NOT FOR PUBLICATION WITHOUT APPROVAL OF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

R.O.P. AVIATION, INC.,	:	TAX COURT OF NEW JERSEY
	:	DOCKET NO. 001323-2018
Plaintiff,	:	
	:	
v.	:	Approved for Publication In the New Jersey Tax Court Reports
	:	
DIRECTOR, DIVISION OF TAXATION,	:	
	:	
Defendant.	:	
	:	

Decided: May 27, 2021

Leah Robinson and Brian Kittle for plaintiff
(Mayer Brown, LLP, attorneys).

Michael J. Duffy for defendant
(Gurbir S. Grewal, Attorney General of New Jersey, attorney).

SUNDAR, P.J.T.C.

This opinion decides plaintiff's motion and defendant's cross-motion for partial summary judgment. Plaintiff argues that defendant's elimination of plaintiff's carried forward net operating losses (NOLs) from 2007 through 2011 as an audit adjustment for tax years 2012 through 2015 has no basis in law. Rather, per plaintiff, the elimination is based on a supposition by defendant's auditor who had determined that since plaintiff had under reported its income from inter-company leasing for the audited years 2012 to 2015 under transfer pricing principles, there should have been a percentage of profit also earned but unreported during 2007 through 2011, the tax years which generated the carried forward NOLs. There being no independent audit of tax years 2007 through 2011, nor any examination of the leasing transactions during those years, plaintiff argues, the NOL adjustment is arbitrary and contrary to defendant's regulations of determining income under transfer pricing principles.

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Defendant opposes the motion on grounds its auditor's elimination of the carried forward NOLs is supported by the broad discretion afforded under N.J.S.A. 54:10A-10, which permits any adjustments in determining the "fair and reasonable" corporation business tax (CBT) for the audited tax years 2012-2015, including investigating tax years which are closed (i.e., beyond the statute of limitations for audit, here years 2007-2011). However, defendant argues, if this court were to opine that the NOL adjustment should be supported with a "formal" transfer pricing study, then it should grant its cross-motion for partial summary judgment permitting amendment of its expert's report to show that plaintiff would have earned a profit under the transfer pricing principles for tax years 2007-2011.

It is undisputed that plaintiff's CBT returns for tax years 2007-2011 were never audited, thus, accepted as filed. It is also undisputed that when defendant audited plaintiff, these years were beyond the statute of limitations for an audit under N.J.S.A. 54:49-6. The court finds that permitting defendant to adjust plaintiff's NOLs carried forward from these closed years would be tantamount to an adjustment of the income reported in those years and thus constitutes an audit of closed years, which is impermissible under N.J.S.A. 54:49-6. Any suggestion that an audit of the closed years would have resulted in the complete denial of any NOL and any NOL carryforward is irrelevant (as well as being without any legal or factual basis) since those years cannot be audited in juxtaposition with the audit of the open years 2012-2015. Since audit of the 2007-2011 is time barred, it is also irrelevant that Taxation's expert be permitted to supplement his report to include an analysis of plaintiff's leasing income for those years. The court therefore grants plaintiff's motion, and denies Taxation's cross-motion, for partial summary judgment.

FACTS AND PROCEDURAL HISTORY

The following are the undisputed facts. Plaintiff (R.O.P.) is in the business of aircraft leasing. The leases are only for the personal property (aircraft). R.O.P. does not provide any services to the lessees such as pilot, ground crew, fuel, or maintenance. This type of lease is known as a "dry" lease.

R.O.P. leases aircrafts to its affiliate MacAndrews & Forbes Group, LLC, a single member entity owned by MacAndrews & Forbes Holdings. MacAndrews & Forbes Holdings also owns R.O.P. R.O.P. also sub-leases an aircraft to its parent, the original lease being between R.O.P. and an unrelated entity.

R.O.P. filed its annual CBT returns with defendant (Taxation). On its tax year 2012 return, it reported the total NOL carried forward as $18,069,516 ($6,247,043; $2,800,442; $676,571; and $7,864,303 for tax years 2007-2010 respectively). For tax year 2011, the NOL was $481,157. These NOLs were carried forward and then used by R.O.P. to offset its tax year 2014 income.[1] The NOLs were generated from income and expense amounts R.O.P. reported on its federal corporate income tax returns with New Jersey statutory modifications. Taxation did not audit R.O.P.'s CBT returns filed for tax years 2007-2011.

