54:10A-6.3

LEGISLATIVE HISTORY CHECKLIST

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LAWS OF: 2011 **CHAPTER:** 59

NJSA: 54:10A-6.3 (Phases-in single sales fraction for corporation business tax income allocation formula over three years and establishes airline-specific sales fraction)

BILL NO: S2753 (Substituted for A3869)

SPONSOR(S) Whelan and others

DATE INTRODUCED: February 22, 2011

COMMITTEE: **ASSEMBLY:** ---

SENATE: ---

AMENDED DURING PASSAGE: No

DATE OF PASSAGE: **ASSEMBLY:** March 3, 2011

SENATE: March 3, 2011

DATE OF APPROVAL: April 28, 2011

FOLLOWING ARE ATTACHED IF AVAILABLE:

FINAL TEXT OF BILL (Introduced version of bill enacted)

S2573

SPONSOR'S STATEMENT: (Begins on page 4 of introduced bill) Yes

COMMITTEE STATEMENT: **ASSEMBLY**: No

SENATE: No

(Audio archived recordings of the committee meetings, corresponding to the date of the committee statement, ***may possibly*** be found at www.njleg.state.nj.us)

FLOOR AMENDMENT STATEMENT: No

LEGISLATIVE FISCAL NOTE: Yes

A3869

SPONSOR'S STATEMENT: (Begins on page 4 of introduced bill) Yes

COMMITTEE STATEMENT: **ASSEMBLY**: No

SENATE: No

FLOOR AMENDMENT STATEMENT: No

LEGISLATIVE FISCAL NOTE: No

(continued)

VETO MESSAGE:	No
GOVERNOR'S PRESS RELEASE ON SIGNING:	Yes

FOLLOWING WERE PRINTED:

To check for circulating copies, contact New Jersey State Government Publications at the State Library (609) 278-2640 ext.103 or mailto:refdesk@njstatelib.org

REPORTS:	No
HEARINGS:	No
NEWSPAPER ARTICLES:	Yes

"Gov. Christie signs bipartisan bills to modernize N.J. tax code for small businesses," NewJerseyNewsroom.com, 4-29-13
"N.J. tax for single sales goes into law," The Philadelphia Inquirer, 4-29-13
"Christie Signs Two Tax Reductions for New Jersey Businesses," Bloomberg Press, 4-29-13
"Governor signs tax cut bills after Democrat pass tweaks," Courier News, 4-29-13
"Christie signs tax-cut bills," Asbury Park Press, 4-29-13
"Christie signs 2 tax cut bills to aid business," Courier-Post, 4-29-13

LAW/KR

§2 - C.54:10A-6.3
§3 - Note to §§1,2

P.L.2011, CHAPTER 59, ***approved April 28, 2011***
Senate, No. 2753

AN ACT modifying the allocation of the entire net income of corporation business taxpayers, amending and supplementing P.L.1945, c.162.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Section 6 of P.L.1945, c.162 (C.54:10A-6) is amended to read as follows:

6. The portion of **[**its**]** a taxpayer's entire net worth to be used as a measure of the tax imposed by subsection (a) of section 5 of P.L.1945, c.162 (C.54:10A-5), and the portion of its entire net income to be used as a measure of the tax imposed by subsection (c) of section 5 of P.L.1945, c.162 (C.54:10A-5), shall be determined by multiplying such entire net worth and entire net income, respectively, by an allocation factor which is the property fraction, plus twice the sales fraction plus the payroll fraction and the denominator of which is four, and which, for privilege periods beginning on or after January 1, 2012, is the sum of the portions of the property fraction, the sales fraction, and the payroll fraction determined in accordance with the following schedule:

for privilege periods beginning on or after January 1, 2012 but before January 1, 2013, 15% of the property fraction plus 70% of the sales fraction plus 15% of the payroll fraction,

for privilege periods beginning on or after January 1, 2013 but before January 1, 2014, 5% of the property fraction plus 90% of the sales fraction plus 5% of the payroll fraction, and

for privilege periods beginning on or after January 1, 2014, 100% of the sales fraction,

except as the director may determine pursuant to section 8 of P.L.1945, c.162 (C.54:10A-8), that is:

(A) The property fraction is the average value of the taxpayer's real and tangible personal property within the State during the period covered by its report divided by the average value of all the taxpayer's real and tangible personal property wherever situated during such period; provided, however, that for the purpose of determining average value, the provisions with respect to depreciation as set forth in subparagraph (F) of paragraph (2) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4) shall be taken into account for arriving at such value.

EXPLANATION – Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and is intended to be omitted in the law.

Matter underlined thus is new matter.

(B) The sales fraction is the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its net income for federal tax purposes, arising during such period from

(1) sales of its tangible personal property located within this State at the time of the receipt of or appropriation to the orders where shipments are made to points within this State,

(2) sales of tangible personal property located without the State at the time of the receipt of or appropriation to the orders where shipment is made to points within the State,

(3) (Deleted by amendment.)

(4) services performed within the State,

(5) rentals from property situated, and royalties from the use of patents or copyrights, within the State,

(6) all other business receipts (excluding dividends excluded from entire net income by paragraph (1) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4)) earned within the State,

divided by the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties and all other business receipts, whether within or without the State.

(C) The payroll fraction is the total wages, salaries and other personal service compensation, similarly computed, during such period of officers and employees within the State divided by the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's officers and employees within and without the State.

