

54:10A-4

LEGISLATIVE HISTORY CHECKLIST
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(Subchapter S corporations-- exempt
from corporations business tax)

NJSA: 54:10A-4

LAWS OF: 1993 **CHAPTER:** 173

BILL NO: A273/A1870

SPONSOR(S) Penn and others

DATE INTRODUCED: Pre-filed

COMMITTEE: **ASSEMBLY:** Appropriations
SENATE: —

AMENDED DURING PASSAGE: No Assembly Committee Substitute enacted

DATE OF PASSAGE: **ASSEMBLY:** June 10, 1993
SENATE: June 17, 1993

DATE OF APPROVAL: July 7, 1993

FOLLOWING STATEMENTS ARE ATTACHED IF AVAILABLE:

SPONSOR STATEMENT: Yes

COMMITTEE STATEMENT: **ASSEMBLY:** Yes
SENATE: No Joint Legislative Committee on
Economic Recovery--also attached

FISCAL NOTE: Yes

VETO MESSAGE: No

MESSAGE ON SIGNING: No

FOLLOWING WERE PRINTED:

REPORTS: No

HEARINGS: Yes

974.90 New Jersey. Legislative. Joint Legislative Committee on Economic
E19 Recovery.
1993 Committee meeting on attracting business., held 20-17-93.
Trenton, 1993.
[see especially vol. I--pp 22-33, vol. II, pp. 5, 51]
(over)

any

974.90 New Jersey. Legislature. Joint Legislative Committee on Economic
E19 Recovery.
1993a Committee meeting to the state's ability to retain and attract
business, held 1-28-93. Trenton, 1993.
[see pp. 63-64]

See newspaper clippings--attached:

KBG:pp

ASSEMBLY COMMITTEE SUBSTITUTE FOR
ASSEMBLY, Nos. 273 and 1870

STATE OF NEW JERSEY

ADOPTED JUNE 3, 1993

Sponsored by Assemblymen PENN, KAVANAUGH
and Assemblywoman DERMAN

1 AN ACT concerning the taxation of certain corporations, the
2 shareholders of those corporations, and tax information
3 reporting, amending and supplementing P.L.1945, c.162, and
4 Title 54A of the New Jersey Statutes.

5

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

8 1. Section 4 of P.L.1945, c.162 (C.54:10A-4) is amended to
9 read as follows:

10 4. For the purposes of this act, unless the context requires a
11 different meaning:

12 (a) "Commissioner" shall mean the Director of the Division of
13 Taxation of the State Department of the Treasury.

14 (b) "Allocation factor" shall mean the proportionate part of a
15 taxpayer's net worth or entire net income used to determine a
16 measure of its tax under this act.

17 (c) "Corporation" shall mean any corporation, joint-stock
18 company or association and any business conducted by a trustee
19 or trustees wherein interest or ownership is evidenced by a
20 certificate of interest or ownership or similar written instrument.

21 (d) "Net worth" shall mean the aggregate of the values
22 disclosed by the books of the corporation for (1) issued and
23 outstanding capital stock, (2) paid-in or capital surplus, (3) earned
24 surplus and undivided profits, and (4) surplus reserves which can
25 reasonably be expected to accrue to holders or owners of
26 equitable shares, not including reasonable valuation reserves,
27 such as reserves for depreciation or obsolescence or depletion.
28 Notwithstanding the foregoing, net worth shall not include any
29 deduction for the amount of the excess depreciation described in
30 paragraph (2)(F) of subsection (k) of this section. The foregoing
31 aggregate of values shall be reduced by 50% of the amount
32 disclosed by the books of the corporation for investment in the
33 capital stock of one or more subsidiaries, which investment is
34 defined as ownership (1) of at least 80% of the total combined
35 voting power of all classes of stock of the subsidiary entitled to
36 vote and (2) of at least 80% of the total number of shares of all
37 other classes of stock except nonvoting stock which is limited and
38 preferred as to dividends. In the case of investment in an entity
39 organized under the laws of a foreign country, the foregoing
40 requisite degree of ownership shall effect a like reduction of such
41 investment from net worth of the taxpayer, if the foreign entity
42 is considered a corporation for any purpose under the United

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.

1 States federal income tax laws, such as (but not by way of sole
2 examples) for the purpose of supplying deemed paid foreign tax
3 credits or for the purpose of status as a controlled foreign
4 corporation. In calculating the net worth of a taxpayer entitled
5 to reduction for investment in subsidiaries, the amount of
6 liabilities of the taxpayer shall be reduced by such proportion of
7 the liabilities as corresponds to the ratio which the excluded
8 portion of the subsidiary values bears to the total assets of the
9 taxpayer.

10 In the case of banking corporations which have international
11 banking facilities as defined in subsection (n), the foregoing
12 aggregate of values shall also be reduced by retained earnings of
13 the international banking facility. Retained earnings means the
14 earnings accumulated over the life of such facility and shall not
15 include the distributive share of dividends paid and federal
16 income taxes paid or payable during the tax year.

17 If in the opinion of the commissioner, the corporation's books
18 do not disclose fair valuations the commissioner may make a
19 reasonable determination of the net worth which, in his opinion,
20 would reflect the fair value of the assets, exclusive of subsidiary
21 investments as defined aforesaid, carried on the books of the
22 corporation, in accordance with sound accounting principles, and
23 such determination shall be used as net worth for the purpose of
24 this act.

25 (e) "Indebtedness owing directly or indirectly" shall include,
26 without limitation thereto, all indebtedness owing to any
27 stockholder or shareholder and to members of his immediate
28 family where a stockholder and members of his immediate family
29 together or in the aggregate own 10% or more of the aggregate
30 outstanding shares of the taxpayer's capital stock of all classes.

31 (f) "Investment company" shall mean any corporation whose
32 business during the period covered by its report consisted, to the
33 extent of at least 90% thereof of holding, investing and
34 reinvesting in stocks, bonds, notes, mortgages, debentures,
35 patents, patent rights and other securities for its own account,
36 but this shall not include any corporation which: (1) is a merchant
37 or a dealer of stocks, bonds and other securities, regularly
38 engaged in buying the same and selling the same to customers; or
39 (2) had less than 90% of its average gross assets in New Jersey, at
40 cost, invested in stocks, bonds, debentures, mortgages, notes,
41 patents, patent rights or other securities or consisting of cash on
42 deposit during the period covered by its report; or (3) is a banking
43 corporation or a financial business corporation as defined in the
44 Corporation Business Tax Act.

45 (g) "Regulated investment company" shall mean any
46 corporation which for a period covered by its report, is registered
47 and regulated under the Investment Company Act of 1940 (54
48 Stat. 789), as amended.

49 (h) "Taxpayer" shall mean any corporation required to report
50 or to pay taxes, interest or penalties under this act.

51 (i) "Fiscal year" shall mean an accounting period ending on any
52 day other than the last day of December on the basis of which the
53 taxpayer is required to report for federal income tax purposes.

54 (j) Except as herein provided, "privilege period" shall mean the

1 calendar or fiscal accounting period for which a tax is payable
2 under this act.

3 (k) "Entire net income" shall mean total net income from all
4 sources, whether within or without the United States, and shall
5 include the gain derived from the employment of capital or labor,
6 or from both combined, as well as profit gained through a sale or
7 conversion of capital assets. For the purpose of this act, the
8 amount of a taxpayer's entire net income shall be deemed prima
9 facie to be equal in amount to the taxable income, before net
10 operating loss deduction and special deductions, which the
11 taxpayer is required to report to the United States Treasury
12 Department for the purpose of computing its federal income tax;
13 provided, however, that in the determination of such entire net
14 income,

15 (1) Entire net income shall exclude for the periods set forth in
16 paragraph (2)(F)(i) of this subsection, any amount, except with
17 respect to qualified mass commuting vehicles as described in
18 section 168(f)(8)(D)(v) of the Internal Revenue Code as in effect
19 immediately prior to January 1, 1984, which is included in a
20 taxpayer's federal taxable income solely as a result of an
21 election made pursuant to the provisions of paragraph (8) of that
22 section.

23 (2) Entire net income shall be determined without the
24 exclusion, deduction or credit of:

25 (A) The amount of any specific exemption or credit allowed in
26 any law of the United States imposing any tax on or measured by
27 the income of corporations;

28 (B) Any part of any income from dividends or interest on any
29 kind of stock, securities or indebtedness, except as provided in
30 paragraph (5) of subsection (k) of this section;

31 (C) Taxes paid or accrued to the United States, a possession or
32 territory of the United States, a state, a political subdivision
33 thereof, or the District of Columbia on or measured by profits or
34 income, or business presence or business activity, or the tax
35 imposed by this act, or any tax paid or accrued with respect to
36 subsidiary dividends excluded from entire net income as provided
37 in paragraph (5) of subsection (k) of this section;

38 (D) (Deleted by amendment, P.L.1985, c.143.)