Sometime in 2017, Taxation audited R.O.P.'s CBT returns for tax years 2012-2015. The audit report noted that Taxation had requested certain documents, several of which were provided,[2]

[1] R.O.P. also generated NOLs for tax years 2012 and 2013, which were carried forward to tax years 2013 and 2014 respectively. These NOL carry forwards are not involved in the instant motions.

[2] Records sought were CBTs, 1120X, Form 851, gross rents, rent expense, lease agreements, intercompany service revenue, intercompany service revenue agreements, transfer pricing, tax expense, corporate allocation, corporate allocation agreement, capital gain, capital gain sale agreement, aircraft blue book values and Jet Perspectives desk appraisal. Except for intercompany service revenue, intercompany service revenue agreements, corporation allocation and corporation allocation agreement, R.O.P. provided all other documents.

and that R.O.P.'s records were sufficient and correct. The worksheets to the report listed eight lease agreements tabulating the types of agreement, parties to the lease, type of service, and the lease terms (period and amount).

The auditor found as an "unusual circumstance," R.O.P.'s lease of aircrafts to its affiliate at a rate below its total costs. The auditor made five separate adjustments to the returns for the audited tax years 2012-2015. Adjustment 1 was increasing R.O.P.'s income due to the allegedly underreported income from the lease rentals. In this connection, he rejected R.O.P.'s proffered transfer pricing study on grounds it was not based on a cost-plus method, and the method used therein (ratio of revenues to net assets of comparable companies, multiplied by R.O.P.'s net assets) did not produce an arm's length result for intercompany transactions.

Adjustment 5 (subject of the instant partial summary judgment motions) was disallowing the use of an NOL for tax year 2014, and of the carried forward NOLs from tax years 2007-2011 against the audited (increased) income for tax years 2012, 2013 and 2015, by reducing those NOLs to zero. The audit report noted that the NOLs "were disallowed for 2014 and not applied for 2012, 2013 and 2015 as the returns filed did not reflect arms-length transactions." The elimination of the carried forward NOLs resulted in the audited income as being the net taxable income.

By e-mail of April 25, 2017, R.O.P. asked the auditor to explain his work papers of April 21, 2017, specifically as to the transfer pricing methodology used for the audit years 2012-2015. R.O.P. noted that his NOL disallowance suggested that Taxation was making a "transfer pricing adjustment to tax years outside of the current audit." R.O.P. asked for Taxation's "analysis of prior years" and the basis for its auditor's conclusion that the prior years' NOLs could not be applied to the audited income for the audited years.

Taxation replied: "A transfer pricing study was not conducted. The adjustment is an estimate. We used the cost plus method due to its simplicity. The NOLs were disallowed on the basis there should have been a percentage of profit in the years they were incurred (see N.J.S.A. 54:10A-10)."

Taxation then issued a Notice of Final Audit determination on November 29, 2017. Due to the various adjustments, R.O.P.'s reported entire net income (ENI), which was a loss for each of the audited tax years except 2014,[3] increased to $7,919,931; $10,401,906; $35,637,995; and $22,240,528. Since no NOLs were allowed to offset this audited income, the entire amount was subject to CBT, which plus interest totaled $8,498,890.11. The Notice repeated the reason for the NOL adjustment, this time including the word "prior" and a citation, thus, the NOLs "were disallowed for 2014 and not applied for 2012, 2013 and 2015 as the prior returns filed did not reflect arms-length transactions" (citing N.J.S.A. 54:10A-10 and N.J.A.C. 18:7-5.10 as authority).

R.O.P. then filed a direct appeal to this court from Taxation's Notice of Final Audit adjustment. Thereafter, the court held several telephonic conferences on the issue of transfer pricing (i.e., whether the lease rentals charged to its affiliate by plaintiff were at market), and the parties' need for and method of exchanging expert reports in this regard. On August 24, 2020, the parties reported that expert reports were exchanged. R.O.P. then filed the instant motion for partial summary judgment only as to the propriety of audit Adjustment 5 (elimination of the carried forward NOLs).

Taxation filed opposition in support of which its auditor certified that he had conducted an informal transfer pricing analysis using a method similar to the cost-plus method in N.J.A.C. 18:7-

[3] R.O.P.'s reported ENI/loss for each year 2012-2015 was as follows: ($256,160); ($3,483,069); $15,036,123; and ($11,158,362).