In the case of a banking corporation which maintains a regular place of business outside this State other than a statutory office, and which elects to take the exclusion from net worth provided in subsection (d) of section 4 of P.L.1945, c.162 (C.54:10A-4) or the deduction from entire net income provided in paragraph (4) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4), the allocation factor shall be computed and applied in accordance with section 6 of P.L.1945, c.162 (C.54:10A-6); provided, however, that the numerators and the denominators of the fractions described in (A), (B) or (C) above shall include all amounts attributable, directly or indirectly, to the production of the eligible net income of an international banking facility as defined in paragraph (4) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4), whether or not such amounts are otherwise attributable to this State.
(cf: P.L.2008, c.120, s.2)

2. (New section) Notwithstanding the provisions of section 6 of P.L.1945, c.162 (C.54:10A-6), the sales fraction for the transportation revenues of a taxpayer that is an airline shall be determined as the ratio of revenue miles in this State divided by total revenue miles; provided however, that if a taxpayer that is an

airline is engaged in the transportation of passengers, the transportation of freight, or the rental of aircraft, the ratio under this section shall be determined by means of an average of a passenger revenue mile fraction, freight revenue mile fraction, and rental revenue mile fraction weighted to reflect the taxpayer's relative gross receipts from passenger transportation, freight transportation, and rentals.

3. This act shall take effect immediately; provided however, that section 2 shall apply to privilege periods beginning on or after January 1, 2012.

STATEMENT

This bill modifies the corporation business tax formula used to determine the portion of the income of a corporation subject to tax by the State of New Jersey from a three-factor formula to a single sales factor formula, and establishes a specialized sales fraction formula for airlines that are subject to taxation.

Each state that imposes a corporate income tax determines the portion of the total income of a corporation subject to state tax by using formulas that measure specific activities of the corporation assigned to that state. The portion of the income of the corporation subject to tax by a state is determined by the proportion of some activity in the state to the total of such activity of the corporation.

The New Jersey corporation business tax employs a three-fraction formula that apportions a share of a corporation's income to this State based on a weighted average of the following fractions: (1) a corporation's property in this State over the corporation's total property; (2) a corporation's sales in this State over the corporation's total sales; and (3) the corporation's payroll in this State over the corporation's total payroll. Currently, the sales fraction accounts for 50% of the apportionment and the property and payroll fractions each account for 25% of the apportionment.

This bill replaces the three-factor formula with a single sales factor formula. The change is phased in over three years, beginning with privilege periods beginning on or after January 1, 2012 but before January 1, 2013. For that year, the sales fraction will account for 70% of the apportionment and the property and payroll fractions will each account for 15% of the apportionment. For privilege periods beginning on or after January 1, 2013 but before January 1, 2014, the sales fraction will increase to 90% and the property and payroll fractions will each account for 5% of the apportionment. For privilege periods beginning on or after January 1, 2014, the sales fraction will account for 100% of the apportionment.

In addition, certain industries have specialized formulas adopted by regulation which more appropriately measure taxpayers' relative activity in New Jersey than the standard formula. The sales fraction for airlines is currently determined based on the ratio of departures from New Jersey to total departures, weighted as to cost and value of aircraft by type where weighting would give a fairer, more reasonable business allocation factor.

This bill codifies a modified sales fraction formula for airlines. Under its provisions, the current sales fraction based on the ratio of departures is replaced by a sales fraction determined as the ratio of an airline's revenue miles in this State divided by an airline's total revenue miles.

Phases-in single sales fraction for corporation business tax income allocation formula over three years and establishes airline-specific sales fraction.

SENATE, No. 2753

STATE OF NEW JERSEY

214th LEGISLATURE

INTRODUCED FEBRUARY 22, 2011

Sponsored by:
Senator JIM WHELAN
District 2 (Atlantic)
Senator FRED H. MADDEN, JR.
District 4 (Camden and Gloucester)
Senator STEVEN V. OROHO
District 24 (Sussex, Hunterdon and Morris)
Assemblyman LOUIS D. GREENWALD
District 6 (Camden)
Assemblyman MATTHEW W. MILAM
District 1 (Cape May, Atlantic and Cumberland)
Assemblywoman L. GRACE SPENCER
District 29 (Essex and Union)
Assemblywoman NELLIE POU
District 35 (Bergen and Passaic)

Co-Sponsored by:
Senator Sarlo, Assemblymen Conaway and Conners

SYNOPSIS

Phases-in single sales fraction for corporation business tax income allocation formula over three years and establishes airline-specific sales fraction.

CURRENT VERSION OF TEXT

As introduced.

(Sponsorship Updated As Of: 3/4/2011)

AN ACT modifying the allocation of the entire net income of corporation business taxpayers, amending and supplementing P.L.1945, c.162.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Section 6 of P.L.1945, c.162 (C.54:10A-6) is amended to read as follows:

6. The portion of **[**its**]** <u>a taxpayer's</u> entire net worth to be used as a measure of the tax imposed by subsection (a) of section 5 of P.L.1945, c.162 (C.54:10A-5), and the portion of its entire net income to be used as a measure of the tax imposed by subsection (c) of section 5 of P.L.1945, c.162 (C.54:10A-5), shall be determined by multiplying such entire net worth and entire net income, respectively, by an allocation factor which is the property fraction, plus twice the sales fraction plus the payroll fraction and the denominator of which is four, <u>and which, for privilege periods beginning on or after January 1, 2012, is the sum of the portions of the property fraction, the sales fraction, and the payroll fraction determined in accordance with the following schedule:</u>

<u>for privilege periods beginning on or after January 1, 2012 but before January 1, 2013, 15% of the property fraction plus 70% of the sales fraction plus 15% of the payroll fraction,</u>

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<u>for privilege periods beginning on or after January 1, 2014, 100% of the sales fraction,</u>

except as the director may determine pursuant to section 8 of P.L.1945, c.162 (C.54:10A-8), that is:

(A) The property fraction is the average value of the taxpayer's real and tangible personal property within the State during the period covered by its report divided by the average value of all the taxpayer's real and tangible personal property wherever situated during such period; provided, however, that for the purpose of determining average value, the provisions with respect to depreciation as set forth in subparagraph (F) of paragraph (2) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4) shall be taken into account for arriving at such value.