39 (E) 90% of interest on indebtedness owing directly or
40 indirectly to holders of 10% or more of the aggregate outstanding
41 shares of the taxpayer's capital stock of all classes; except that
42 such interest may, in any event, be deducted:

43 (i) Up to an amount not exceeding \$1,000.00;

44 (ii) In full to the extent that it relates to bonds or other
45 evidences of indebtedness issued, with stock, pursuant to a bona
46 fide plan of reorganization, to persons, who, prior to such
47 reorganization, were bona fide creditors of the corporation or its
48 predecessors, but were not stockholders or shareholders thereof;

49 (iii) In full to the extent that it relates to debt of a financial
50 business corporation owed to an affiliate corporation; provided
51 that such interest rate does not exceed 2% over prime rate; the
52 prime rate to be determined by the Commissioner of Banking;

53 (iv) In full to the extent that it relates to financing of motor
54 vehicle inventory held for sale to customers; provided said

1 indebtedness is owed to a taxpayer customarily and routinely
2 providing this type of financing;

3 (v) In full to the extent it relates to debt of a banking
4 corporation to a bank holding company, of which the banking
5 corporation is a subsidiary, or to a debt of a banking corporation
6 to another banking corporation with respect to federal funds
7 transactions governed by section 23A of the Federal Reserve Act
8 (12 U.S.C. §371c.) when both banking corporations are
9 subsidiaries of the same bank holding company, as defined in 12
10 U.S.C. §1841.

11 (F)(i) The amount by which depreciation reported to the United
12 States Treasury Department for property placed in service on and
13 after January 1, 1981, for purposes of computing federal taxable
14 income in accordance with section 168 of the Internal Revenue
15 Code in effect after December 31, 1980, exceeds the amount of
16 depreciation determined in accordance with the Internal Revenue
17 Code provisions in effect prior to January 1, 1981, but only with
18 respect to a taxpayer's accounting period ending after December
19 31, 1981; provided, however, that where a taxpayer's accounting
20 period begins in 1981 and ends in 1982, no modification shall be
21 required with respect to this paragraph (F) for the report filed for
22 such period with respect to property placed in service during that
23 part of the accounting period which occurs in 1981.

24 (ii) For the periods set forth in subparagraph (F)(i) of this
25 subsection, any amount, except with respect to qualified mass
26 commuting vehicles as described in section 168(f)(8)(D)(v) of the
27 Internal Revenue Code as in effect immediately prior to January
28 1, 1984, which the taxpayer claimed as a deduction in computing
29 federal income tax pursuant to a qualified lease agreement under
30 paragraph (8) of that section.

31 The director shall promulgate rules and regulations necessary
32 to carry out the provisions of this section, which rules shall
33 provide, among others, the manner in which the remaining life of
34 property shall be reported.

35 (G) (1) The amount of any civil, civil administrative, or
36 criminal penalty or fine, including a penalty or fine under an
37 administrative consent order, assessed and collected for a
38 violation of a State or federal environmental law, an
39 administrative consent order, or an environmental ordinance or
40 resolution of a local governmental entity, and any interest earned
41 on the penalty or fine, and any economic benefits having accrued
42 to the violator as a result of a violation, which benefits are
43 assessed and recovered in a civil, civil administrative, or criminal
44 action, or pursuant to an administrative consent order. The
45 provisions of this paragraph shall not apply to a penalty or fine
46 assessed or collected for a violation of a State or federal
47 environmental law, or local environmental ordinance or
48 resolution, if the penalty or fine was for a violation that resulted
49 from fire, riot, sabotage, flood, storm event, natural cause, or
50 other act of God beyond the reasonable control of the violator, or
51 caused by an act or omission of a person who was outside the
52 reasonable control of the violator.

53 (2) The amount of treble damages paid to the Department of
54 Environmental Protection pursuant to subsection a. of section 7

1 of P.L.1976, c.141 (C.58:10-23.11f) for costs incurred by the
2 department in removing, or arranging for the removal of, an
3 unauthorized discharge upon failure of the discharger to comply
4 with a directive from the department to remove, or arrange for
5 the removal of, the discharge.

6 (3) The commissioner may, whenever necessary to properly
7 reflect the entire net income of any taxpayer, determine the year
8 or period in which any item of income or deduction shall be
9 included, without being limited to the method of accounting
10 employed by the taxpayer.

11 (4) There shall be allowed as a deduction from entire net
12 income of a banking corporation, to the extent not deductible in
13 determining federal taxable income, the eligible net income of an
14 international banking facility determined as follows:

15 (A) The eligible net income of an international banking facility
16 shall be the amount remaining after subtracting from the eligible
17 gross income the applicable expenses;

18 (B) Eligible gross income shall be the gross income derived by
19 an international banking facility, which shall include, but not be
20 limited to, gross income derived from:

21 (i) Making, arranging for, placing or carrying loans to foreign
22 persons, provided, however, that in the case of a foreign person
23 which is an individual, or which is a foreign branch of a domestic
24 corporation (other than a bank), or which is a foreign corporation
25 or foreign partnership which is controlled by one or more
26 domestic corporations (other than banks), domestic partnerships
27 or resident individuals, all the proceeds of the loan are for use
28 outside of the United States;

29 (ii) Making or placing deposits with foreign persons which are
30 banks or foreign branches of banks (including foreign subsidiaries)
31 or foreign branches of the taxpayers or with other international
32 banking facilities; or

33 (iii) Entering into foreign exchange trading or hedging
34 transactions related to any of the transactions described in this
35 paragraph;

36 (iv) Such other activities as an international banking facility
37 may, from time to time, be authorized to engage in;

38 (C) Applicable expenses shall be any expense or other
39 deductions attributable, directly or indirectly, to the eligible
40 gross income described in subparagraph (B) of this paragraph.

41 (5) Entire net income shall exclude 100% of dividends which
42 were included in computing such taxable income for federal
43 income tax purposes, paid to the taxpayer by one or more
44 subsidiaries owned by the taxpayer to the extent of the 80% or
45 more ownership of investment described in subsection (d) of this
46 section. With respect to other dividends, entire net income shall
47 not include 50% of the total included in computing such taxable
48 income for federal income tax purposes.

49 (6)(A) Net operating loss deduction. There shall be allowed as a
50 deduction for the taxable year the net operating loss carryover to
51 that year.

52 (B) Net operating loss carryover. A net operating loss for any
53 taxable year ending after June 30, 1984 shall be a net operating
54 loss carryover to each of the seven years following the year of

1 the loss. The entire amount of the net operating loss for any
2 taxable year (the "loss year") shall be carried to the earliest of
3 the taxable years to which the loss may be carried. The portion
4 of the loss which shall be carried to each of the other taxable
5 years shall be the excess, if any, of the amount of the loss over
6 the sum of the entire net income, computed without the
7 exclusions permitted in paragraphs (4) and (5) of this subsection
8 or the net operating loss deduction provided by subparagraph (A)
9 of this paragraph, for each of the prior taxable years to which the
10 loss may be carried.

11 (C) Net operating loss. For purposes of this paragraph the term
12 "net operating loss" means the excess of the deductions over the
13 gross income used in computing entire net income without the net
14 operating loss deduction provided for in subparagraph (A) of this
15 paragraph and the exclusions in paragraphs (4) and (5) of this
16 subsection.

17 (D) Change in ownership. Where there is a change in 50% or
18 more of the ownership of a corporation because of redemption or
19 sale of stock and the corporation changes the trade or business
20 giving rise to the loss, no net operating loss sustained before the
21 changes may be carried over to be deducted from income earned
22 after such changes. In addition where the facts support the
23 premise that the corporation was acquired under any
24 circumstances for the primary purpose of the use of its net
25 operating loss carryover, the director may disallow the carryover.

26 (l) "Real estate investment trust" shall mean any corporation,
27 trust or association qualifying and electing to be taxed as a real
28 estate investment trust under federal law.