5.10 (a) (8) (iii), and had disallowed the NOL carryforwards because the prior returns filed did not reflect arm's length transactions. He further stated that he did not need to know "[a] specific taxable income amount for the prior years . . . since those years were not being audited." Rather, he certified, the NOLs were disallowed on the basis that there should have been some percentage of profits in the years they were incurred. During litigation, R.O.P. obtained the auditor's worksheets which parties agreed was the auditor's informal transfer pricing analysis conducted during his audit of plaintiff's 2012-2015 CBT returns. The worksheets included a list of R.O.P.'s lease transactions and mathematical computations.

ANALYSIS

(1) Appropriateness of Summary Judgment

Our Supreme Court has indicated that summary judgment provides a prompt, business-like and appropriate method of disposing of litigation in which material facts are not in dispute. Brill v. Guardian Life Ins. Co. of Am., 142 N.J. 520, 530 (1995). Summary judgment can be granted as to one issue only. See R. 4:46-2(c) ("summary judgment or order, interlocutory in character, may be rendered on any issue in the action (including the issue of liability) although there is a genuine factual dispute as to any other issue").

In the instant partial summary judgment motion filed by plaintiff, the only issue is whether Taxation's elimination of R.O.P.'s NOLs generated in closed years (2007-2011) and carried forward to the open years (2012-2015), is valid as an audit adjustment of the open tax years. No facts are in dispute in this regard, whether as to the audit, the audit findings, or the auditor's reasons for adjusting R.O.P.'s carried forward NOLs from 2007-2011 into the audited open years 2012-2015. Nor is there any dispute that tax years 2007-2011 are closed years. Therefore, partial summary judgment is an appropriate method of deciding the issue expeditiously.

Taxation argues that the issue of the propriety of the NOL adjustment must be tried because there is sufficient evidence "in the record" to support the disallowance – this evidence is the auditor's findings, and Taxation's expert's opinion that a cost-plus methodology of transfer pricing "would have yielded a profit." However, the auditor's determination as to his NOL adjustments are undisputed here. The issue is simply whether that adjustment is proper as a matter of law. This does not involve credibility findings. Additionally, and as explained below, Taxation's expert's opinion (if permitted to be amended) on what would have occurred in the closed years is irrelevant - the issue is whether, under New Jersey law, an open tax year can be used to adjust transactions which occurred in a closed tax year. Determination of this legal issue does not require an expert's opinion.

Taxation also opposes R.O.P.'s motion on grounds it requested but was not provided R.O.P.'s federal and state income tax returns for the closed tax years. The opposition is meritless. It is undisputed that R.O.P. filed its CBT returns for all years (closed and open) with Taxation (it also included its 2012 CBT return with this motion). As such, these returns are in Taxation's possession. The court also notes that the auditor's report states that requested CBTs and the federal 1120s were provided by R.O.P. during audit. Therefore, Taxation's opposition that the disposition of the NOL adjustment issue warrants a trial is unpersuasive.

In sum, the court finds that summary judgment is an appropriate vehicle to promptly adjudicate the issue on the validity of Taxation's NOL adjustment.

(2) Net Operating Loss

A taxpayer's ENI is "deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions" as reported on the taxpayer's federal corporate income tax returns, with certain specified exceptions. N.J.S.A. 54:10A-4(k). The

"excess of allowable deductions over gross income used in computing" the ENI for a tax year produces an NOL for that particular tax year. N.J.A.C. 18:7-5.15(a). See also N.J.S.A. 54:10A-4(k)(6)(C) (NOL defined as "the excess of the deductions over the gross income used in computing" ENI).

"There is no [NOL] for any year that a [CBT] Return . . . is not filed or if filed" shows the ENI as a positive amount. N.J.A.C. 18:7-5.15(c). However, if there is a positive ENI in a tax year, it can be reduced or fully absorbed by a carried forward NOL. N.J.S.A. 54:10A-4(k)(6)(A) ("there shall be allowed as a deduction for the privilege period the [NOL] carryover to that period"). An NOL carryover is the NOL which is generated or incurred in one tax year and which is permitted to be carried forward to successive future tax years. N.J.S.A. 54:10A-4(k)(6)(B). The carry forward period is seven years "following the period of the loss." Ibid.[4]

Thus, while an NOL is substantively significant (reduces or offsets ENI and can be carried forward for a certain number of years for this purpose), its creation is mostly a mathematical function (i.e., the computation of expenses/deductions over income). This would logically mean that unless its components are suspect, the components being the items of income and expenses/deductions, the entirety of the NOL is necessarily a valid deduction for up to its statutory period of life (here, seven years).