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EXPLANATION – Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and is intended to be omitted in the law.

Matter underlined <u>thus</u> is new matter.

(1) sales of its tangible personal property located within this State at the time of the receipt of or appropriation to the orders where shipments are made to points within this State,

(2) sales of tangible personal property located without the State at the time of the receipt of or appropriation to the orders where shipment is made to points within the State,

(3) (Deleted by amendment.)

(4) services performed within the State,

(5) rentals from property situated, and royalties from the use of patents or copyrights, within the State,

(6) all other business receipts (excluding dividends excluded from entire net income by paragraph (1) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4)) earned within the State,

divided by the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties and all other business receipts, whether within or without the State.

(C) The payroll fraction is the total wages, salaries and other personal service compensation, similarly computed, during such period of officers and employees within the State divided by the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's officers and employees within and without the State.

In the case of a banking corporation which maintains a regular place of business outside this State other than a statutory office, and which elects to take the exclusion from net worth provided in subsection (d) of section 4 of P.L.1945, c.162 (C.54:10A-4) or the deduction from entire net income provided in paragraph (4) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4), the allocation factor shall be computed and applied in accordance with section 6 of P.L.1945, c.162 (C.54:10A-6); provided, however, that the numerators and the denominators of the fractions described in (A), (B) or (C) above shall include all amounts attributable, directly or indirectly, to the production of the eligible net income of an international banking facility as defined in paragraph (4) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4), whether or not such amounts are otherwise attributable to this State.
(cf: P.L.2008, c.120, s.2)

2. (New section) Notwithstanding the provisions of section 6 of P.L.1945, c.162 (C.54:10A-6), the sales fraction for the transportation revenues of a taxpayer that is an airline shall be determined as the ratio of revenue miles in this State divided by total revenue miles; provided however, that if a taxpayer that is an airline is engaged in the transportation of passengers, the transportation of freight, or the rental of aircraft, the ratio under this section shall be determined by means of an average of a passenger revenue mile fraction, freight revenue mile fraction, and rental

revenue mile fraction weighted to reflect the taxpayer's relative gross receipts from passenger transportation, freight transportation, and rentals.

3. This act shall take effect immediately; provided however, that section 2 shall apply to privilege periods beginning on or after January 1, 2012.

STATEMENT

This bill modifies the corporation business tax formula used to determine the portion of the income of a corporation subject to tax by the State of New Jersey from a three-factor formula to a single sales factor formula, and establishes a specialized sales fraction formula for airlines that are subject to taxation.

Each state that imposes a corporate income tax determines the portion of the total income of a corporation subject to state tax by using formulas that measure specific activities of the corporation assigned to that state. The portion of the income of the corporation subject to tax by a state is determined by the proportion of some activity in the state to the total of such activity of the corporation.

The New Jersey corporation business tax employs a three-fraction formula that apportions a share of a corporation's income to this State based on a weighted average of the following fractions: (1) a corporation's property in this State over the corporation's total property; (2) a corporation's sales in this State over the corporation's total sales; and (3) the corporation's payroll in this State over the corporation's total payroll. Currently, the sales fraction accounts for 50% of the apportionment and the property and payroll fractions each account for 25% of the apportionment.

This bill replaces the three-factor formula with a single sales factor formula. The change is phased in over three years, beginning with privilege periods beginning on or after January 1, 2012 but before January 1, 2013. For that year, the sales fraction will account for 70% of the apportionment and the property and payroll fractions will each account for 15% of the apportionment. For privilege periods beginning on or after January 1, 2013 but before January 1, 2014, the sales fraction will increase to 90% and the property and payroll fractions will each account for 5% of the apportionment. For privilege periods beginning on or after January 1, 2014, the sales fraction will account for 100% of the apportionment.

In addition, certain industries have specialized formulas adopted by regulation which more appropriately measure taxpayers' relative activity in New Jersey than the standard formula. The sales fraction for airlines is currently determined based on the ratio of departures from New Jersey to total departures, weighted as to cost and value of aircraft by type where weighting would give a fairer, more reasonable business allocation factor.

This bill codifies a modified sales fraction formula for airlines. Under its provisions, the current sales fraction based on the ratio of departures is replaced by a sales fraction determined as the ratio of an airline's revenue miles in this State divided by an airline's total revenue miles.

FISCAL NOTE
SENATE, No. 2753
STATE OF NEW JERSEY
214th LEGISLATURE

DATED: MARCH 4, 2011

SUMMARY

Synopsis:	Phases-in single sales fraction for corporation business tax income allocation formula over three years and establishes airline-specific sales fraction.
Type of Impact:	Annual revenue loss from the corporation business tax, affecting the General Fund and the 4 percent Constitutional dedication for certain environmental programs.
Agencies Affected:	Department of the Treasury. Department of Environmental Protection.

