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Subject: Settlement Opportunities May Exist in New Jersey in Light of Lanco Litigation
Date: April 26, 2006

To: Our Clients and Friends

It is my understanding that the New Jersey Division of Taxation is informally entertaining settlement proposals from taxpayers impacted by the ongoing Lanco litigation. By way of background, on August 24, 2005, the New Jersey Superior Court, Appellate Division, ruled in *Lanco, Inc. v. Director, Division of Taxation* that the corporation business tax may be imposed on a corporation with no physical presence in New Jersey that derives income from a New Jersey source pursuant to a license agreement. Reversing the Tax Court, the Appellate Division held that the physical presence requirement set forth in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), is not applicable to the corporation business tax. The New Jersey Supreme Court has granted certiorari and will hear the taxpayer's appeal from the Appellate Division.

In the meantime, taxpayers with potential nonfiling exposure may approach New Jersey with a settlement proposal based on the average of the following 2 tax calculations: (1) operating company royalty deduction times operating company apportionment factor times tax rate; and (2) intangible property company taxable income times intangible property company apportionment factor times tax rate. As part of the settlement proposal, the intangible property company would only be required to file returns from 2002 forward (i.e., potential nonfiling exposure for years prior to 2002 would be forgiven). Certain late-filing penalties would be waived, but not late-payment penalties and interest.

Taxpayers entering into settlements with New Jersey would be permitted to utilize the above tax calculation prospectively for 3 years. In addition, the operating company would be eligible to file refund claims based on New Jersey's royalty addback exception (i.e., since the intangible property company would now be subject to tax in New Jersey, the operating company would not be required to add the royalty deduction back to taxable income).

Taxpayers should carefully evaluate the overall impact of such a settlement proposal prior to approaching New Jersey. If a settlement is entered into, taxpayers must agree to waive appeal rights. This is quite significant in light of the ongoing Lanco litigation, as well as the potential for constitutional challenges to New Jersey's throwout rule (which greatly impacts the intangible property company tax calculation in most instances).

If you are interested in approaching New Jersey anonymously to negotiate a settlement proposal, or would like to discuss the implications to your company of the issues addressed herein, please do not hesitate to contact me.

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