(3) Statute of Limitations for Audit

The time to audit a filed CBT return is specified under the State Uniform Tax Procedure Law (SUTPL), N.J.S.A. 54:48-1 to 54-6. See N.J.S.A. 54:10A-19.1 ("The examination of returns and the assessment of additional taxes, penalties and interest shall be as provided by the" SUTPL).

[4] An NOL generated after July 31, 2019 is permitted a carry forward for 20 years. N.J.S.A. 54:10A-4(v)(1).

Under the SUTPL, Taxation "shall . . . examine[]" a filed return, and "may make such further audit or investigation" of the same, and "if therefrom" Taxation "determine[s]" that there is a tax deficiency, then it should (1) "assess the additional taxes" plus interest and penalties; (2) "give notice of such assessment to the taxpayer;" and (3) demand payment. N.J.S.A. 54:49-6(a). However, no "assessment of additional tax" shall be made after "four years from the date of the filing of a return." N.J.S.A. 54:49-6(b).[5]

Here, it is undisputed that at the time of the audit in 2017, tax years 2007-2011 were outside of the statute of limitations for being audited, i.e., were closed years. Both parties agree that Taxation did not assess any additional CBT for those years. Per Taxation, therefore, N.J.S.A. 54:49-6(b) is not material to the issue before the court. While R.O.P. acknowledges that there was no assessment of additional CBT for 2007-2011, it points out that this subsection is silent whether the returns can be "*audited*" after the four-year period.

The court finds that N.J.S.A. 54:49-6(a) and (b) must be read together. Subsection (a) requires Taxation to examine a filed return and provides it the ability to "audit or investigate" the filed return. If the audit is conducted, and a deficiency is determined, Taxation must assess the additional tax. However, although Subsection (b) separately requires that assessment of any additional tax shall be made within four years of the return's filed date, it does not mean that the return's audit/investigation can be made at any time, and outside the four-year period. The tax assessment flows from the audit made under Subsection (a), therefore, the audit and resultant tax assessment should be subject to the same four-year period. In other words, Taxation should

[5] There are exceptions to this four-year time limit. These are (1) if there is a shorter time specified by law imposing a specific tax; (2) if the return was false or fraudulent and filed with an intent to evade tax; or (3) if the taxpayer consents to enlargement of the time. N.J.S.A. 54:49-6(b). None of these exceptions apply, or are alleged to apply, here.

conduct an audit before imposing an additional assessment of tax, and since such additional assessment of tax must be made within four years (or within the extended period with consent of the taxpayer, see N.J.S.A. 54:49-6(b)), it logically means that an audit must also be performed within the same four-year period (or within the extended period with consent of the taxpayer, see N.J.S.A. 54:49-6(b)). The result should be the same even if no additional tax results from the audit. In other words, that there is no assessment of additional tax in a closed tax year does not mean that the return can be audited (examined and investigated) at any time, and that the result of such audit (examination and investigation) be deemed as an audit adjustment of the open years.

Although Taxation's auditor here asserts that he did not need to review the CBT returns for 2007-2011 to know "[a] specific taxable income amount for the prior years . . . since those years were not being audited," he adjusted the carried forward NOLs from those tax years because he believed that the income in those closed years were understated. Realistically, determining the true reportable income to determine the true NOLs for those years, is an audit or investigation of those tax years' CBT returns for purposes of N.J.S.A. 54:49-6(a). Indeed, both parties agree that the auditor's NOL adjustment (its elimination) is tied to the transfer pricing issue (whether plaintiff's lease rentals to its corporative relatives were at arms-length). Thus, R.O.P. is correct that the auditor should be required to analyze the transactions or income in each tax year 2007-2011 to determine that the reported income was distorted to reduce or eliminate the reported NOLs for those years. To maintain that Taxation can change the components of the NOL at any time (and presumably even beyond the seven-year life of the NOL), simply because it is not imposing an additional assessment of CBT under N.J.S.A. 54:49-6(b) in the closed years would render the existence of this statute of limitations illusory as to any item of carryforward (NOL or other permitted carryforwards) under the CBT Act.