Executive Estimate

Fiscal Impact	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
State Revenue Loss	$24,000,000	$38,500,000	$60,500,000	$87,500,000	$98,000,000

- The Executive Branch estimates that this bill would reduce corporation business tax revenues deposited into the General Fund by between $24.0 million and $98.0 million, phased in over three tax years and five fiscal years. This estimate is subject to significant fluctuations, because a very few large taxpayers may account for significant tax revenues, and Director of the Division of Taxation may negotiate the apportionment fraction based on specific circumstances.

- The Office of Legislative Services (OLS) believes the Executive estimates of annual revenue losses under this bill to be plausible and consistent with past analyses. The OLS does not have access to individual corporate returns, and has no other means by which to estimate the impact of this bill on corporate tax liability. The OLS also notes that 4 percent of any revenue loss from the corporation business tax under this bill would also impact resources Constitutionally dedicated to certain environmental mitigation programs.

Office of Legislative Services
State House Annex
P.O. Box 068
Trenton, New Jersey 08625

-OLS-

Legislative Budget and Finance Office
Phone (609) 292-8030
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BILL DESCRIPTION

Senate Bill No. 2753 of 2011 modifies the corporation business tax formula used to determine the portion of the income of a corporation subject to tax by the State of New Jersey from a three-factor formula to a single sales factor formula, and establishes a specialized sales fraction formula for airlines that are subject to taxation.

The New Jersey corporation business tax employs a three-fraction formula that apportions a share of a corporation's income to this State based on a weighted average of the following fractions: (1) a corporation's property in this State over the corporation's total property; (2) a corporation's sales in this State over the corporation's total sales; and (3) the corporation's payroll in this State over the corporation's total payroll. Currently, the sales fraction accounts for 50 percent of the apportionment and the property and payroll fractions each account for 25% percent of the apportionment.

This bill replaces the three-factor formula with a single sales factor formula. The change is phased in over three years, beginning with privilege periods beginning on or after January 1, 2012 but before January 1, 2013. For that year, the sales fraction will account for 70 percent of the apportionment and the property and payroll fractions will each account for 15 percent of the apportionment. For privilege periods beginning on or after January 1, 2013 but before January 1, 2014, the sales fraction will increase to 90 percent and the property and payroll fractions will each account for 5 percent of the apportionment. For privilege periods beginning on or after January 1, 2014, the sales fraction will account for 100 percent of the apportionment.

In addition, this bill codifies a modified sales fraction formula for airlines. Under its provisions, the current sales fraction based on the ratio of departures is replaced by a sales fraction determined as the ratio of an airline's revenue miles in this State divided by an airline's total revenue miles.

FISCAL ANALYSIS

EXECUTIVE BRANCH

The Governor's Budget Message for FY 2012 proposes the three-year phase-in of the single sales factor. Figures from the Budget-in-Brief indicate that the phase-in would reduce corporation business tax revenues deposited into the General Fund over five fiscal years by $24.0 million in FY 2012, by $38.5 million in FY 2013, by $60.5 million in FY 2014, by $87.5 million in FY 2015 and by $98.0 million in FY 2016. The total fiscal impact is similar to the Department of the Treasury and the Office of Management and Budget estimate for Senate Bill No. 1540 of 2010. That estimate also noted that the proposed tax change is subject to significant fluctuations, because a very few large taxpayers may account for significant tax revenues, and Director of the Division of Taxation may negotiate the apportionment fraction based on specific circumstances.

The Treasury's Office of Revenue and Economic Analysis estimated the Executive's revenue loss amounts based on a review of a representative set of corporation business tax filers with apportionment fractions during tax years 2004 through 2008. The analysis adjusted the weights of the sales fraction according to the phase-in provisions of the bill.

OFFICE OF LEGISLATIVE SERVICES

The OLS believes the Executive estimates of annual revenue losses under this bill to be plausible and consistent with past analyses. The OLS does not have access to individual corporate returns, and has no other means by which to estimate the impact of this bill on corporate tax liability. However, for a bill in the prior legislative session (S-2136 of 2008), the Executive estimated that *manufacturing corporations* would save $77.5 million in annual liabilities after a shift to a single sales fraction formula. In a paper published in the *Journal of State Taxation* in 2002, the authors estimated a potential $49 million revenue reduction in the New Jersey corporation business tax in 1997 under a single sales fraction formula (when that tax raised about half the amount it currently raises). These amounts are suggestive of the potential magnitude of a switch to a single sales fraction formula and consistent with the Executive's current estimates of this bill. The OLS also notes that 4 percent of any revenue loss from the corporation business tax under this bill would also impact resources Constitutionally dedicated to certain environmental mitigation programs.

The tax impact will vary depending on the specific financial characteristics of each corporation. Corporations with a large measure of sales in the State but a small share of property and payroll in the State, would face tax liability increases. On the other hand, corporations with a small measure of sales in the State (a larger proportion of sales outside the State) but a large share of property and payroll in the State, would face tax liability decreases. The following two tables illustrate these differences conceptually.

Table 1 provides an example of a corporation that would benefit from the bill. The business earns $35 million in nationwide profits. The fraction of the corporation's $35 million that is taxable by New Jersey equals 17.71 percent under current law (a quarter of the sum of twice the 0.0625 sales fraction plus the 0.25 property fraction plus the 0.3333 payroll fraction). $6,197,888 of the $35 million is thus taxable by New Jersey. Under the bill, 6.25 percent of the corporation's $35 million would be taxable by New Jersey (the 0.0625 sales fraction), or $2,187,500. The bill would thus decrease the net income taxable by New Jersey by $4,010,388, or 64.7 percent. At a tax rate of 9 percent, this would translate into $360,935 in tax savings.

