form [Taxation's] policies and practices," it added "examples to better explain" those policies, such as the LD telephone example. *Ibid.*[10]

In 1997, Taxation "updated and restructured" N.J.A.C. 18:7-8.10 "to show more clearly [Taxation's] emphasis on the cost of performance for sourcing purposes for receipts

10. The pre-1997 version of subsection (c) addressed the allocation of "a lump sum is received by the taxpayer in payment for services within and without New Jersey." N.J.A.C. 18:7-8.10(c) (pre-1997). As to such payment, "the amount attributable to services performed within New Jersey is to be determined on the basis of the relative values of, or amounts of time spent in the performance of those services within and without New Jersey, or by some other reasonable method which should reflect the trade or business practice and economic realities underlying the generation of the compensation for services." *Ibid.* Example 1 illustrated allocation of receipts from advertising "in the course of broadcasting television or radio services." Example 2, as noted above, illustrated allocation of LD telephone toll revenues. *Ibid.*

from services." *See* 29 N.J.R. 3426(a) (Aug. 4, 1997). They also explain "the use of the locations of the origination and termination in these transactions," and "describe[] a formula for the proper treatment of receipts as the result of use of certain machines through credit cards and internet access where the taxpayer otherwise has nexus with New Jersey." *Ibid*. Subsection (a) was amended, and the substantive portion of the then-existing subsection (c), as well as Example 2, were moved to subsection (a). See 29 N.J.R. 4324(a) (Oct. 6, 1997). The prior subsection (c) was replaced by the 25-50-25 allocation formula as follows:

> (c) Certain service fees from transactions having contact with this State are allocable to New Jersey based upon the following:
>
> 1. Twenty-five percent of such fees are allocated to the state of origination.
>
> 2. Fifty percent of such fees are allocated to the state in which the service is performed.
>
> 3. Twenty-five percent of such fees are allocable to the state in which the transaction terminates.
>
> [N.J.A.C. 18:7-8.10(c).]

For instance, if an entity provides "on-line internet access," with equipment for such purposes "located outside" the State, to customers within and without the State, then it must allocate 50% of "revenue from internet access charges to New Jersey based upon the origination and termination of such access from points within New Jersey." N.J.A.C. 18:7-8.10(c), Example 2. If the "points of origination and termination," cannot be specifically identified, then, "the customer's billing address will serve to locate these activities." *Ibid. See also United Parcel*, 25 N.J. Tax at 37 (Example 2 means that due to the "essential" equipment's location "outside this State, transactions occurring in New Jersey, but using equipment located outside this State, have only "'contact' with New Jersey" therefore, there is a "percentage allocation of revenue . . . .").

Initially, it is important to note that an example does not, in and of itself, control, expand or limit the general intent and scope of either the implanting statute or its interpretive regulation. *See Praxair Tech., Inc. v. Dir., Div. of Taxation*, 201 N.J. 126, 139-40 (2009) (rejecting the taxpayer's argument that until the regulation provided an example, taxpayer's "business arrangement with its corporate parent became" taxable, and that "tax liability somehow can flow from a regulatory change," and holding that although Taxation's regulatory powers are "circumscribed by the taxing authority in fact conferred by the Legislature," nonetheless, "the legislative intent behind the [CBT] Act is for [Taxation] . . . to give the tax its broadest reach constitutionally permissible;" thus, Taxation does not require "a precise regulatory example" to enforce imposition of the CBT); *Cosmair, Inc. v. Dir., N.J. Div. of Taxation*, 109 N.J. 562, 570 (1988) (a State agency "cannot extend a statute beyond its language to expand its effect.")

Here, N.J.S.A. 54:10A-6(B)(4) is worded broadly to include receipts for "services performed within the state." N.J.A.C. 18:7-8.10(a), the implementing regulation is also broadly intended by providing that an allocation methodology must "reflect the trade or business practice and economic realities underlying the generation of the compensation for services," so that receipts from services are subject to the CBT, and if not otherwise apportioned, must be allocated to New Jersey. Under this controlling principle, the court is not required to focus only on an example as the correct allocation methodology.