Further, adjusting the amount of the NOL carryforward of a closed year, in the audited (open) year, is an indirect additional assessment of tax for the closed year. In other words, the imposition of the additional tax otherwise due in the closed year is being collected in the open year. This is because the increased additional tax for the open year is due to denial of the carryforward NOL from the closed year.[6] While Taxation may technically view its audit adjustment as one to the open year, the reality is that the adjustment is being made to a closed year. The court finds that auditing a closed year and applying the revisions from that closed year in the open year of audit is doing indirectly what the statute does not permit directly: bypassing the four-year statute of limitations.[7]

(4) Taxation's Authority to Adjust Carried Forward NOLs Under N.J.S.A. 54:10A-10

N.J.S.A. 54:10A-10 provides Taxation with broad authority to adjust a taxpayer's reported ENI where (1) the taxpayer's transactions are entered "at more or less than a fair price," or (2) the taxpayer's transactions with a related party are "on such terms as to create an improper loss or net income." N.J.S.A. 54:10A-10(b). Similarly, Taxation "is authorized and empowered" in its "discretion and in such manner as" it determines, to, among others, "adjust and redetermine" any "items" which "either directly or indirectly to distort" a taxpayer's "true" ENI, or where a taxpayer's activities, receipts or expenses are improperly or inaccurately reported. N.J.S.A. 54:10A-10(a). Taxation may "make <u>any</u> other adjustments in <u>any</u> tax report or tax returns as may

[6] The practical impact of disallowing use of the about $18 million of carried forward NOLs generated in 2007-2011 to offset the almost $70 million audited income is that more tax is assessed in the audited years than it would be if the NOLs were used to offset the income.

[7] Moreover, it is not known what the result of any audit of the closed year's would have been. Taxation's suggestion that an audit would have resulted in the complete denial of any NOL and any NOL carryforward is without any factual basis whatsoever.

be necessary to make a fair and reasonable determination of the amount of tax payable under" the CBT Act. Ibid. (emphasis added).[8]

Thus, under N.J.S.A. 54:10A-10, Taxation can revise income in an open audit year, and therefore, revise the NOL for that year. It follows that the NOL carryover will also consequently be the revised (audited) amount. Thus, for instance, N.J.A.C. 18:7-5.16 provides: "[a]n audit adjustment to entire net income shall serve to revise the amount of any net operating loss for the year of the change and the net operating loss carryover to which it relates." (emphasis added). The regulation thus provides that when, because of an audit, corporate income is changed, the resultant reported NOL which is generated for that tax year will also change. The phrase "and the [NOL] carryover to which it relates" can only mean that the audited tax year's now revised NOL will be the future NOL carried over amount to the pertinent future tax year. Here then, because Taxation determined that R.O.P. had increased income for tax years 2012 and 2013 (under the transfer pricing principles), it can also revise or adjust the reported NOLs generated in these two years. Consequently, the carried over NOLs will not be as reported, but will be the amount as revised by the audit, which may be used to offset income for the next seven years.[9]

Despite the breadth of Taxation's powers under N.J.S.A. 54:10A-10(a), the court will not construe it to defeat the statute of limitations for an audit under N.J.S.A. 54:49-6. Rather, both statutes can be read harmoniously, recognizing that each has a distinct purpose: the former permits Taxation to audit a taxpayer's returns and records and make any adjustment deemed necessary to

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[8] The phrase "fair and reasonable tax" is defined as "the tax that would have been payable by a taxpayer reporting the same transaction(s) on a separate entity basis where the parties to the transaction(s) had independent economic interests." N.J.A.C. 18:7-5.10(a)(3).

[9] R.O.P. concedes that its present motion does not address the 2012 NOL (carried forward to 2013) and the 2013 NOL (carried forward to 2014). Rather, R.O.P. maintains, those NOLs will be addressed as a consequence to its challenge to Taxation's imputation of additional revenue under the transfer pricing methodology.

provide a reasonable tax; the latter simply states that such an audit should be performed within a four-year period (as explained above, see supra pp. 9-11). To hold otherwise would negate the very repose and finality underlying the basis of a statute of limitations. Can this result in the net assessed CBT being lesser in the audited year? Undoubtedly. But this is a function of the statute of limitations, not a misapplication of N.J.S.A. 54:10A-10 under the aegis of its liberality.

A contrary construction would also expand the requirement of N.J.S.A. 54:10A-14.1, that a corporate taxpayer retains its records for five years. Note that this statute extends the five-year retention period if Taxation "require[s] that" the corporate records "be kept longer." However, there are no regulations alerting a taxpayer that as to NOLs (or other types of deductions or credits which can be carried forward), a taxpayer's records must be retained in perpetuity.[10] Cf. N.J.A.C. 18:7-5.10(b) ("Where [Taxation] determines that there is an adjustment to net income under this section, [it] . . . may also make a corresponding adjustment to the allocation factor").