Table 1: Example of Corporation Benefiting from Change

	In NJ	Total Domestic	Current Fractions	Proposed Fractions	Current Total Fraction	Proposed Total Fraction
Sales	$10,000,000	$160,000,000	0.0625	0.0625		
Property	$60,000,000	$240,000,000	0.2500	0.0000	0.1771	0.0625
Payroll	$25,000,000	$75,000,000	0.3333	0.0000		
					NJ Taxable Income	
Taxable Net Income		$35,000,000			$6,197,888	$2,187,500

Table 2 provides an example of a corporation that the legislation would affect adversely. Again, the manufacturer earns $35 million in nationwide profits. The fraction of the corporation's $35 million that is taxable by New Jersey equals 39.58 percent under current law (a quarter of the sum of twice the 0.5 sales fraction plus the 0.25 property fraction plus the 0.3333 payroll fraction). $13,854,138 of the $35 million is thus taxable by New Jersey. Under the bill, 50 percent of the corporation's $35 million in profits would be taxable by New Jersey (the 0.5000 sales fraction), or $17,500,000. The bill would thus increase the net income taxable by

New Jersey by $3,645,862, or 26.3 percent. At a tax rate of 9 percent, this would translate into $360,935 in additional taxes.

Table 2: Example of Corporation Harmed by Change

	In NJ	Total Domestic	Current Fractions	Proposed Fractions	Current Total Fraction	Proposed Total Fraction
Sales	$50,000,000	$100,000,000	0.5000	0.5000		
Property	$25,000,000	$100,000,000	0.2500	0.0000	0.3958	0.500
Payroll	$20,000,000	$60,000,000	0.3333	0.0000		
					NJ Taxable Income	
Taxable Net Income		$35,000,000			$13,854,138	$17,500,000

For some corporations, the specific characteristics may result in no net tax change under this bill. However, the general consensus of current and past analyses of a single sales fraction formula is that the overall State impact would see corporation business tax liabilities decline. Lastly, the OLS has no data which would allow an analysis of the section of this bill that changes the sales fraction formula for airlines.

Section: *Revenue, Finance and Appropriations*

Analyst: *Martin Poethke*
Lead Fiscal Analyst

Approved: *David J. Rosen*
Legislative Budget and Finance Officer

This fiscal note has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).

ASSEMBLY, No. 3869

STATE OF NEW JERSEY

214th LEGISLATURE

INTRODUCED FEBRUARY 22, 2011

Sponsored by:
Assemblyman LOUIS D. GREENWALD
District 6 (Camden)
Assemblyman MATTHEW W. MILAM
District 1 (Cape May, Atlantic and Cumberland)
Assemblywoman L. GRACE SPENCER
District 29 (Essex and Union)
Assemblywoman NELLIE POU
District 35 (Bergen and Passaic)

Co-Sponsored by:
Assemblymen Conaway and Conners

SYNOPSIS

Phases-in single sales fraction for corporation business tax income allocation formula over three years and establishes airline-specific sales fraction.

CURRENT VERSION OF TEXT

As introduced.

(Sponsorship Updated As Of: 3/4/2011)

AN ACT modifying the allocation of the entire net income of corporation business taxpayers, amending and supplementing P.L.1945, c.162.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Section 6 of P.L.1945, c.162 (C.54:10A-6) is amended to read as follows:

6. The portion of **[**its**]** <u>a taxpayer's</u> entire net worth to be used as a measure of the tax imposed by subsection (a) of section 5 of P.L.1945, c.162 (C.54:10A-5), and the portion of its entire net income to be used as a measure of the tax imposed by subsection (c) of section 5 of P.L.1945, c.162 (C.54:10A-5), shall be determined by multiplying such entire net worth and entire net income, respectively, by an allocation factor which is the property fraction, plus twice the sales fraction plus the payroll fraction and the denominator of which is four, <u>and which, for privilege periods beginning on or after January 1, 2012, is the sum of the portions of the property fraction, the sales fraction, and the payroll fraction determined in accordance with the following schedule:</u>

<u>for privilege periods beginning on or after January 1, 2012 but before January 1, 2013, 15% of the property fraction plus 70% of the sales fraction plus 15% of the payroll fraction,</u>

<u>for privilege periods beginning on or after January 1, 2013 but before January 1, 2014, 5% of the property fraction plus 90% of the sales fraction plus 5% of the payroll fraction, and</u>

<u>for privilege periods beginning on or after January 1, 2014, 100% of the sales fraction,</u>

except as the director may determine pursuant to section 8 of P.L.1945, c.162 (C.54:10A-8), that is:

(A) The property fraction is the average value of the taxpayer's real and tangible personal property within the State during the period covered by its report divided by the average value of all the taxpayer's real and tangible personal property wherever situated during such period; provided, however, that for the purpose of determining average value, the provisions with respect to depreciation as set forth in subparagraph (F) of paragraph (2) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4) shall be taken into account for arriving at such value.

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EXPLANATION – Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and is intended to be omitted in the law.

Matter underlined <u>thus</u> is new matter.

(1) sales of its tangible personal property located within this State at the time of the receipt of or appropriation to the orders where shipments are made to points within this State,

(2) sales of tangible personal property located without the State at the time of the receipt of or appropriation to the orders where shipment is made to points within the State,

(3) (Deleted by amendment.)

(4) services performed within the State,

(5) rentals from property situated, and royalties from the use of patents or copyrights, within the State,

(6) all other business receipts (excluding dividends excluded from entire net income by paragraph (1) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4)) earned within the State,

divided by the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties and all other business receipts, whether within or without the State.