29 (m) "Financial business corporation" shall mean any corporate
30 enterprise which is (1) in substantial competition with the
31 business of national banks and which (2) employs moneyed capital
32 with the object of making profit by its use as money, through
33 discounting and negotiating promissory notes, drafts, bills of
34 exchange and other evidences of debt; buying and selling
35 exchange; making of or dealing in secured or unsecured loans and
36 discounts; dealing in securities and shares of corporate stock by
37 purchasing and selling such securities and stock without recourse,
38 solely upon the order and for the account of customers; or
39 investing and reinvesting in marketable obligations evidencing
40 indebtedness of any person, copartnership, association or
41 corporation in the form of bonds, notes or debentures commonly
42 known as investment securities; or dealing in or underwriting
43 obligations of the United States, any state or any political
44 subdivision thereof, or of a corporate instrumentality of any of
45 them. This shall include, without limitation of the foregoing,
46 business commonly known as industrial banks, dealers in
47 commercial paper and acceptances, sales finance, personal
48 finance, small loan and mortgage financing businesses, as well as
49 any other enterprise employing moneyed capital coming into
50 competition with the business of national banks; provided that the
51 holding of bonds, notes, or other evidences of indebtedness by
52 individual persons not employed or engaged in the banking or
53 investment business and representing merely personal
54 investments not made in competition with the business of

1 national banks, shall not be deemed financial business. Nor shall
2 "financial business" include national banks, production credit
3 associations organized under the Farm Credit Act of 1933 or the
4 Farm Credit Act of 1971, Pub.L. 92-181 (12 U.S.C. § 2091 et
5 seq.), stock and mutual insurance companies duly authorized to
6 transact business in this State, security brokers or dealers or
7 investment companies or bankers not employing moneyed capital
8 coming into competition with the business of national banks, real
9 estate investment trusts, or any of the following entities
10 organized under the laws of this State: credit unions, savings
11 banks, savings and loan and building and loan associations,
12 pawnbrokers, and State banks and trust companies.

13 (n) "International banking facility" shall mean a set of asset
14 and liability accounts segregated on the books and records of a
15 depository institution, United States branch or agency of a
16 foreign bank, or an Edge or Agreement Corporation that includes
17 only international banking facility time deposits and international
18 banking facility extensions of credit as such terms are defined in
19 section 204.8(a)(2) and section 204.8(a)(3) of Regulation D of the
20 board of governors of the Federal Reserve System, 12 CFR Part
21 204, effective December 3, 1981. In the event that the United
22 States enacts a law, or the board of governors of the Federal
23 Reserve System adopts a regulation which amends the present
24 definition of international banking facility or of such facilities'
25 time deposits or extensions of credit, the Commissioner of
26 Banking shall forthwith adopt regulations defining such terms in
27 the same manner as such terms are set forth in the laws of the
28 United States or the regulations of the board of governors of the
29 Federal Reserve System. The regulations of the Commissioner of
30 Banking shall thereafter provide the applicable definitions.

31 (o) "S corporation" means a corporation included in the
32 definition of an "S corporation" pursuant to section 1361 of the
33 federal Internal Revenue Code of 1986, 26 U.S.C. §1361.

34 (p) "New Jersey S corporation" means a corporation that is an
35 S corporation; which has made a valid election pursuant to
36 section 3 of P.L. , c. (C.) (now pending before the
37 Legislature as this bill); and which has been an S corporation
38 continuously since the effective date of the valid election made
39 pursuant to section 3 of P.L. , c. (C.).

40 (cf: P.L.1990, c.79, s.2)

41 2. Section 5 of P.L.1945, c.162 (C. 54:10A-5) is amended to
42 read as follows:

43 5. The franchise tax to be annually assessed to and paid by
44 each taxpayer shall be the sum of the amount computed under
45 subsection (a) hereof, or in the alternative to the amount
46 computed under subsection (a) hereof, the amount computed
47 under subsection (f) hereof, and the amount computed under
48 subsection (c) hereof:

49 (a) That portion of its entire net worth as may be allocable to
50 this State as provided in section 6, multiplied by the following
51 rates: 2 mills per dollar on the first \$100,000,000.00 of allocated
52 net worth; 4/10 of a mill per dollar on the second
53 \$100,000,000.00; 3/10 of a mill per dollar on the third
54 \$100,000,000.00; and 2/10 of a mill per dollar on all amounts of

allocated net worth in excess of \$300,000,000.00; provided, however, that with respect to reports covering accounting or privilege periods set forth below, the rate shall be that percentage of the rate set forth in this subsection for the appropriate year:

Accounting or Privilege Periods Beginning on or After:	The Percentage of the Rate to be Imposed Shall Be:
April 1, 1983	75%
July 1, 1984	50%
July 1, 1985	25%
July 1, 1986	0

(b) (Deleted by amendment, P.L.1968, c.250, s.2.)

(c) (1) For a taxpayer that is not a New Jersey S corporation, 3¼% of its entire net income or such portion thereof as may be allocable to this State as provided in section 6 of P.L.1945, c.162 (C.54:10A-6); provided, however, that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1967, the rate shall be 4¼%; and that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1971, the rate shall be 5½%; and that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1974, the rate shall be 7½%; and that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1979, the rate shall be 9%.

(2) For a taxpayer that is a New Jersey S corporation, the rate determined by subtracting the maximum tax bracket rate provided under N.J.S.54A:2-1 for the taxable period from the tax rate provided under paragraph (1) of this subsection for the taxable period multiplied by its entire net income that is not subject to federal income taxation or such portion thereof as may be allocable to this State pursuant to sections 6 through 10 of P.L.1945, c.162 (C.54:10A-6 through 54:10A-10); plus

(3) For a taxpayer that is a New Jersey S corporation, the tax rate provided under paragraph (1) of this subsection for the taxable period multiplied by any of its entire net income that is subject to federal income taxation or such portion thereof as may be allocable to this State pursuant to sections 6 through 10 of P.L.1945, c.162 (C.54:10A-6 through 54:10A-10).

(d) Provided, however, that the franchise tax to be annually assessed to and paid by any investment company or real estate investment trust, which has elected to report as such and has filed its return in the form and within the time provided in this act and the rules and regulations promulgated in connection therewith, shall, in the case of an investment company, be measured by 25% of its entire net income and 25% of its entire net worth, and in the case of a real estate investment trust, by 4% of its entire net income and 15% of its entire net worth, at the rates hereinbefore set forth for the computation of tax on net income and net worth, respectively, but in no case less than \$250.00, and further provided, however, that the franchise tax to be annually assessed to and paid by a regulated investment

company which for a period covered by its report satisfies the requirements of Chapter 1, Subchapter M, Part I, Section 852(a) of the federal Internal Revenue Code shall be \$250.00.

(e) The tax assessed to any taxpayer pursuant to this section shall not be less than \$25.00 in the case of a domestic corporation, \$50.00 in the case of a foreign corporation, or \$250.00 in the case of an investment company or regulated investment company.

Provided however, that for accounting or privilege periods beginning in calendar year 1994 and thereafter the minimum taxes for taxpayers other than an investment company or a regulated investment company shall be as provided in the following schedule:

<u>Period Beginning</u> <u>In Calendar Year</u>	<u>Domestic</u> <u>Corporation</u> <u>Minimum Tax</u>	<u>Foreign</u> <u>Corporation</u> <u>Minimum Tax</u>
1994	\$50	\$100
1995	\$100	\$200
1996	\$150	\$200
1997	\$200	\$200

and provided further that the director shall adjust the minimum tax for accounting or privilege periods beginning in each fifth year following calendar year 1997 and each fifth year thereafter by multiplying the minimum tax for periods beginning in 1997 by an amount equal to one plus 75% of the increase, if any, in the annual average total producer price index for finished goods published by the federal Department of Labor, Bureau of Labor Statistics, for the year preceding the determination year over such index for calendar year 1996.

(f) In lieu of the portion of the tax based on net worth and to be computed under subsection (a) of this section, any taxpayer, the value of whose total assets everywhere, less reasonable reserves for depreciation, as of the close of the period covered by its report, amounts to less than \$150,000.00, may elect to pay the tax shown in a table which shall be promulgated by the director.

(cf: P.L.1983, c.75, s.1)

3. (New section) a. A corporation may elect, in accordance with the provisions of this section, to be a New Jersey S corporation. In order for an election to be valid, the corporation and each of its shareholders on the day on which the election is made (hereinafter "initial shareholders") must consent to such election and the jurisdictional requirements of becoming a New Jersey S corporation. The form of the election and consent to jurisdictional requirements and the place for filing shall be as prescribed by the Director of the Division of Taxation.

b. Each initial shareholder and the corporation shall consent to the following jurisdictional requirements:

(1) That this State shall have the right and jurisdiction to tax and collect the tax on each shareholder's S corporation income as defined pursuant to section 12 of P.L. , c. (C.) (now pending before the Legislature as this bill);

(2) That New Jersey's right and jurisdiction to tax the income

1 as set forth in paragraph (1) of this subsection shall not be
2 affected by a change of a shareholder's residency, except as
3 provided by the "New Jersey Gross Income Tax Act,"
4 N.J.S.54A:1-1 et seq.; and

5 (3) If shareholders that are not initial shareholders of the
6 corporation, while the corporation is a New Jersey S corporation,
7 fail to consent to New Jersey's jurisdiction to tax S corporation
8 income to such shareholders, this State shall have the right and
9 jurisdiction to collect a payment of tax each year directly from
10 the corporation equal to the S corporation income allocated to
11 this State, as defined pursuant to section 12 of P.L. , c.
12 (C.) (now pending before the Legislature as this bill), of the
13 nonconsenting shareholders for the accounting or privilege period
14 multiplied by the maximum tax bracket rate provided under
15 N.J.S.54A:2-1 for the accounting or privilege period. In such
16 case, the corporation shall have the right, but not the obligation,
17 to recover payments made by the corporation pursuant to this
18 paragraph from each nonconsenting shareholder.