The court's conclusion also finds support in the specific legislative exceptions to the use of, or revision to, the amount of an NOL carryover. For instance, N.J.S.A. 54:10A-4(k)(6)(F) authorizes a reduction of an NOL generated in a particular tax year or of an NOL carried forward to that year, by the amount of federally discharged indebtedness under I.R.C. §108(1)(a) for that tax year. See also N.J.S.A. 54:10A-4(k)(6)(D) (bars a successor entity from using a predecessor entity's NOL carryforward); N.J.S.A. 54:10A-4(k)(6)(E) (denying and limiting the use of NOL

[10] Similarly, there is a four-year record retention period for purposes of sales tax unless Taxation permits their destruction "within that period or may require that they be kept longer." N.J.S.A. 54:32B-16. Taxation could also bypass this law in a sales tax audit of a corporate entity under the same theory as here: since the prior years' sales were underreported for sales tax, the CBT returns also underreported income, therefore the prior years' income for sales tax and CBT was also underreported, therefore the carried forward NOLs should be eliminated regardless of the four-year retention period (or of the statute of limitations for sales tax audits which is four years unless extended with consent of the taxpayer, similar to the SUPTL provisions, see N.J.S.A. 54:32B-27).

carryovers in certain tax years). Cf. N.J.S.A. 46:15-7.2(c) (the State's "mansion" tax is subject to SUTPL "provided however . . . [N.J.S.A. 54:49-14(b)] shall not apply to any additional fee assessed"). There is no similar carve out or exception in the SUTPL that the four-year limitations period does not apply to items of carryforward such as NOLs.

Taxation notes that its auditor is "authorized to conclude that the arm's length charge was equal, at a minimum, to the costs and deductions incurred by [R.O.P.] in performing [its] services" which means that R.O.P. "should not be providing services to an affiliate below costs" (see N.J.A.C. 18:7-5.10(a)(6)).[11] Regardless, this authority and exercise is permissible only as to open audit years, and not as here, to the closed tax years 2007-2011. Taxation cannot use supposition as the basis for its determination to eliminate the carried forward NOLs, or without also adjusting R.O.P.'s income for 2007-2011 pursuant to a timely conducted audit of those years.

Taxation's "interpretation of the operative law is entitled to prevail," but only as "long as it is not plainly unreasonable." Metromedia, Inc. v. Dir., Div. of Taxation, 97 N.J. 313, 327 (1984). Under N.J.S.A. 54:10A-10, Taxation can make any adjustment to any return, however, it may only do so for returns which are being audited (i.e., the returns of an open year), within the statutory time frame. Here, by eliminating R.O.P.'s 2007-2011 NOL carryovers, Taxation indirectly attempts to do what it cannot directly do: adjust R.O.P.'s reported income for those tax years which are time barred under N.J.S.A. 54:49-6. Thus, the NOL adjustment here is plainly at odds with

[11] N.J.A.C. 18:7-5.10(a)(6) provides that "[w]here a service by one member of a group to another member is rendered for less than an arm's length charge," Taxation "may make appropriate allocations to reflect an arm's length charge for that service. The arm's length charge is equal to the costs or deductions incurred by the member performing the service, except in cases where the service is an integral part of the business activity of either member." R.O.P. points out that this regulation does not apply since it is engaged in "dry" leasing, not providing services. But see N.J.A.C. 18:7-5.10(a)(7) (applying the same "arm's length" requirement for a "rental charge" where "tangible property is made available by one member of the group to another").

N.J.S.A. 54:49-6 and N.J.A.C. 18:7-5.16, rendering Taxation's determination is this regard an unreasonable construction of N.J.S.A. 54:10A-10.

Taxation notes, and R.O.P. agrees, that the Internal Revenue Service (IRS) routinely revises the amount of the NOL carryforwards by revising the NOL of the source year, even if that year is closed. See Internal Rev. Manual §4.11.11.13 (2) (The IRS "may redetermine correct taxable income in a closed year in order to ascertain either the amount of an NOL, or the amount of an NOL that is absorbed in the closed year for purposes of determining the correct [NOL] deduction for an open year. The authority for doing so is IRC 7602(a)"). I.R.C. §7602(a)(1) provides that "[f]or the purpose of ascertaining the correctness of any return" the IRS "is authorized . . . to examine any books, papers, records, or any other data which may be relevant or material to such inquiry."