(C) The payroll fraction is the total wages, salaries and other personal service compensation, similarly computed, during such period of officers and employees within the State divided by the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's officers and employees within and without the State.

In the case of a banking corporation which maintains a regular place of business outside this State other than a statutory office, and which elects to take the exclusion from net worth provided in subsection (d) of section 4 of P.L.1945, c.162 (C.54:10A-4) or the deduction from entire net income provided in paragraph (4) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4), the allocation factor shall be computed and applied in accordance with section 6 of P.L.1945, c.162 (C.54:10A-6); provided, however, that the numerators and the denominators of the fractions described in (A), (B) or (C) above shall include all amounts attributable, directly or indirectly, to the production of the eligible net income of an international banking facility as defined in paragraph (4) of subsection (k) of section 4 of P.L.1945, c.162 (C.54:10A-4), whether or not such amounts are otherwise attributable to this State.
(cf: P.L.2008, c.120, s.2)

2. (New section) Notwithstanding the provisions of section 6 of P.L.1945, c.162 (C.54:10A-6), the sales fraction for the transportation revenues of a taxpayer that is an airline shall be determined as the ratio of revenue miles in this State divided by total revenue miles; provided however, that if a taxpayer that is an airline is engaged in the transportation of passengers, the transportation of freight, or the rental of aircraft, the ratio under this section shall be determined by means of an average of a passenger revenue mile fraction, freight revenue mile fraction, and rental

revenue mile fraction weighted to reflect the taxpayer's relative gross receipts from passenger transportation, freight transportation, and rentals.

3. This act shall take effect immediately; provided however, that section 2 shall apply to privilege periods beginning on or after January 1, 2012.

STATEMENT

This bill modifies the corporation business tax formula used to determine the portion of the income of a corporation subject to tax by the State of New Jersey from a three-factor formula to a single sales factor formula, and establishes a specialized sales fraction formula for airlines that are subject to taxation.

Each state that imposes a corporate income tax determines the portion of the total income of a corporation subject to state tax by using formulas that measure specific activities of the corporation assigned to that state. The portion of the income of the corporation subject to tax by a state is determined by the proportion of some activity in the state to the total of such activity of the corporation.

The New Jersey corporation business tax employs a three-fraction formula that apportions a share of a corporation's income to this State based on a weighted average of the following fractions: (1) a corporation's property in this State over the corporation's total property; (2) a corporation's sales in this State over the corporation's total sales; and (3) the corporation's payroll in this State over the corporation's total payroll. Currently, the sales fraction accounts for 50% of the apportionment and the property and payroll fractions each account for 25% of the apportionment.

This bill replaces the three-factor formula with a single sales factor formula. The change is phased in over three years, beginning with privilege periods beginning on or after January 1, 2012 but before January 1, 2013. For that year, the sales fraction will account for 70% of the apportionment and the property and payroll fractions will each account for 15% of the apportionment. For privilege periods beginning on or after January 1, 2013 but before January 1, 2014, the sales fraction will increase to 90% and the property and payroll fractions will each account for 5% of the apportionment. For privilege periods beginning on or after January 1, 2014, the sales fraction will account for 100% of the apportionment.

In addition, certain industries have specialized formulas adopted by regulation which more appropriately measure taxpayers' relative activity in New Jersey than the standard formula. The sales fraction for airlines is currently determined based on the ratio of departures from New Jersey to total departures, weighted as to cost and value of aircraft by type where weighting would give a fairer, more reasonable business allocation factor.

This bill codifies a modified sales fraction formula for airlines. Under its provisions, the current sales fraction based on the ratio of departures is replaced by a sales fraction determined as the ratio of an airline's revenue miles in this State divided by an airline's total revenue miles.

FISCAL NOTE

ASSEMBLY, No. 3869

STATE OF NEW JERSEY
214th LEGISLATURE

DATED: MARCH 31, 2011

SUMMARY

Synopsis:	Phases-in single sales fraction for corporation business tax income allocation formula over three years and establishes airline-specific sales fraction.
Type of Impact:	Annual revenue loss from the corporation business tax, affecting the General Fund and the 4 percent Constitutional dedication for certain environmental programs.
Agencies Affected:	Department of the Treasury. Department of Environmental Protection.

Executive Estimate

Fiscal Impact	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
State Revenue Loss	$24,000,000	$38,500,000	$60,500,000	$87,500,000	$98,000,000

- The Executive Branch estimates that this bill would reduce corporation business tax revenues deposited into the General Fund by between $24.0 million and $98.0 million, phased in over three tax years and five fiscal years. This estimate is subject to significant fluctuations, because a very few large taxpayers may account for significant tax revenues, and Director of the Division of Taxation may negotiate the apportionment fraction based on specific circumstances.

- The Office of Legislative Services (OLS) believes the Executive estimates of annual revenue losses under this bill to be plausible and consistent with past analyses. The OLS does not have access to individual corporate returns, and has no other means by which to estimate the impact of this bill on corporate tax liability. The OLS also notes that 4 percent of any revenue loss from the corporation business tax (CBT) under this bill would also impact resources Constitutionally dedicated to certain environmental mitigation programs.

BILL DESCRIPTION

Assembly Bill No. 3869 of 2011 modifies the corporation business tax formula used to determine the portion of the income of a corporation subject to tax by the State of New Jersey from a three-factor formula to a single sales factor formula, and establishes a specialized sales fraction formula for airlines that are subject to taxation.

