CASE STUDY

Winning a First-of-a-Kind Lawsuit and Millions in Tax Relief

"[T]his decision may provide refund opportunities for taxpayers that... would not have qualified for the unreasonable exception under the Director's narrow interpretation."

—An analysis of Pillsbury's victory by one of the Big Four accounting firms

Client:	**Beneficial New Jersey, Inc.**
Industry:	Consumer loans and finance
Area of Law:	Tax
Venue:	New Jersey Tax Court
Results:	Scored a summary judgment victory in the first-ever challenge to New Jersey's interest add-back law, garnering a $4.4 million refund and sparing our client millions in future taxes

In 2002, New Jersey became an early adopter of an increasingly popular addition to state business tax rules: interest add-back tax provisions. These provisions aim to funnel more tax dollars into state coffers by disallowing deductions on interest paid by companies to other members of the same corporate group.

In 2007, Beneficial New Jersey, a consumer finance company that has operated in the state for 75 years, was assessed additional taxes in the amount of $4.4 million, plus interest and penalties, when the New Jersey Tax Director disallowed the deduction of all interest Beneficial had paid on loans from its parent company, HSBC Finance Corporation. The company turned to Pillsbury to challenge the assessment.

Pillsbury lawyers noted that the New Jersey Legislature had included five exceptions in its interest add-back law. However, because the burden is on the taxpayer to prove its entitlement to the deductions, Beneficial and Pillsbury faced a high bar in court.

The facts were relatively straightforward. To obtain the funds it would then loan to consumers, Beneficial borrowed money from HSBC at a lower interest rate than it could get on its own. HSBC paid tax on the interest income it received from Beneficial, while Beneficial deducted the interest it paid to HSBC. As Pillsbury demonstrated, Beneficial's borrowing was in the normal course of its business operations.

Thus, Pillsbury argued, the company should be allowed to deduct its interest expenses under the "unreasonable" exception, which states: "A deduction shall also be permitted if the taxpayer establishes by clear and convincing evidence, as determined by the [Tax Director], that the disallowance of a deduction is unreasonable…."

In discovery, Pillsbury deposed a number of state tax officials who admitted they had granted the unreasonable exception only in the most limited of circumstances, though the law itself was not so narrowly written. The New Jersey Tax Court agreed with Pillsbury and concluded that Beneficial's case presented the kind of situation contemplated by the Legislature when it enacted the unreasonable exception.

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