19 c. A corporation may make an election to become a New
20 Jersey S corporation with respect to an accounting or privilege
21 period for which the corporation is or will be an S corporation.
22 The election for an accounting or privilege period, along with the
23 consents to jurisdictional requirements, shall be filed within one
24 calendar month of the time at which a federal S corporation
25 election would be required if such accounting or privilege period
26 were a "taxable year" for which a federal S corporation election
27 were to be made pursuant to section 1362 of the federal Internal
28 Revenue Code of 1986, 26 U.S.C. §1362. Such elections may only
29 be revoked pursuant to subsection d. of this section. Such
30 election shall terminate immediately upon the corporation's
31 failure to satisfy the definition of a New Jersey S corporation
32 pursuant to paragraph (p) of section 4 of P.L.1945, c.162
33 (C.54:10A-4).

34 d. A corporation may revoke an election pursuant to this
35 section on or before the last day of the first accounting or
36 privilege period to which the election would otherwise apply.

37 4. (New section) a. With respect to each of its shareholders
38 that is not an initial shareholder, a New Jersey S corporation
39 shall satisfy the requirements of either paragraph b. or c. of this
40 section.

41 b. Deliver a consent to the jurisdictional requirements as set
42 forth in subsection b. of section 3 of P.L. , c. (C.) (now
43 pending before the Legislature as this bill).

44 c. Make payments to the Director of the Division of Taxation
45 on behalf of each nonconsenting shareholder in an amount equal
46 to the shareholder's pro rata share of S corporation income
47 allocated to this State, as defined pursuant to section 12 of
48 P.L. , c. (C.)(now pending before the Legislature as this
49 bill), reflected on the corporation's return for the accounting or
50 privilege period, multiplied by the maximum tax bracket rate
51 provided under N.J.S.54A:2-1 in effect at the end of the
52 accounting or privilege period. The payments shall be made no
53 later than the time for filing of the return for the accounting or
54 privilege period. The director may, by regulation, require that

1 amounts estimated to be equal to the liability expected to be due
2 pursuant to this subsection be withheld from any distribution
3 made to a nonconsenting shareholder.

4 d. If a shareholder that is not an initial shareholder of a New
5 Jersey S corporation fails to deliver a consent to the
6 jurisdictional requirements set forth in subsection b. of section 3
7 of P.L. , c. (C.) (now pending before the Legislature as this
8 bill), and objects to New Jersey's jurisdiction to withhold
9 payments pursuant to subsection c. of this section, then this State
10 shall have the right and jurisdiction to collect a tax each year
11 directly from the corporation equal to the pro rata share of the S
12 corporation income allocated to this State, as defined pursuant to
13 section 12 of P.L. , c. (C.) (now pending before the
14 Legislature as this bill), of the nonconsenting shareholder times
15 the maximum tax bracket rate provided under N.J.S.54A:2-1 for
16 the appropriate accounting or privilege period. In such case, the
17 corporation shall have the right, but not the obligation, to
18 recover payments made by the corporation pursuant to this
19 paragraph from each nonconsenting shareholder.

20 5. (New section) a. "Operational income" subject to allocation
21 to New Jersey means income from tangible and intangible
22 property if the acquisition, management, and disposition of the
23 property constitute integral parts of the taxpayer's regular trade
24 or business operations and includes investment income serving an
25 operational function. Income that a taxpayer demonstrates with
26 clear and cogent evidence is not operational income is classified
27 as nonoperational income, and the nonoperational income of
28 taxpayers, other than those that have their principal place from
29 which the trade or business of the taxpayer is directed or
30 managed in this State, is not subject to allocation.

31 b. Corporate expenses related to nonoperational income are
32 not deductible in determining entire net income.
33 Notwithstanding the provisions of R.S.54:49-6 or any other law to
34 the contrary:

35 (1) if in prior privilege periods property had been classified
36 as operational property, and later is demonstrated to have been
37 nonoperational property and is subsequently disposed of, all
38 expenses, without limitation, deducted for prior privilege periods
39 related to such nonoperational property shall be added back and
40 recaptured as income in the period of disposition of such property;

41 (2) if in prior privilege periods income had been classified as
42 serving an operational function, and later is demonstrated not to
43 have been serving an operational function, all expenses, without
44 limitation, deducted in prior privilege periods related to such
45 income not serving an operational function shall be added back
46 and recaptured as income; and

47 (3) the denominators of the fractions used to determine the
48 allocation factor pursuant to section 6 of P.L.1945, c.162
49 (C.54:10A-6), for privilege periods for which redeterminations
50 are required pursuant to paragraphs (1) and (2) of this subsection
51 shall be redetermined to exclude the amounts, if any, relating to
52 the nonoperational property or the nonoperational income.

53 c. The Director of the Division of Taxation shall prescribe
54 such forms for administration and adopt such administrative rules

1 as the director deems necessary for the implementation of this
2 section.

3 6. Section 18 of P.L.1945, c.162 (C.54:10A-18) is amended to
4 read as follows:

5 18. a. The commissioner shall design a form of return and
6 forms for such additional statements or schedules as he may
7 require to be filed therewith. Such forms shall provide for the
8 setting forth of such facts as the commissioner may deem
9 necessary for the proper enforcement of this act. He shall cause
10 a supply thereof to be printed and shall furnish appropriate blank
11 forms to each taxpayer upon application or otherwise as he may
12 deem necessary. Failure to receive a form shall not relieve any
13 taxpayer from the obligation to file a return under the provisions
14 of this act. Each such return shall have annexed thereto a
15 certification by the president, vice-president, comptroller,
16 secretary, treasurer, assistant treasurer, accounting officer of
17 the taxpayer or any other officer of the taxpayer duly authorized
18 so to act to the effect that the statements contained therein are
19 true. The fact that an individual's name is signed on a
20 certification of the report shall be prima facie evidence that such
21 individual is authorized to sign and certify the report on behalf of
22 the corporation. In the case of a corporation in liquidation or in
23 the hands of a receiver or trustee, certification shall be made by
24 the person responsible for the conduct of the affairs of such
25 corporation.

26 b. The return of an S corporation shall, in addition to any
27 information set forth pursuant to subsection a. of this section, set
28 forth with respect to each shareholder: the shareholder's name,
29 address and federal taxpayer identification number (social
30 security number or employer identification number); whether the
31 shareholder is a resident of this State; whether the shareholder
32 has filed a consent to jurisdictional requirements pursuant to
33 section 3 or section 4 of P.L. , c. (C.) (now pending before
34 the Legislature as this bill); the allocation factor determined
35 pursuant to sections 6 through 10 of P.L.1945, c.162 (C.54:10A-6
36 through 54:10A-10); the amount of any distribution made to the
37 shareholder, including any amount paid on behalf of the
38 shareholder pursuant to subsections c. or d. of section 4 of P.L.
39 , c. (C.)(now pending before the Legislature as this bill); the
40 balance of the accumulated earnings and profits account; the
41 balance of the accumulated adjustments account described in
42 section 16 of P.L. , c. (C.)(now pending before the
43 Legislature as this bill), which account the corporation shall
44 maintain; and such other information as the director may
45 prescribe by regulation. The S corporation shall, on or before the
46 day on which such return is required to be filed, furnish to each
47 person who was a shareholder during the accounting or privilege
48 period a copy of such information shown on the return as the
49 director may by regulation prescribe.

50 (cf: P.L.1958, c.63, s.10)

51 7. N.J.S.54A:4-1 is amended to read as follows:

52 54A:4-1. Resident credit for tax of another state. (a) A
53 resident taxpayer shall be allowed a credit against the tax
54 otherwise due under this act for the amount of any income tax or

1 wage tax imposed for the taxable year by another state of the
2 United States or political subdivision of such state, or by the
3 District of Columbia, with respect to income which is also
4 subject to tax under this act, except as provided by subsections
5 (c) and (d) of this section.

6 (b) The credit provided under this section shall not exceed the
7 proportion of the tax otherwise due under this act that the
8 amount of the taxpayer's income subject to tax by the other
9 jurisdiction bears to his entire New Jersey income.

10 (c) No credit shall be allowed against the tax otherwise due
11 under this act for the amount of any income tax or wage tax
12 imposed for the taxable year on S corporation income allocated
13 to this State.