The New Jersey CBT employs a three-fraction formula that apportions a share of a corporation's income to this State based on a weighted average of the following fractions: (1) a corporation's property in this State over the corporation's total property; (2) a corporation's sales in this State over the corporation's total sales; and (3) the corporation's payroll in this State over the corporation's total payroll. Currently, the sales fraction accounts for 50 percent of the apportionment and the property and payroll fractions each account for 25 percent of the apportionment.

This bill replaces the three-factor formula with a single sales factor formula. The change is phased in over three years, beginning with privilege periods beginning on or after January 1, 2012 but before January 1, 2013. For that year, the sales fraction will account for 70 percent of the apportionment and the property and payroll fractions will each account for 15 percent of the apportionment. For privilege periods beginning on or after January 1, 2013 but before January 1, 2014, the sales fraction will increase to 90 percent and the property and payroll fractions will each account for 5 percent of the apportionment. For privilege periods beginning on or after January 1, 2014, the sales fraction will account for 100 percent of the apportionment.

In addition, this bill codifies a modified sales fraction formula for airlines. Under its provisions, the current sales fraction based on the ratio of departures is replaced by a sales fraction determined as the ratio of an airline's revenue miles in this State divided by an airline's total revenue miles.

FISCAL ANALYSIS

EXECUTIVE BRANCH

The Governor's Budget Message for FY 2012 proposes the three-year phase-in of the single sales factor. Figures from the Budget-in-Brief indicate that the phase-in would reduce CBT revenues deposited into the General Fund over five fiscal years by $24.0 million in FY 2012, by $38.5 million in FY 2013, by $60.5 million in FY 2014, by $87.5 million in FY 2015 and by $98.0 million in FY 2016. The total fiscal impact is similar to the Department of the Treasury and the Office of Management and Budget estimate for Senate Bill No. 1540 of 2010. That estimate also noted that the proposed tax change is subject to significant fluctuations, because a very few large taxpayers may account for significant tax revenues, and Director of the Division of Taxation may negotiate the apportionment fraction based on specific circumstances.

The Treasury's Office of Revenue and Economic Analysis estimated the Executive's revenue loss amounts based on a review of a representative set of CBT filers with apportionment fractions during tax years 2004 through 2008. The analysis adjusted the weights of the sales fraction according to the phase-in provisions of the bill.

OFFICE OF LEGISLATIVE SERVICES

The OLS believes the Executive estimates of annual revenue losses under this bill to be plausible and consistent with past analyses. The OLS does not have access to individual corporate returns, and has no other means by which to estimate the impact of this bill on corporate tax liability. However, for a bill in the prior legislative session (S-2136 of 2008), the Executive estimated that *manufacturing corporations* would save $77.5 million in annual liabilities after a shift to a single sales fraction formula. In a paper published in the *Journal of State Taxation* in 2002, the authors estimated a potential $49 million revenue reduction in the New Jersey CBT in 1997 under a single sales fraction formula (when that tax raised about half the amount it currently raises). These amounts are suggestive of the potential magnitude of a switch to a single sales fraction formula and consistent with the Executive's current estimates of this bill. The OLS also notes that 4 percent of any revenue loss from the CBT under this bill would also impact resources Constitutionally dedicated to certain environmental mitigation programs.

The tax impact will vary depending on the specific financial characteristics of each corporation. Corporations with a large measure of sales in the State but a small share of property and payroll in the State, would face tax liability increases. On the other hand, corporations with a small measure of sales in the State (a larger proportion of sales outside the State) but a large share of property and payroll in the State, would face tax liability decreases. The following two tables illustrate these differences conceptually.

Table 1 provides an example of a corporation that would benefit from the bill. The business earns $35 million in nationwide profits. The fraction of the corporation's $35 million that is taxable by New Jersey equals 17.71 percent under current law (a quarter of the sum of twice the 0.0625 sales fraction plus the 0.25 property fraction plus the 0.3333 payroll fraction). $6,197,888 of the $35 million is thus taxable by New Jersey. Under the bill, 6.25 percent of the corporation's $35 million would be taxable by New Jersey (the 0.0625 sales fraction), or $2,187,500. The bill would thus decrease the net income taxable by New Jersey by $4,010,388, or 64.7 percent. At a tax rate of 9 percent, this would translate into $360,935 in tax savings.

<table>
<tr><th colspan="7">Table 1: Example of Corporation Benefiting from Change</th></tr>
<tr><th></th><th>In NJ</th><th>Total Domestic</th><th>Current Fractions</th><th>Proposed Fractions</th><th>Current Total Fraction</th><th>Proposed Total Fraction</th></tr>
<tr><td>Sales</td><td>$10,000,000</td><td>$160,000,000</td><td>0.0625</td><td>0.0625</td><td rowspan="3">0.1771</td><td rowspan="3">0.0625</td></tr>
<tr><td>Property</td><td>$60,000,000</td><td>$240,000,000</td><td>0.2500</td><td>0.0000</td></tr>
<tr><td>Payroll</td><td>$25,000,000</td><td>$75,000,000</td><td>0.3333</td><td>0.0000</td></tr>
<tr><td rowspan="2">Taxable Net Income</td><td rowspan="2"></td><td rowspan="2">$35,000,000</td><td rowspan="2" colspan="2"></td><th colspan="2">NJ Taxable Income</th></tr>
<tr><td>$6,197,888</td><td>$2,187,500</td></tr>
</table>

Table 2 provides an example of a corporation that the legislation would affect adversely. Again, the manufacturer earns $35 million in nationwide profits. The fraction of the corporation's $35 million that is taxable by New Jersey equals 39.58 percent under current law (a quarter of the sum of twice the 0.5 sales fraction plus the 0.25 property fraction plus the 0.3333 payroll fraction). $13,854,138 of the $35 million is thus taxable by New Jersey. Under the bill, 50 percent of the corporation's $35 million in profits would be taxable by New Jersey (the 0.5000 sales fraction), or $17,500,000. The bill would thus increase the net income taxable by New Jersey by $3,645,862, or 26.3 percent. At a tax rate of 9 percent, this would translate into $360,935 in additional taxes.

