

**To: New Jersey Law Review Commission**  
**From: Arshiya M. Fyazi, Counsel<sup>1</sup>**  
**Re: *Stanislaus Food Prod. Co. v. Director, Div. of Tax'n;***  
**Preemption (N.J.S. 54:10A-5a and 15 U.S.C. §381)**  
**Date: October 7, 2019**

## MEMORANDUM

### Executive Summary

In *Stanislaus Food Prod. Co. v. Director, Div. of Taxation*,<sup>2</sup> the New Jersey Tax Court considered whether the Alternative Minimum Assessment (“AMA”)<sup>3</sup> is an obstacle to the accomplishment and execution of the purposes and objectives of the Interstate Income Act of 1959 (“IIA”).<sup>4</sup> The Court determined that the AMA is preempted by the IIA pursuant to the Commerce Clause and the Supremacy Clause of the United States Constitution.

### Background

New Jersey first enacted the Corporation Business Tax (“CBT”) in 1945.<sup>5</sup> It was a tax based solely on a corporation’s net worth which was allocated to New Jersey.<sup>6</sup> In 1958, the statute was amended to also tax corporations based on net income allocable to New Jersey.<sup>7</sup> Thereafter, Congress, under the purview of the Commerce Clause<sup>8</sup>, enacted the Interstate Income Act of 1959.<sup>9</sup> This Congressional enactment included minimum standards that prevent a state from imposing “Net Income Tax” on interstate commerce if the only in-state activities are limited to the solicitation of orders of tangible personal property which are approved or rejected outside of the state.<sup>10</sup> Under the Act, “Net Income Tax” is defined as “any tax imposed on, or measured by, net income.”<sup>11</sup>

In 2002, New Jersey enacted the first phase of the AMA, in effect from 2002 until June 30, 2006.<sup>12</sup> Initially, the AMA applied to all corporate taxpayers, and they were required to pay greater

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<sup>1</sup> Preliminary work in this area was completed by Myla Wailoo - 2019 NJLRC Summer Legislative Intern.

<sup>2</sup> *Stanislaus Food Products Co. v. Director, Div. of Taxation*, No. 011050-2017, 2019 WL 2720346 (N.J. Tax, June 28, 2019).

<sup>3</sup> N.J.S. 54:10A-5A (2002).

<sup>4</sup> P.L. 86-272, 15 U.S.C. §381 (1959).

<sup>5</sup> *Id.* at \*2, N.J.S. 54:10A-1 to 27 (L.1945, c.162, §5(a)).

<sup>6</sup> *Id.* N.J.S. 54:10A-5(c) (L.1958, c.63).

<sup>7</sup> *Id.*

<sup>8</sup> U.S. Const. art I, §8, cl. 3. The Commerce Clause gives Congress the ability to determine the parameters for interstate commerce.

<sup>9</sup> *Stanislaus Food Prod. Co. v. Director, Div. of Tax'n.* at \*4.

<sup>10</sup> *Id.* at \*4.

<sup>11</sup> *Id.* quoting 15 U.S.C. §383.

<sup>12</sup> *Id.* at \*6.

of either CBT (tax on net income allocated to the state) or the AMA (tax on either gross profits or gross receipts).<sup>13</sup>

In 2006, the New Jersey Legislature implemented the second phase of the AMA.<sup>14</sup> This second phase allows for assessment on gross receipts or gross profits tax solely on entities that are exempt from paying the CBT under the IIA.<sup>15</sup> If the protected entity consents to the CBT tax of New Jersey, however, it will not be taxed under the AMA.<sup>16</sup>

The interplay between the second phase of the AMA and the IIA raised the issue of preemption in *Stanislaus*.