14 (d) No credit shall be allowed for the amount of any taxes paid
15 or accrued for the taxable year on or measured by profits or
16 income imposed on or paid on behalf of a person other than the
17 taxpayer, whether or not the taxpayer may be held liable for the
18 tax.

19 (e) Readjustment of the tax of another state or political
20 subdivision thereof--if the taxpayer is allowed credit under this
21 section for more or less of the tax of another state or political
22 subdivision thereof than he is finally required to pay, the
23 taxpayer shall send notice of the difference to the director who
24 shall redetermine the tax for any years affected regardless of any
25 otherwise applicable statute of limitations.

26 (cf: N.J.S.54A:4-1)

27 8. N.J.S.54A:4-2 is amended to read as follows:

28 54A:4-2. Credit for taxes withheld [on wages]. a. Any amount
29 of tax actually deducted and withheld by an employer under this
30 act in any calendar year shall be deemed to have been paid to the
31 director on behalf of the person from whom withheld, and such
32 person shall be credited with having paid that amount of tax for
33 the taxable year beginning in such calendar year. For a taxable
34 year of less than 12 months, the credit shall be made under
35 regulations of the director.

36 b. An amount of tax actually paid to the director by an S
37 corporation pursuant to subsections c. of section 4 of P.L. ,

38 c. (C.)(now pending before the Legislature as this bill),
39 shall be credited to the shareholder of the S corporation on whose
40 behalf the payment was made as of the date of its receipt by the
41 director, except as otherwise provided by N.J.S.54A:9-11, and the
42 shareholder shall be credited with having paid that amount of tax
43 for the taxable year in which the S corporation's accounting or
44 privilege period ends.

45 (cf: N.J.S.54A:4-2)

46 9. N.J.S.54A:5-1 is amended to read as follows:

47 54A:5-1. New Jersey Gross Income Defined. New Jersey gross
48 income shall consist of the following categories of income:

49 a. Salaries, wages, tips, fees, commissions, bonuses, and other
50 remuneration received for services rendered whether in cash or in
51 property.

52 b. Net profits from business. The net income from the
53 operation of a business, profession or other activity after
54 provision for all costs and expenses incurred in the conduct

1 thereof, determined either on a cash or accrual basis in
2 accordance with the method of accounting allowed for federal
3 income tax purposes but without deduction of the amount of:

4 (1) taxes based on income;

5 (2) a civil, civil administrative, or criminal penalty or fine,
6 including a penalty or fine under an administrative consent order,
7 assessed and collected for a violation of a State or federal
8 environmental law, an administrative consent order, or an
9 environmental ordinance or resolution of a local governmental
10 entity, and any interest earned on the penalty or fine, and any
11 economic benefits having accrued to the violator as a result of a
12 violation, which benefits are assessed and recovered in a civil,
13 civil administrative, or criminal action, or pursuant to an
14 administrative consent order. The provisions of this paragraph
15 shall not apply to a penalty or fine assessed or collected for a
16 violation of a State or federal environmental law, or local
17 environmental ordinance or resolution, if the penalty or fine was
18 for a violation that resulted from fire, riot, sabotage, flood,
19 storm event, natural cause, or other act of God beyond the
20 reasonable control of the violator, or caused by an act or
21 omission of a person who was outside the reasonable control of
22 the violator; and

23 (3) treble damages paid to the Department of Environmental
24 Protection pursuant to subsection a. of section 7 of P.L.1976,
25 c.141 (C.58:10-23.11f) for costs incurred by the department in
26 removing, or arranging for the removal of, an unauthorized
27 discharge upon the failure of the discharger to comply with a
28 directive from the department to remove, or arrange for the
29 removal of, a discharge.

30 c. Net gains or income from disposition of property. Net gains
31 or net income, less net losses, derived from the sale, exchange or
32 other disposition of property, including real or personal, whether
33 tangible or intangible as determined in accordance with the
34 method of accounting allowed for federal income tax purposes.
35 For the purpose of determining gain or loss, the basis of property
36 shall be the adjusted basis used for federal income tax purposes,
37 except as expressly provided for under this act, but without a
38 deduction for penalties, fines, or economic benefits excepted
39 pursuant to paragraph (2), or for treble damages excepted
40 pursuant to paragraph (3) of subsection b. of this section.

41 A taxpayer's net gain or loss on the sale, exchange or other
42 disposition of a share of an S corporation shall be calculated by
43 increasing the adjusted basis of the share by an amount equal to
44 the shareholder's net losses and deductions in respect of the
45 share allowed and deducted from income for federal income tax
46 purposes, not including any personal net operating loss
47 deductions, to the extent that such net losses were not offset by
48 the taxpayer's pro rata share of S corporation income otherwise
49 subject to taxation pursuant to subsection p. of this section in
50 respect of another S corporation, subject to rules of priority and
51 assignment determined by the director.

52 For the tax year 1976, any taxpayer with a tax liability under
53 this subsection, or under the "Tax on Capital Gains and Other
54 Unearned Income Act" (P.L.1975, c.172), shall not be subject to

1 payment of an amount greater than the amount he would have
2 paid if either return had covered all capital transactions during
3 the full tax year 1976; provided, however, that the rate which
4 shall apply to any capital gain shall be that in effect on the date
5 of the transaction. To the extent that any loss is used to offset
6 any gain under P.L.1975, c.172, it shall not be used to offset any
7 gain under the "New Jersey Gross Income Tax Act" (P.L.1976,
8 c.47).

9 The term "net gains or income" shall not include gains or
10 income derived from obligations which are referred to in clause
11 (1) or (2) of section 54A:6-14 of this act or from securities which
12 evidence ownership in a qualified investment fund as defined in
13 section 2 of P.L.1987, c.310 (C.54A:6-14.1). The term "net gains
14 or net income" shall not include gains or income from
15 transactions to the extent to which nonrecognition is allowed for
16 federal income tax purposes. The term "sale, exchange or other
17 disposition" shall not include the exchange of stock or securities
18 in a corporation a party to a reorganization in pursuance of a plan
19 of reorganization, solely for stock or securities in such
20 corporation or in another corporation a party to the
21 reorganization and the transfer of property to a corporation by
22 one or more persons solely in exchange for stock or securities in
23 such corporation if immediately after the exchange such person
24 or persons are in control of the corporation. For purposes of this
25 clause, stock or securities issued for services shall not be
26 considered as issued in return for property.

27 For purposes of this clause, the term "reorganization" means--

28 (i) A statutory merger or consolidation;

29 (ii) The acquisition by one corporation, in exchange solely for
30 all or part of its voting stock (or in exchange solely for all or a
31 part of the voting stock of a corporation which is in control of
32 the acquiring corporation) of stock of another corporation if,
33 immediately after the acquisition, the acquiring corporation has
34 control of such other corporation (whether or not such acquiring
35 corporation had control immediately before the acquisition);

36 (iii) The acquisition by one corporation, in exchange solely for
37 all or part of its voting stock (or in exchange solely for all or a
38 part of the voting stock of a corporation which is in control of
39 the acquiring corporation). of substantially all of the properties
40 of another corporation, but in determining whether the exchange
41 is solely for stock the assumption by the acquiring corporation of
42 a liability of the other, or the fact that property acquired is
43 subject to a liability, shall be disregarded;

44 (iv) A transfer by a corporation of all or a part of its assets to
45 another corporation if immediately after the transfer the
46 transferor, or one or more of its shareholders (including persons
47 who were shareholders immediately before the transfer), or any
48 combination thereof, is in control of the corporation to which the
49 assets are transferred;

50 (v) A recapitalization;

51 (vi) A mere change in identity, form, or place of organization
52 however effected; or

53 (vii) The acquisition by one corporation, in exchange for stock
54 of a corporation (referred to in this subclause as 'controlling

1 corporation") which is in control of the acquiring corporation, of
2 substantially all of the properties of another corporation which in
3 the transaction is merged into the acquiring corporation shall not
4 disqualify a transaction under subclause (i) if such transaction
5 would have qualified under subclause (i) if the merger had been
6 into the controlling corporation, and no stock of the acquiring
7 corporation is used in the transaction;

8 (viii) A transaction otherwise qualifying under subclause (i)
9 shall not be disqualified by reason of the fact that stock of a
10 corporation (referred to in this subclause as the "controlling
11 corporation") which before the merger was in control of the
12 merged corporation is used in the transaction, if after the
13 transaction, the corporation surviving the merger holds
14 substantially all of its properties and of the properties of the
15 merged corporation (other than stock of the controlling
16 corporation distributed in the transaction); and in the transaction,
17 former shareholders of the surviving corporation exchanged, for
18 an amount of voting stock of the controlling corporation, an
19 amount of stock in the surviving corporation which constitutes
20 control of such corporation.

21 For purposes of this clause, the term "control" means the
22 ownership of stock possessing at least 80% of the total combined
23 voting power of all classes of stock entitled to vote and at least
24 80% of total number of shares of all other classes of stock of the
25 corporation.