The court is not bound by the IRS' construction of a federal income tax statute for purposes of the CBT as to statute of limitations or audit procedures. See e.g. Centex Homes of New Jersey, Inc. v. Dir., Div. of Taxation, 10 N.J. Tax 473, 492-93 (Tax 1989) (when there are no provisions in the CBT permitting Taxation to recast a loan as a capital contribution, it cannot use the IRS' such treatment on grounds "federal tax concepts are an inherent part of the CBT." The court noted that "[t]here is nothing in the CBT or its history that indicates that the Legislature intended the Director to become enmeshed in the complexities and administrative difficulties of the federal tax laws") (citations omitted)), aff'd, 241 N.J. Super. 16 (App. Div. 1990); cf. also Wigton v. Dir., Div. of Taxation, 12 N.J. Tax 373, 379 (Tax 1992) (for gross income tax purposes, there is no statute similar to I.R.C. §1341, "thus [it is] clear that the New Jersey Legislature has not adopted the federal claim-of-right alternative calculations allowing a taxpayer to calculate tax due in the year of repayment using the original payment year as the basis for calculation instead of the

repayment year"). This is especially where under the CBT Act, a taxpayer's income is as reported for federal purposes but "before" NOL "deduction and special deductions." See N.J.S.A. 54:10A-4(k).[12]

Notably, the plain language of I.R.C. §7602(a)(1) itself does not permit opening closed years or circumventing the statute of limitations. Nor are there any regulations in this regard. The IRS' manual for its audit procedures is not binding authority, let alone persuasive authority for the interpretation of N.J.S.A. 54:10A-10 vis-à-vis the statute of limitations for an audit. Note that almost every New Jersey tax statute provides Taxation with authority similar to I.R.C. §7602(a). See e.g. N.J.S.A. 54:50-2 (for purpose of administering the SUTPL, Taxation or its employee(s) can examine or investigate "the books, records, papers, vouchers, accounts and documents of any taxpayer"); N.J.S.A. 54:10A-14(b) (for CBT purposes, Taxation can require the taxpayer to maintain such books and records which will permit "determination of the" CBT and its "enforcement and collection"); N.J.S.A. 54:32B-16; 32B-19 (for sales and use tax purposes, a taxpayer must keep records for up to four years of any and all transactions, and if the return is "incorrect or insufficient," Taxation can determine the "tax due . . . from such information as may be available").

However, this broad authority is not a basis to support auditing a closed year and carryforward the results of such audit to an open year by revising the carried forward item of deduction (here, the NOL). The IRS' broad interpretation of I.R.C. §7602(a)(1) is not binding on this court and does not permit circumvention of the New Jersey's statute of limitations on an audit. That the IRS and the federal courts may deem auditing a closed year as simply a "verification of

[12] Cf. N.J.S.A. 54:10A-4.5(c) (the I.R.C. treatment of NOL carryover for federal income tax purposes "shall apply" under the CBT law for tax years after January 1, 2020).

the accuracy" of the reported NOL is similarly of no import. To the court, when such verification is not limited to pure math (as here, where Taxation is applying an unknown markup to plaintiff's reported income), semantics does not control: it is an audit of the components of an NOL. If such audit is untimely, the NOL cannot be revised.

For these same reasons, the court declines Taxation's request to use equity and apply the provisions of I.R.C. §6214(b) to decide the matter. This statute permits federal courts, "in redetermining a deficiency of income tax for any taxable year" to "consider such facts with relation to the taxes for other years or calendar quarters as may be necessary correctly to redetermine the amount of such deficiency." While it is true that this court's review of Taxation's final determination is on a de novo basis, it is not empowered to revisit a closed year when the Legislature forbids the state agency from doing so.

There is unquestionably some tension in reconciling the finality afforded to auditing of tax returns by the statute of limitations with the flexibility afforded to Taxation under N.J.S.A. 54:10A-10 which essentially disrupts that finality (even though there is no direct "additional assessment" of CBT), vis-à-vis the fact that the accuracy of a carried forward NOL necessarily depends on the accuracy of the reported items of income and expenses/deductions in the closed year/s. The court resolves this tension in favor of the taxpayer. While Taxation is allowed utmost discretion under N.J.S.A. 54:10A-10, statutes of limitations are construed strictly. Further, even if it were considered that N.J.S.A. 54:10A-10 is ambiguous as to adjusting NOLs of a closed tax year so that its effects are reflected in the open audited year, the court will construe the ambiguity in favor of the taxpayer because Taxation's reduction or elimination of the NOLs by a purported audit of the closed tax years results in increased tax upon the taxpayer. See Fedders Fin. Corp. v.