It is undisputed that Xpedite has in-State and out-of-State customers. Xpedite receives all of its customers' orders, *i.e.* the information to be mass-delivered or blasted, at its operations centers in Tinton Falls and/or Piscataway, and disseminates the same from New Jersey to recipients both within and outside the State. The hardware and/or software used to receive the customer's orders, and to determine the least cost route for transmission of the information required to be blasted or mass-delivered, are located in New Jersey. Xpedite's business model sketch endorses Taxation's conclusion that Xpedite's hub is in New Jersey, New Jersey is where the services are performed, and New Jersey is where the significant tangible and intangible property required to initiate, and perform the services is located. Consequently, Taxation's allocation methodology, *i.e.* using the 25-50-25 formula under N.J.A.C. 18:7-8.10(c), is not patently unreasonable or invalid.

Additionally, Taxation's regulations are not solely focused on the customer base. *See, e.g., United Parcel*, 25 N.J. Tax at 36 (rejecting the taxpayer's argument that its data processing receipts should be allocated based on location of its customers similar to the example of allocation to "the location of originators of long distance calls," because "the users of the service" of the taxpayer "contact and interact with the equipment [in New Jersey] remotely."). The court found that 100% of the receipts were taxable (*i.e.* sourced to New Jersey) because "[t]he equipment performing the data processing was located in New Jersey, and the personnel necessary to operate, maintain and repair the equipment also were located in this State." *Id.* at 36-37. The fact that the "users of the service having equipment necessary to access the information generated in New Jersey were located outside of this State does not alter the fact that the services producing the revenue subject to tax all were performed within New Jersey." *Id.* at 37. The court noted that the two examples in N.J.A.C. 18:7-8.10(c) evidenced that equipment location is of "significance," thus, supported its conclusion, since if the taxpayer had equipment outside New Jersey, then its receipts would very likely be allocated under the 25-50-25 rule. *United Parcel*, 25 N.J. Tax at 37. This is precisely how Taxation's auditor allocated the receipts.

The court does not consider N.J.A.C. 18:7-8.10(c) as limited to internet access providers. That is simply an example of how subsection (c) can be applied. Therefore, although Xpedite is not in the business of providing the services of internet access to the public, it does not foreclose application of that regulation to Xpedite.

It is true that the 25-50-25 rule addresses "fees" for services, such as, for example, fees for internet access, or "service income fees" for cash advances to credit card users. It does not appear that all of Xpedite's charges include flat fees. Nonetheless, this does not render the assessment invalid, nor does it require the court to fit Xpedite's revenues into Example 2, as a default mechanism. Xpedite still charges fees for its services, plus a "minimum commitment" fee, as well as flat fees for other services. Those receipts would still be taxable under N.J.S.A. 54:10A-6(B)(6) as "all other business receipts." *See, e.g., Bank of Am. Consumer Card Holdings v. Dir., Div. of Taxation*, 29 N.J. Tax 427, 460 (Tax 2016) (rejecting an argument that when services are not performed in New Jersey, then credit card fees are not allocable under N.J.S.A. 54:10A-6(B)(4), and when so excluded cannot be included under N.J.S.A. 54:10A-6(B)(6), thus, "should be excluded from the numerator of the allocation fraction *in toto*." Such an argument, the court held, would "ignore[] subsection 6," which is a catch-all provision). Based on factual representations that some POPs and/or switching devices are located out-of-State, it was not unreasonable nor arbitrary for Taxation to use 25-50-25 as an allocation method for sourcing Xpedite's receipts.

Does Xpedite fit within Example 2 so that its receipts allocable to New Jersey are limited to the "billings for calls originating in New Jersey"? As noted above, Example 2 addresses the allocation of LD "toll revenues," from the sales of "long distance telephone communications service." Xpedite claims it sells LD telephone services. Taxation argues Xpedite is not a LD telephone company, *i.e.* one which is regulated and licensed by the FCC, or the traditional ILEC such as AT&T. Therefore, per Taxation, Xpedite cannot provide, thus, sell LD telephone services.