26 For purposes of this clause, the term "a party to a
27 reorganization" includes a corporation resulting from a
28 reorganization, and both corporations, in the case of a
29 reorganization resulting from the acquisition by one corporation
30 of stock or properties of another. In the case of a reorganization
31 qualifying under subclause (i) by reason of subclause (vii) the term
32 "a party to a reorganization" includes the controlling corporation
33 referred to in such subclause (vii).

34 Notwithstanding any provisions hereof, upon every such
35 exchange or conversion, the taxpayer's basis for the stock or
36 securities received shall be the same as the taxpayer's actual or
37 attributed basis for the stock, securities or property surrendered
38 in exchange therefor.

39 d. Net gains or net income derived from or in the form of
40 rents, royalties, patents, and copyrights.

41 e. Interest, except interest referred to in clause (1) or (2) of
42 N.J.S.54A:6-14, or distributions paid by a qualified investment
43 fund as defined in section 2 of P.L.1987, c.310 (C.54A:6-14.1), to
44 the extent provided in that section.

45 f. Dividends. "Dividends" means any distribution in cash or
46 property made by a corporation, association or business trust that
47 is not an S corporation, (1) out of accumulated earnings and
48 profits, or (2) out of earnings and profits of the year in which
49 such dividend is paid and any distribution in cash or property
50 made by an S corporation, as specifically determined pursuant to
51 section 16 of P.L. , c. (C.) (now pending before the
52 Legislature as this bill).

53 The term "dividends" shall not include distributions paid by a
54 qualified investment fund as defined in section 2 of P.L.1987,

- 1 c.310 (C.54A:6-14.1), to the extent provided in that section.
- 2 g. Gambling winnings.
- 3 h. Net gains or income derived through estates or trusts.
- 4 i. Income in respect of a decedent.
- 5 j. Amounts distributed or withdrawn from an employee trust
- 6 attributable to contributions to the trust which were excluded
- 7 from gross income under the provisions of chapter 6 of Title 54A
- 8 of the New Jersey Statutes and pensions and annuities except to
- 9 the extent of exclusions in section 54A:6-10 hereunder,
- 10 notwithstanding the provisions of N.J.S.18A:66-51, P.L.1973,
- 11 c.140, s.41 (C.43:6A-41), P.L.1954, c.84, s.53 (C.43:15A-53),
- 12 P.L.1944, c.255, s.17 (C.43:16A-17), P.L.1965, c.89, s.45
- 13 (C.53:5A-45), R.S.43:10-14, P.L.1943, c.160, s.22 (C.43:10-18.22),
- 14 P.L.1948, c.310, s.22 (C.43:10-18.71), P.L.1954, c.218, s.32
- 15 (C.43:13-22.34), P.L.1964, c.275, s.11 (C.43:13-22.60),
- 16 R.S.43:10-57, P.L.1938, c.330, s.13 (C.43:10-105), R.S.43:13-44,
- 17 and P.L.1943, c.189, s.5 (C.43:13-37.5).
- 18 k. Distributive share of partnership income.
- 19 l. Amounts received as prizes and awards, except as provided
- 20 in sections 54A:6-8 and 54A:6-11 hereunder.
- 21 m. Rental value of a residence furnished by an employer or a
- 22 rental allowance paid by an employer to provide a home.
- 23 n. Alimony and separate maintenance payments to the extent
- 24 that such payments are required to be made under a decree of
- 25 divorce or separate maintenance but not including payments for
- 26 support of minor children.
- 27 o. Income, gain or profit derived from acts or omissions
- 28 defined as crimes or offenses under the laws of this State or any
- 29 other jurisdiction.
- 30 p. Net pro rata share of S corporation income.
- 31 (cf: P.L.1990, c.79, s.1)
- 32 10. N.J.S.54A:5-8 is amended to read as follows:
- 33 54A:5-8. Income from sources within this State for a
- 34 nonresident individual, estate or trust means the same as
- 35 compensation, net profits, gains, dividends, interest or income
- 36 enumerated and classified under chapter 5 of this act to the
- 37 extent that it is earned, received or acquired from sources within
- 38 this State:
- 39 (1) By reason of ownership or disposition of any interest in real
- 40 or tangible personal property in this State; or
- 41 (2) In connection with a trade, profession, occupation carried
- 42 on in this State or for the rendition of personal services
- 43 performed in this State; or
- 44 (3) As a distributive share of the income of an unincorporated
- 45 business, profession, enterprise, undertaking or other activity as
- 46 the result of work done, services rendered or other business
- 47 activities conducted in this State except as allocated to another
- 48 state pursuant to regulations promulgated by the director under
- 49 this act; or
- 50 (4) From intangible personal property employed in a trade,
- 51 profession, occupation or business carried on in this State; or
- 52 (5) As S corporation income allocated to this State of a New
- 53 Jersey S corporation.
- 54 Income from sources within this State for a nonresident
- 55 individual shall not include income from pensions and annuities as

1 set forth in subsection j. of N.J.S.54A:5-1.
2 (cf: P.L.1989, c.219, s.2)

3 11. (New section) An S corporation as such shall not be subject
4 to the tax imposed by the "New Jersey Gross Income Tax Act,"
5 N.J.S.54A:1-1 et seq., but the S corporation income, dividends
6 and gain of a shareholder of an S corporation shall be subject to
7 the tax, and the tax shall be imposed on the shareholder's pro
8 rata share, whether or not distributed, of the S corporation
9 income for its taxable year ending within or with the
10 shareholder's taxable year.

11 12. (New section) For the purposes of the "New Jersey Gross
12 Income Tax Act," N.J.S.54A:1-1 et seq.:

13 "New Jersey S corporation" means a corporation that is an S
14 corporation; which has made a valid election pursuant to section
15 3 of P.L. , c. (C.) (now pending before the Legislature as
16 this bill); and which has been an S corporation continuously since
17 the effective date of the valid election made pursuant to section
18 3 of P.L. , c. (C.).

19 "Pro rata share" means the portion of any items attributable to
20 an S corporation shareholder for a taxable year determined in the
21 manner provided in, and subject to any election made under
22 subsection (a) of section 1377 or subsection (e) of section 1362 of
23 the federal Internal Revenue Code of 1986, 26 U.S.C. §1377 and
24 §1362.

25 "Pro rata share of S corporation income" means the sum of the
26 shareholder's proportionate share of:

27 For a New Jersey S corporation, the S corporation income
28 allocated to this State of all New Jersey S corporations; and
29 the S corporation income not allocated to this State.

30 "S corporation" means a corporation included in the definition
31 of an "S corporation" pursuant to section 1361 of the federal
32 Internal Revenue Code of 1986, 26 U.S.C. §1361.

33 "S corporation income" means the net of an S corporation's
34 items of income, loss or deduction taken into account by the
35 shareholder in the manner provided in section 1366 of the federal
36 Internal Revenue Code of 1986, 26 U.S.C. §1366; provided
37 however that:

38 a. S corporation income shall be determined without the
39 exclusion, deduction or credit of:

40 (1) any dividend exclusion or deduction otherwise allowed
41 pursuant to paragraph 5 of subsection (k) of section 4 of P.L.1945,
42 c.162 (C.54:10A-4);

43 (2) taxes paid or accrued to the United States, a possession
44 or territory of the United States, a state including this State, a
45 political subdivision thereof, or the District of Columbia on or
46 measured by profits or income, or business presence or business
47 activity, of the corporation;

48 (3) any income taxes paid or accrued to the United States, a
49 possession or territory of the United States, a state including this
50 State, a political subdivision thereof, or the District of Columbia
51 paid or accrued by the S corporation on behalf of, or in
52 satisfaction of the liabilities of, shareholders of the corporation;

53 (4) interest income on obligations of any state other than
54 this State, or of a political subdivision thereof, or of the federal

1 government, except as deducted pursuant to paragraph (2) of
2 subsection b. of this section; or

3 (5) interest on indebtedness incurred or continued, expenses
4 paid and incurred to purchase, carry, manage or conserve, and
5 expenses of collection of the income or gain from obligations the
6 income or gain from which is deductible pursuant to subsection b.
7 of this definition; and

8 b. S corporation income shall be determined after deduction of
9 any gains or income derived from obligations which are referred
10 to in N.J.S.54A:6-14 or from securities which evidence ownership
11 in a qualified investment fund as defined in section 2 of P.L.1987,
12 c.310 (C.54A:6-14.1), and any interest excluded from gross
13 income pursuant to N.J.S.54A:6-14, or distributions excluded
14 from income pursuant to section 2 of P.L.1987, c.310
15 (C.54A:6-14.1); and

16 c. The character of any S corporation item taken into account
17 by a shareholder of an S corporation shall be determined as if
18 such items were received or incurred by the S corporation and not
19 its shareholder.