Dir., Div. of Taxation, 96 N.J. 376, 385 (1984) (ambiguity in a taxing statute with no legislative guidance to resolve the same, results in construing doubts in favor of the taxpayer).

In sum, the court finds that Taxation's elimination of the NOL carryovers from tax years 2007-2011 is impermissible as statutorily time barred. Because of this conclusion, the court finds it unnecessary to decide plaintiff's argument that Taxation's elimination of its NOL carryforwards was arbitrary, capricious, and without any basis in fact or law, therefore, is not presumptively correct or capable of being proven by Taxation at trial and should be reversed. The court however notes that there is no factual basis for Taxation's elimination of plaintiff's NOLs. The "informal" analysis submitted by Taxation to R.O.P. during litigation and provided to this court are only mathematical computations (cost plus 10% for increasing plaintiff's rental income). Further, as R.O.P. notes, the total elimination cannot be substantiated even if the same 10% markup applied to the open tax years was applied to each unaudited closed year: such application would only reduce, not eliminate, the NOLs.[13] To eliminate the $18,069,516 NOL carryover amounts, Taxation would have had to either increase the markup to 234.7% for tax year 2011, or if it was zeroing out the NOL for each unaudited tax year, its markup would range from 6.2% to 75.5%.

A court can "reverse an agency's decision if (1) it was arbitrary, capricious, or unreasonable; (2) it violated express or implied legislative policies; (3) . . . or (4) the findings on which it was based were not supported by substantial, credible evidence in the record." AccuZIP, Inc. v. Dir., Div. of Taxation, 25 N.J. Tax 158, 167 (Tax 2009) (citations and internal quotation

[13] R.O.P. reported a net loss for each tax year 2007 to 2011 as follows: ($6,247,043); ($2,800,442); ($676,571); ($7,864,303); and ($481,157) for a total of ($18,069,516). With a 10% profit percentage or markup, the reported amounts would be: ($4,396,096); ($1,442,436); $373,615; ($6,822,911); and $288,736 for a total loss of -$11,999,091. Thus, the available NOL carryover into 2012 would be around $12 million.

marks omitted).[14] However, since R.O.P. has contested the entire assessment, not just audit Adjustment 5 (NOLs), the court will not apply this principle in a partial summary judgment motion as to one issue only. In any event, such recourse is unnecessary here since the court has decided that the NOL adjustment is time barred.

(5) Supplementing Taxation's Expert's Report

The last issue is Taxation's cross-motion for partial summary judgment that its expert be allowed to amend his report to include an analysis of the NOL adjustment issue. R.O.P. points out that its expert's report included an analysis of the NOL adjustment, but Taxation's expert did not. Taxation provided the court a two-paragraph quote from its expert's report which opines that R.O.P.'s continued losses render its financial viability suspect when the aircraft leasing industry is generally profitable.

The court cannot glean the relevance of the experts' opinions on the issue presented here (and the consequent request from Taxation on amending its report): whether the carried forward NOLs from 2007-2011 can be eliminated without adjusting or changing the income for those years pursuant to a timely audit under the aegis of N.J.S.A. 54:10A-10 regardless of time limitations specified in N.J.S.A. 54:49-6 and contrary to the NOL regulation N.J.A.C. 18:7-5.16. Even if the experts opine on whether the transactions in 2007-2011 were at arms-length or otherwise, the ability to use or eliminate the use of those NOLs is controlled by the statute of limitations which is not superseded by N.J.S.A. 54:10A-10. Unless the statute of limitations does not apply, the court fails to understand why the experts' opinion on the NOL adjustment matters for purpose of deciding the validity of eliminating the carried over NOLs of 2007-2011. In fact, Taxation

[14] The matter was decided on summary judgment motions by the taxpayer and Taxation. AccuZIP, Inc., 25 N.J. Tax at 162.

correctly argues that this issue does not require support of, or explanation from transfer pricing experts' opinions. However, Taxation's further contention that "the fact that Taxation has expert reports should be sufficient to deny the motion, since the NOL adjustment is closely related to the transfer price study adjustment" is unpersuasive for the reasons explained above.

CONCLUSION

For the aforementioned reasons, the court grants R.O.P.'s motion for partial summary judgment. An Order will be entered in conformance with this opinion voiding the elimination of the carried forward NOLs (i.e., Taxation's audit Adjustment 5).