Example 2 does not define what comprises "[LD] telephone communication services." It does not require the seller to be a telecommunications provider or carrier, or a LD telephone company such as AT&T. It does not define "originators" or "toll revenues." However, when considered in the time and context in which Example 2 was promulgated, Taxation's argument limiting the illustration to an FCC licensed LD telephone carrier is not unreasonable.

As explained above, Example 2 was promulgated in 1984, and in reaction to *Metromedia. See* 16 N.J.R. 3420(b). It was re-structured in 1997, however, until then (or at least until 1996) "local telephone markets were monopolies of each" ILEC, such as AT&T. *Sw. Bell Tel. Co.*, 207 F. Supp. 3d at 692. Even after the monopolies were broken up by an amendment to the federal telecommunications law in 1996, telecommunications providers were still subject to several fees and "tariffs," *see id*. at 693-94, as well as being regulated by the FCC. *See also* N.J.S.A. 54:4-1 (defining a "local exchange telephone company" as a "telecommunications carrier providing dial tone and access to 51% of a local telephone exchange"); *Verizon N.J. Inc. v. Borough of Hopewell*, 26 N.J. Tax 400, 407-10 (Tax 2012) (after the breakup of AT&T in 1984 "[c]ompetitive [LD] telephone service . . . was offered by carriers such as the post-divestiture AT&T, MCI and Sprint," and after the 1996 federal telecommunications statute was passed, the LECs increased and the ILECs provided the majority of "end-user connections for land line . . . local telephone services in New Jersey . . . .").

Thus, it is not unreasonable to construe Example 2 as applying to a carrier, which is regulated and licensed by the FCC, such AT&T, MCI, or Verizon or other licensed LECs or CLECs, which originate the carrier signals. Based on the facts above, Xpedite is not a carrier; is not licensed by the FCC (even if its sister company, PCI is licensed); is not paying common carrier tariffs required by the FCC; is not licensed or authorized by New Jersey agencies regulating utilities as a LD telephone provider or carrier; and is fully dependent on third-party LD telephone companies and local telephone companies in the performance of, and for the success/longevity of its business; in transmitting its customers' LD calls, and for call origination and termination. *Cf. RCN Telecom Serv., Inc. v. Dir., Div. of Taxation*, 25 N.J. Tax 409, 421 (Tax 2010) (rejecting Taxation's argument that the taxpayer, who had for purposes of the SUT exemption, provided "as proof that it was a service provider subject to the jurisdiction of the FCC . . . a list of licenses granted by the FCC," should still show that it was "licensed in New Jersey" to be exempt).[11]

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11. Xpedite's claim that it need not be licensed but is still "subject to" FCC's jurisdiction, does not change this conclusion since any entity can be liable for using faxes for sending unsolicited advertisements. *See* 47 U.S.C. § 227 (b)(1)(C), making it unlawful to "use any telephone facsimile machine, computer, or other device to send, to a telephone facsimile machine, an unsolicited advertisement."