20 "S corporation income allocated to this State" means that
21 portion of the S corporation income that is allocated to this State
22 by the allocation factor of the corporation for the fiscal or
23 calendar accounting period pursuant to sections 6 through 10 of
24 P.L.1945, c.162 (C.54:10A-6 through 54:10A-10), reduced by any
25 tax imposed pursuant to paragraph (3) of subsection (c) of section
26 5 of P.L.1945, c.162 (C. 54:10A-5).

27 "S corporation income not allocated to this State" means S
28 corporation income less S corporation income allocated to this
29 State.

30 13. (New section) a. A resident shareholder of S corporation
31 stock held by the shareholder on the first day of the first taxable
32 year following enactment of this section shall have an initial
33 basis in the stock of that S corporation and any indebtedness of
34 the S corporation equal to the basis of the stock determined as
35 though the stock was stock of a corporation not an S corporation
36 plus any indebtedness of the S corporation to the shareholder and
37 shall be determined as of the first day of the first taxable year
38 following enactment of this section

39 b. A resident shareholder of S corporation stock to which
40 subsection a. of this section does not apply shall have an initial
41 basis in the stock of the S corporation and any indebtedness of
42 the S corporation as determined pursuant to the federal Internal
43 Revenue Code of 1986, determined as of the date that is the
44 latest to occur of: the date on which the shareholder last became
45 a resident of this State; the date on which the shareholder
46 acquired the stock of the corporation; or the effective date of
47 the corporation's most recent S election under the federal
48 Internal Revenue Code of 1986.

49 c. The initial basis of a resident shareholder in the stock and
50 indebtedness of an S corporation shall be adjusted after the date
51 specified in subsections a. or b. of this section in the manner
52 required by section 1011 of the federal Internal Revenue Code of
53 1986, 26 U.S.C. §1011, except that such adjustments shall be
54 limited to that portion of S corporation income allocated to this

1 State and S corporation income not allocated to this State that is
2 included in the shareholder's pro rata share of S corporation
3 income and except that, with respect to any taxable period during
4 which the shareholder is a resident of this State:

5 (1) any modification made pursuant to the definition of S
6 corporation income pursuant to section 12 of P.L. , c.
7 (C.)(now pending before the Legislature as this bill) other than
8 those for income exempt from taxation by this State pursuant to
9 paragraph (5) of subsection a. and subsection b. of that definition
10 shall be taken into account; and

11 (2) any adjustments made pursuant to section 1367 of the
12 federal Internal Revenue Code of 1986, 26 U.S.C. §1367, for a
13 taxable period during which this State did not measure the
14 income of a shareholder of an S corporation by reference to the S
15 corporation's income shall not be taken into account.

16 d. A nonresident shareholder of S corporation stock shall have
17 an initial basis in the stock of the S corporation and any
18 indebtedness of the S corporation of zero as of the date that is
19 the latest to occur of: the date on which the shareholder last
20 became a nonresident of this State; the date on which the
21 shareholder acquired the stock of the corporation; the effective
22 date of the corporation's most recent S election under the
23 federal Internal Revenue Code of 1986; or the effective date of
24 the corporation's most recent election pursuant to section 3 of
25 P.L. , c. (C.)(now pending before the Legislature as this
26 bill).

27 e. The initial basis of a nonresident shareholder in the stock
28 and indebtedness of an S corporation shall be adjusted after the
29 date specified in subsection d. of this section as provided in
30 section 1367 of the of the federal Internal Revenue Code of 1986,
31 26 U.S.C. §1367, except that such adjustments shall be limited to
32 that portion of S corporation income allocated to this State that
33 is included in the shareholder's pro rata share of S corporation
34 income. In computing S corporation income allocated to this
35 State any modification made pursuant to the definition of S
36 corporation income pursuant to section 12 of P.L. , c.
37 (C.)(now pending before the Legislature as this bill) for income
38 exempt from taxation by this State pursuant to paragraph (5) of
39 subsection a. and subsection b. of that definition shall not be
40 taken into account.

41 f. The basis in the hands of a resident shareholder of an S
42 corporation in stock of the S corporation shall be reduced by the
43 amount of any cash distribution which is not taxable to the
44 shareholder as a result of the application of section 16 of P.L. ,
45 c. (C.)(now pending before the Legislature as this bill).

46 g. For purposes of this section, any person acquiring stock or
47 indebtedness of an S corporation by gift shall be considered to
48 have acquired the stock or indebtedness at the time the donor
49 acquired the stock or indebtedness.

50 14. (New section) a. The aggregate amount of losses or
51 deductions of an S corporation taken into account by a
52 shareholder of the S corporation for a taxable period pursuant to
53 section 11 of P.L. , c. (C.)(now pending before the
54 Legislature as this bill), shall not exceed the shareholder's

1 combined adjusted basis, determined in accordance with section
2 13 of P.L. , c. (C.)(now pending before the Legislature as
3 this bill), in the stock of the S corporation and any indebtedness
4 of the S corporation to the shareholder.

5 b. Any loss or deduction of an S corporation which is
6 disallowed for a taxable period pursuant to subsection a. of this
7 section shall not be treated as incurred by the corporation in any
8 succeeding taxable period with respect to that shareholder.

9 15. (New section) For purposes of this act, if a shareholder of
10 an S corporation is both a resident and a nonresident of this State
11 during any taxable year, the shareholder's pro rata share of the S
12 corporation income allocated to this State and S corporation
13 income not allocated to this State for the taxable period shall be
14 further prorated between the shareholder's periods of residence
15 and nonresidence during the taxable period, in accordance with
16 the number of days in each period.

17 16. (New section) a. Subject to subsection c. of this section, a
18 distribution made by an S corporation with respect to its stock to
19 a resident shareholder shall be taken into account by the
20 shareholder for purposes of the "New Jersey Gross Income Tax
21 Act," N.J.S.54A:1-1 et seq., to the extent that the distribution is
22 treated as a dividend or as gain from the sale or exchange of
23 property in the manner provided by section 1368 of the federal
24 Internal Revenue Code of 1986, 26 U.S.C. §1368.

25 b. Subject to subsection c. of this section, a distribution of
26 money made by a corporation with respect to its stock to a
27 resident shareholder during a post-termination transition period
28 shall not be taken into account by the shareholder for purposes of
29 the "New Jersey Gross Income Tax Act," N.J.S.54A:1-1 et seq.,
30 to the extent the distribution is applied against and reduces the
31 adjusted basis of the stock of the shareholder in the manner
32 provided by section 1371(e) of the federal Internal Revenue Code
33 of 1986, 26 U.S.C. §1371.

34 c. In applying sections 1368 and 1371(e) of the federal Internal
35 Revenue Code of 1986, 26 U.S.C. §§1368 and 1371. to any
36 distribution referred to in subsection a. or b. of this section:

37 (1) the term "adjusted basis of the stock" means the
38 shareholder's adjusted basis in the stock of the S corporation, as
39 determined under section 13 of P.L. , c. (C.)(now pending
40 before the Legislature as this bill); and

41 (2) the term "accumulated adjustments account" means an
42 amount that is equal to, and adjusted in the same manner as, the
43 S corporation's accumulated adjustments account defined in
44 section 1368(e)(1)(A) of the federal Internal Revenue Code of
45 1986, 26 U.S.C. §1368, except that any modifications required to
46 be made pursuant to the definition of S corporation income shall
47 be taken into account.

48 17. Section 3 of P.L.1977, c.273 (C.54A:6-15) is amended to
49 read as follows:

50 3. Other retirement income. a. Gross income shall not
51 include income of up to \$10,000.00 for a married couple filing
52 jointly, \$5,000.00 for a married person filing separately, or
53 \$7,500.00 for an individual filing as a single taxpayer or an
54 individual determining tax pursuant to subsection a. of

1 N.J.S.54A:2-1, when received in any tax year by a person aged 62
2 years or older who received no income in excess of \$3,000.00
3 from one or more of the sources enumerated in subsections a., b.
4 [and] , k. and p. of N.J.S.54A:5-1, provided, however, that the
5 total exclusion under this subsection and that allowable under
6 N.J.S.54A:6-10 shall not exceed the amounts of the exclusions set
7 forth in this subsection.