<table>
<tr><th colspan="7">Table 2: Example of Corporation Harmed by Change</th></tr>
<tr><th></th><th>In NJ</th><th>Total Domestic</th><th>Current Fractions</th><th>Proposed Fractions</th><th>Current Total Fraction</th><th>Proposed Total Fraction</th></tr>
<tr><td>Sales</td><td>$50,000,000</td><td>$100,000,000</td><td>0.5000</td><td>0.5000</td><td rowspan="3">0.3958</td><td rowspan="3">0.500</td></tr>
<tr><td>Property</td><td>$25,000,000</td><td>$100,000,000</td><td>0.2500</td><td>0.0000</td></tr>
<tr><td>Payroll</td><td>$20,000,000</td><td>$60,000,000</td><td>0.3333</td><td>0.0000</td></tr>
<tr><td rowspan="2">Taxable Net Income</td><td rowspan="2"></td><td rowspan="2">$35,000,000</td><td rowspan="2" colspan="2"></td><th colspan="2">NJ Taxable Income</th></tr>
<tr><td>$13,854,138</td><td>$17,500,000</td></tr>
</table>

For some corporations, the specific characteristics may result in no net tax change under this bill. However, the general consensus of current and past analyses of a single sales fraction formula is that the overall State impact would see CBT liabilities decline. Lastly, the OLS has no data which would allow an analysis of the section of this bill that changes the sales fraction formula for airlines.

Section: *Revenue, Finance and Appropriations*

Analyst: *Martin Poethke*
Lead Fiscal Analyst

Approved: *David J. Rosen*
Legislative Budget and Finance Officer

This fiscal note has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).

Governor Chris Christie Takes Action on Budget Proposals to Provide Tax Relief and Spur Economic Growth

Thursday, April 28, 2011 Tags: Education

Signs Two Bills Implementing Key Proposals from Fiscal Year 2012 Budget

Trenton, NJ – Affirming his commitment to creating jobs for New Jersey families, Governor Chris Christie today signed Senate Bills 2753 and 2754 to provide common sense, targeted tax relief to improve the state's business climate and spur economic growth. In his Fiscal Year 2012 Budget proposal, Governor Christie proposed a $200 million package of job-creating tax reforms and incentives to boost New Jersey's economy. The Governor has stressed the importance of reforms to break from the state's hostile climate towards business expansion and job growth, while maintaining fiscal discipline over state spending and adhering a constitutionally-balanced budget. The legislation signed today implements key proposals advanced by Governor Christie in that effort.

"Today, we are providing critical tax reforms and incentives to boost our economy, foster job growth and opportunity for New Jersey families, and putting a down payment on a more prosperous future for our state," said Governor Christie. "We must continue to take action to lay a sustainable fiscal path for New Jersey, ensure that tax cuts are done in the context of a balanced budget and implement reform in the most efficient manner possible. I'm pleased that there is a bipartisan consensus in New Jersey around the need to improve our state's oppressive business tax climate through tax policy changes and common sense regulatory reform, and I look forward to pursuing more needed reforms with the legislature."

S-2753 will change the corporate business tax formula from a three-factor formula to a single sales factor formula, as well as create a modified sales fraction formula for airlines. S-2754 will permit taxpayers to net gains and losses from certain business-related categories of gross incomes and allow those losses to be carried forward for up to twenty years.

Since Governor Christie took office, the Administration has been committed to bringing real, bipartisan solutions to the critical challenges faced by the state. These include closing an $11 billion budget deficit without tax increases, passing Cap 2.0 to bring real property tax relief, and taking major steps toward pension and benefit reform. Last fall, Governor Christie called on the legislature to deliver for New Jersey families by acting on his proposals, including his "took kit" legislation to give local governments the tools to control costs and limit property taxes.

Additionally, the Administration has continued to advance policies to further improve New Jersey's business climate by sunsetting the corporate business tax surcharge, signing new, robust business attraction legislation, and protecting businesses from an average $400 per employee, or 52% increase in the unemployment insurance payroll tax. Those policies, coupled with recent activities like the Governor's 'Creating Jersey Jobs Summit,' the Lt. Governor's '100 Businesses' initiative, and the recent Illinois ad campaign to promote New Jersey as a destination for businesses, all demonstrate that New Jersey is well-positioned for business expansion, economic growth and job creation as our economy recovers.

Prime Sponsors of S-2753 included Senators Jim Whelan (D-Atlantic), Fred Madden (D-Gloucester), and Steven Oroho (R- Sussex/Hunterdon/Morris). Assembly sponsors included Assembly member Lou Greenwald (D-Camden), Matthew Milam (D- Cumberland/Atlantic/Cape May), Grace Spencer (D-Essex), and Nellie Pou (D-Passaic). Prime sponsors of S-2754 included Senators Barbara Buono (D-Middlesex), Linda Greenstein (D-Middlesex/Mercer) and Steven Oroho (R-Sussex/Hunterdon/Morris). Assembly sponsors included Assembly members Lou Greenwald (D-Camden), Peter Barnes (D-Middlesex), Gordon Johnson (D-Bergen), and Nellie Pou (D-Passaic).

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