Does the fact that Xpedite leases LD telephone services from third party LD carriers such as AT&T, and uses those carriers' telephone lines, network, and communications facilities to make telephone calls to perform its fax blast services render it as a provider selling LD telephone services, and deriving income from LD "toll revenues"? The court thinks not. Xpedite uses LD carriers and their telephone network, telephone lines, POPs and the like, depending on which is the cheapest (*i.e.* least cost routing), and enhances the same by offering its "fax broadcast" and "gateway services." It is still AT&T or a similar carrier that is providing LD telephone communication services. Verily, Example 2 addresses an entity which earns income from "sale" of LD telephone services, not an entity which "provides" such services. However, as noted above, when considered in the time and context of the example's promulgation, there was no distinction between the two, since only a provider, *i.e.*, an FCC licensed carrier, could sell such services, not entities such as Xpedite which used those carrier signals, and are not licensed by the FCC as a long distance telephone communications provider. *See, e.g., In re Fed.-State Jt. Bd. on Univ. Srvc.*, 13 F.C.C. Rec. 11501, 11520-21, n.78 (Apr. 10, 1998) ("[W]here users rely on the public switched network to reach the information service provider, it is the telephone company, not the information service provider, that is offering to the public transmission over the public switched network. The information service provider, therefore, is not providing telecommunications service," and "[w]hen an entity offers subscribers the capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing or making available information via telecommunications, it does not provide telecommunications; it is using telecommunications.") (internal quotation marks omitted); *Vonage Holdings Corp. v. Minn. Pub. Util. Comm'n*, 290 F. Supp. 2d 993, 1003 (D. Minn. 2003) (provision of voice over internet protocol services was "the enhanced functionality on top of the underlying network," thus, was not an FCC regulated telecommunications service) (relying upon the FCC's report to Congress, 13 F.C.C. Rec. 11501)), *aff'd*, 394 F.3d 568 (8th Cir. 2004). Xpedite, which claims to be providing "enhanced" telecommunication services, can similarly be said to be providing an enhancement "on top" of the third party's LD telephone network, thus, is not providing or selling LD telephone services as contemplated by the illustration at issue here (Example 2).

The court makes one final observation. Even if it were to be argued that the type of entity intended to be addressed by, the scope of, and the terms/phrases used in Example 2 are vague, and the regulatory history provides no insight or assistance in this regard, it does not require a conclusion that the allocation of Xpedite's receipts of "toll revenues" is limited to "billings for calls originating in New Jersey," (the latter phrase itself indicating that the limited allocation would not apply since Example 2 would not apply to Xpedite since 100% of its calls originate in New Jersey). As explained above, an example or illustration cannot limit or expand the statute or the regulation. It is the statutory intent which controls. Moreover, the issue in this case is the reasonableness of Taxation's allocation methodology as to which it has "broad authority" to make adjustments which would "accurately and fairly" represent a taxpayer's "activity, business, receipts." *Metromedia, Inc.*, 97 N.J. at 323. Here, the intent of N.J.S.A. 54:10A-6 is inclusive, not exclusive. The same inclusive intent underlies N.J.A.C. 18:7-5.10(a). Under both the statute and the regulation then, Xpedite's receipts would be 100% allocable to New Jersey. As such, any ambiguity in Example 2 need not be resolved in favor of Xpedite such that it can allocate 5% -7% as reported on its CBT returns. *See, e.g., Fedders Fin. Corp. v. Dir., Div. of Taxation*, 96 N.J. 376, 384-386 (1984) (in interpreting statutes, courts must "follow the clear import of statutory language," and "when interpretation of a taxing provision is in doubt, and there is no legislative history that dispels that doubt, the court should construe the statute in favor of the taxpayer," so that a taxpayer cannot be taxed beyond what the statute provides, however, where the taxpayer seeks an exemption from tax, then "the probable legislative intent is one of inclusion."); *Adamar of N.J. v. Dir., Div. of Taxation*, 17 N.J. Tax 80, 86 (Tax 1997) ("Regardless of which principle applies, and which party has the burden of persuasion, the court's duty in construing a statute is to determine" legislative intent, and if the court finds the intent is "inclusive," such as the SUT Act, then taxpayers "have the burden of demonstrating that their" transactions are not taxable, "and any doubt as [sic] taxability should be resolved in favor of" Taxation) (citation and internal quotation marks omitted), *aff'd*, 18 N.J. Tax 70 (App. Div. 1999).

The remaining issue is possible inconsistent treatment of Xpedite under the SUT Act. Taxation does not dispute that Xpedite collects sales tax from its customers under

N.J.S.A. 54:32B-3.[12] The auditor accepted Xpedite's reporting based on the "two out of three" factors. *See supra* note 2. Thus, when collecting such tax for New Jersey, Taxation has not disputed that Xpedite is selling telecommunications.