### Statement of Facts

Stanislaus Food Products Company (hereinafter “taxpayer”) is located in California. The taxpayer grows produce that is shipped to an independent distributor in New Jersey who then sells the vegetables directly to restaurants.<sup>17</sup> From 2012 to 2014, the taxpayer did not maintain an inventory of products in New Jersey.<sup>18</sup>

Initially, the taxpayer filed its returns and paid the CBT based upon its net income.<sup>19</sup> The Director, however, audited the taxpayer's returns and issued a deficiency assessment.<sup>20</sup> The taxpayer filed amended returns indicating it qualified as an IIA taxpayer. The Director agreed and allowed a refund of the CBT, but imposed the AMA gross profits tax, which reduced the amount of the refund.<sup>21</sup>

The taxpayer appealed to the Tax Court.<sup>22</sup> The parties did not dispute that the taxpayer was a protected entity under IIA.<sup>23</sup>

### Analysis

The Supremacy Clause of the United States Constitution provides a rule for courts to follow when federal and state law are in conflict.<sup>24</sup> In *Stanislaus*, the Tax Court examined whether New

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<sup>13</sup> *Id.* at \*7.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* See N.J.S. 54:10A-5A(e)

<sup>16</sup> *Id.*

<sup>17</sup> *Stanislaus Food Prod. Co. v. Director, Div. of Tax'n.* at \*2.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at \*5, citing *Armstrong v. Exceptional Child Ctr., Inc.*, 135 S. Ct. 1378, 1383 (2015).

Jersey's AMA is pre-empted by the Supremacy Clause, because it conflicts with the Congress' Commerce Clause powers to regulate interstate commerce through the IIA.<sup>25</sup> To determine whether the federal and the state laws are in conflict, the Supremacy Clause requires that "the relationship between state and federal laws [are considered] as they are interpreted and applied, not merely as they are written."<sup>26</sup>

The Court noted that the second phase of AMA, which went into effect in 2006, imposed an assessment "upon no other group of taxpayers except those which enjoy a IIA exemption."<sup>27</sup> Moreover, the Court further noted that the legislative intent behind the implementation of the AMA was to "effectively capture the value of the activities in New Jersey of out-of-state companies"<sup>28</sup> that receive exemption from a tax, like CBT, pursuant to the IIA.

While the AMA is not a net income tax, it requires the taxpayer to determine the amount of tax to be paid, "regardless of whether the tax ultimately paid is the AMA or CBT."<sup>29</sup>

The *Stanislaus* Court noted that there are instances in which the AMA can coerce a taxpayer to consent to and pay the CBT.<sup>30</sup> In certain situations, the AMA is more financially demanding than the CBT, so taxpayers that would have ordinarily been exempt from the CBT end up paying that net income tax because it is less financially demanding.<sup>31</sup>

The Court explained that there are three circumstances in which preemption can occur, which are referred to as: express; conflict; and, field preemption.<sup>32</sup> Conflict preemption occurs when it is impossible for a party to comply with both state and federal requirements or where state law stands as an obstacle to the accomplishment and execution of the objectives of Congress.<sup>33</sup> Express preemption occurs when Congress explicitly indicates through statutory language what type of state law the enactment is attempting to preempt.<sup>34</sup> In *Stanislaus*, the Court found that the AMA expressly conflicts with Interstate Income Act because it specifically targets IIA entities.

Furthermore, since the AMA creates a greater tax liability than the CBT in specific situations, the Court determined that it constitutes conflict preemption because it stands as an obstacle to Congress exempting those same entities from net income taxation, albeit indirectly.<sup>35</sup>

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<sup>25</sup> *Id.* at \*7.

<sup>26</sup> *Id.* at \*6, quoting *R.F. v. Abbott Laboratories*, 162 N.J. 596, 618 (2000).

<sup>27</sup> *Stanislaus Food Prod. Co. v. Director, Div. of Tax'n*, at \*7.

<sup>28</sup> *Id.* at \*8, quoting legislative statements by the Assembly Budget Committee and the State Budget Appropriation Committee (emphasis original).

<sup>29</sup> *Id.* at \*9.

<sup>30</sup> *Id.* at \*8.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*, at \*6.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

The Court stated “the manner in which the state legislature has described and categorized [a tax] cannot mask the fact that the purpose and effect of the provisions are to impose a levy” contrary to the clear directives of the Congress.<sup>36</sup>

Based on its analysis, the Tax Court determined that the AMA is preempted by the IIA.

### **Conclusion**

Staff seeks authorization to conduct additional research and outreach regarding this issue in order to determine whether it is possible to modify the AMA to be consistent with the federal statute or whether some other action or recommendation would be appropriate.

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<sup>36</sup> *Id.* at \*9, quoting *Aloha Airlines v. Dir. of Tax’n of Hawaii*, 464 U.S. 7, 13-14 (1983).