Taxation maintains that the inconsistency, if any, is not controlling not only because the SUT Act broadly defines telecommunications, but also because the issue here is the allocation of receipts to New Jersey, where consideration must be given not just to the nature of services, but also to the cost of performance and economic realities, and Example 2 is limited to an LD telephone company, of LD telephone calls, and of toll revenues from LD calls. Xpedite contends that it is the same sales which are at issue, therefore, if it is deemed to be selling telecommunications under the SUT Act, then it must be doing the same for purposes of the CBT Act.

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12. In 2002, Xpedite's protested Taxation's denial of its claim for refunds of SUT for 1997-2001, claiming its computers (including the hardware and software) and "related communications equipment," such as servers and routers, were exempt under N.J.S.A. 54:32B-8.13(c). It contended that "all telecommunications services performed at Xpedite's New Jersey facility originate in the State," it resold the third party phone services as part of its fax services, and was "subject to" FCC's jurisdiction generally having submitted comments to a proposed FCC regulation on unsolicited phone/fax advertisements. Taxation granted the SUT refund for Xpedite's equipment pursuant to N.J.S.A. 54:32B-8.13, but claimed it had insufficient information of the "assets used directly in the transmission of [Xpedite's] faxes."

The issue here is the quantum of receipts allocable to New Jersey for CBT. Xpedite has not challenged the validity of the controlling statute, N.J.S.A. 54:10A-6(B)(4), -6(B)(6), or the regulation, N.JA.C. 18:7-8.10(a). As noted above, the allocation methodology must ultimately be one which fairly reflects the business and the economic realities of how income is generated. The economic reality is that almost everything to do with the fax blasts (Xpedite's services), occurs in New Jersey. Xpedite receives the customers' order in New Jersey. Xpedite uses it software and hardware, located in New Jersey, to decide the least cost routes. Xpedite originates the fax blasts from New Jersey. Xpedite monitors the progress and delivery of the fax blasts from New Jersey. Xpedite generates delivery status reports to its customers from New Jersey. The fact that it uses RFDC's or POPs located outside New Jersey is only to lower costs, and does not change the fact that the transmissions begin in New Jersey (the customer is presumably using its own LEC, CLEC, or ILEC to send its order to Xpedite, thus, Xpedite cannot claim to be providing LD telephone services to its customer in this regard).

The SUT Act deeming Xpedite as selling telecommunications becomes relevant only if one is attempting to fit Xpedite into Example 2, and then construe Example 2 broadly to cover any type of telecommunications. The court has found to the contrary. Additionally, under such a construction, internet access providers could also fit into Example 2 since they could be using LD telephone lines (at least back in 1984 when the regulation was amended and modems were used to connect to the internet). If so, N.J.A.C. 18:7-8.10(c), and Example 2 therein addressing internet access services become redundant.[13] Of note is also the fact that the SUT Act broadly encompasses all forms of telecommunications as subject to the tax except for radio and television broadcast. Example 2 is limited to LD telephone services.

In any event, Taxation applied a similar 25-50-25 analogy to "source receipts to NJ," and determine sales tax payable (*i.e.* based on call origin, customer billing, and call destination). Thus, even if Xpedite is considered a retailer of telecommunications under the SUT Act, it does not require that the allocation be limited to its customers billed at a New Jersey address for purposes of determining the numerator portions of the receipts factor under the CBT Act.

CONCLUSION

In sum, the court finds that Taxation's allocation methodology for the numerator portions of receipts from services comports with the language and intent of the controlling statute and regulations, and its adjustment to Xpedite's allocation factor was reasonable. *Metromedia, Inc.*, 97 N.J. at 323. Xpedite has not met its burden of overcoming the presumptive correctness of Taxation's CBT assessments. *TAS Lakewood v. Dir., Div. of Taxation*, 19 N.J. Tax 13, 140-41 (Tax 2000). Therefore,

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13. Effective 2008, internet access service is not considered "telecommunications" under the SUT Act. *See* N.J.SA. 54:32B-3(cc).

the court grants Taxation's cross-motion for summary judgment. The complaint is dismissed.

Very truly yours,

Mala Sundar, J.T.C.