8 b. In addition to the exclusion provided under N.J.S.54A:6-10
9 and subsection a. of this section, gross income shall not include
10 income of up to \$6,000.00 for a married couple filing jointly or an
11 individual determining tax pursuant to subsection a. of
12 N.J.S.54A:2-1, or \$3,000.00 for a single person or a married
13 person filing separately, who is not covered under N.J.S.54A:6-2
14 or N.J.S.54A:6-3, but who would be eligible in any year to receive
15 payments under either section if he or she were covered thereby.
16 (cf: P.L.1990, c.61, s.17)

17 18. N.J.S.54A:8-6 is amended to read as follows:

18 54A:8-6. Requirements concerning returns, notices, records
19 and statements. (a) General. The director may prescribe
20 regulations as to the keeping of records, the content and form of
21 returns and statements, and the filing of copies of federal income
22 tax returns and determinations. The director may require any
23 person, by regulation or notice served upon such person, to make
24 such returns, render such statements, or keep such records, as the
25 director may deem sufficient to show whether or not such person
26 is liable under this act for tax or for collection of tax.

27 (b) Partnerships. Every partnership having a resident partner
28 or having any income derived from New Jersey sources, shall
29 make a return for the taxable year setting forth all items of
30 income, gain, loss and deduction and such other pertinent
31 information as the director may by regulations and instructions
32 prescribe. The director shall prescribe a State return form that,
33 at a minimum, includes the name, principal residence address if
34 applicable and telephone number of each partner of the
35 partnership for taxable years ending after December 15, 1993.
36 Such return shall be filed on or before the fifteenth day of the
37 fourth month following the close of each taxable year. For the
38 purposes of this subsection, "taxable year" means a year or
39 period which would be a taxable year of the partnership if it were
40 subject to tax under this act.

41 (c) Information at source. The director may prescribe
42 regulations and instructions requiring returns of information to be
43 made and filed on or before February 15 of each year as to the
44 payment or crediting in any calendar year of amounts of \$100.00
45 or more to any taxpayer under this act. Such returns may be
46 required of any person, including lessees or mortgagors of real or
47 personal property, fiduciaries, employers, and all officers and
48 employees of this State, or of any municipal corporation or
49 political subdivision of this State, having the control, receipt,
50 custody, disposal or payment of interest, rents, salaries, wages,
51 premiums, annuities, compensations, remunerations, emoluments
52 or other fixed or determinable gains, profits or income, except
53 interest coupons payable to bearer. A duplicate of the statement
54 as to tax withheld on wages, required to be furnished by an

1 employer to an employee, shall constitute the return of
2 information required to be made under this section with respect
3 to such wages.

4 (d) Notice of qualification as receiver, et cetera. Every
5 receiver, trustee in bankruptcy, assignee for benefit of creditors,
6 or other like fiduciary shall give notice of his qualification as
7 such to the director, as may be required by regulation.
8 (cf: N.J.S.54A:8-6)

9 19. This act shall take effect immediately and sections 1
10 through 6 shall apply to fiscal or calendar accounting years
11 beginning after enactment and sections 7 through 17 shall apply
12 to taxable years beginning after enactment.

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17 Provides reduced corporation business tax for electing S
18 corporations, gross income taxation of shareholders, phased
19 increase in minimum corporation business tax and partnership
20 informational return filing; disallows deduction of certain costs
21 of generating nontaxable income.

ASSEMBLY, No. 273
STATE OF NEW JERSEY

Introduced Pending Technical Review by Legislative Counsel

PRE-FILED FOR INTRODUCTION IN THE 1992 SESSION

By Assemblymen PENN and KAVANAUGH

1 **AN ACT** concerning the taxation of certain corporations and the
2 shareholders of those corporations, amending P.L.1945, c.162
3 and supplementing Title 54A of the New Jersey Statutes.

4
5 BE IT ENACTED *by the Senate and General Assembly of the*
6 *State of New Jersey:*

7 1. Section 3 of P.L.1945, c.162 (C.54:10A-3) is amended to
8 read as follows:

9 3. The following corporations shall be exempt from the tax
10 imposed by this act:

11 (a) Corporations subject to a tax under the provisions of
12 article 2 of chapter 13 of Title 54 of the Revised Statutes, or to
13 a tax assessed upon the basis of gross receipts [other than the
14 Retail Gross Receipts Tax Act,] or issuance premiums collected;

15 (b) Corporations which operate regular route autobus service
16 within this State under operating authority conferred pursuant
17 to R.S. 48:4-3, provided, however, that such corporations shall
18 not be exempt from the tax on net income imposed by
19 subsection (c) of section 5 of P.L.1945, c.162 (C.54:10A-5 (c));

20 (c) Railroad, canal corporations, savings banks, production
21 credit associations organized under the Farm Credit Act of 1933
22 or the Farm Credit Act of 1971, Pub. L.92-181 (12 U.S.C. § 2091
23 et seq.), agricultural cooperative associations incorporated or
24 domesticated under or subject to chapter 13 of Title 4 of the
25 Revised Statutes and exempt under Subtitle A, Chapter 1 F,
26 Part III, Section 521 of the federal Internal Revenue Code, or
27 building and loan or savings and loan associations;

28 (d) Cemetery corporations not conducted for pecuniary profit
29 or any private shareholder or individual;

30 (e) Nonprofit corporations, associations or organizations
31 established, organized or chartered, without capital stock,
32 under the provisions of Titles 15, 16 or 17 of the Revised
33 Statutes or Title 15A of the New Jersey Statutes, or under a
34 special charter or under any similar general or special law of
35 this or any other State, and not conducted for pecuniary profit
36 of any private shareholders or individual;

37 (f) Corporations subject to a tax under the provisions of
38 P.L.1940, c.4 (C.54:30A-16 et seq.), or P.L.1940, c.5
39 (C.54:30A-49 et seq.), or any statute or law imposing a similar
40 tax or taxes;

41 (g) Nonstock corporations organized amended under the laws
42 of this State or of any other state of the United States to

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.

1 provide mutual ownership housing under federal law by tenants,
2 provided, however, that the exemption hereunder shall continue
3 only so long as the corporations remain subject to rules and
4 regulations of the Federal Housing Authority and the
5 Commisioner of the Federal Housing Authority holds
6 membership certificates in the corporations and the corporate
7 property is encumbered by a mortgage deed or deed of trust
8 insured under the National Housing Act (48 Stat. 1246) as
9 amended by subsequent Acts of Congress. In order to be
10 exempted under this subsection, corporations shall annually file
11 a report on or before August 15 with the commissioner, in the
12 form required by the commissioner, to claim such exemption,
13 and shall pay a fillng fee of \$25.00;

14 (h) Corporations not for profit organized under any law of this
15 State where the primary purpose thereof is to provide for its
16 shareholders or members housing in a retirement community as
17 same is defined under the provisions of the "Retirement
18 Community Full Disclosure Act" (P.L.1969, c.215, C.45:22A-1
19 et seq.);

20 (i) Corporations having the status of an electing small business
21 corporation under subchapter S of the federal Internal Revenue
22 Code, Pub. L.97-354 (26 U.S.C. § 1361 et seq.).

23 2. (New section) A corporation having the status of an
24 electing small business corporation under subchapter S of the
25 federal Internal Revenue Code, Pub. L. 97-354 (26 U.S.C. § 1361
26 et seq.) shall not be subject to the New Jersey gross income
27 tax. Individuals who are shareholders in such a corporation shall
28 be liable for the New Jersey gross income tax only in their
29 separate or individual capacities.

30 3. (New section) A corporation having the status of an
31 electing small business corporation under subchapter S of the
32 federal Internal Revenue Code, Pub. L.97-354 (26 U.S.C. § 1361
33 et seq.) as such shall not be subject to the New Jersey gross
34 income tax, but the income or gain of a shareholder shall be
35 subject to the tax and the tax shall be imposed on his share of
36 the income or gain received by that corporation for its taxable
37 year ending within or with the shareholder's taxable year and
38 distributed to him.

39 4. This act shall take effect immediately and apply to
40 distributions of income received on or after January, 1, 1986.

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Sponsors STATEMENT

45 This bill exempts subchapter S corporations from the
46 corporation business tax. The purpose of the federal exemption
47 of subchapter S corporations from corporate taxes is to
48 encourage certain small closely held businesses to use the
49 corporate form and receive tax treatment similar to
50 proprietorships and partnerships. The bill accords similar
51 treatment to subchapter S corporations with respect to New
52 Jersey taxes, and in effect, eliminates the double taxation
53 presently applicable to small individual businesses operating
54 under federal subchapter "S." The shareholders of subchapter S

1 corporations would be taxed under the New Jersey gross income
2 tax only on the share of the corporation's income distributed to
3 them in any tax year.

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8 Exempts subchapter S corporations from the corporation
9 business tax.

ASSEMBLY APPROPRIATIONS COMMITTEE

STATEMENT TO

ASSEMBLY COMMITTEE SUBSTITUTE FOR

ASSEMBLY, Nos. 273 and 1870

STATE OF NEW JERSEY

DATED: June 3, 1993

The Assembly Appropriations Committee reports favorably Assembly Bill Nos. 273 and 1870 (Acs).

Assembly Bill Nos. 273 and 1870 (Acs) provides for a special corporation business tax rate on certain closely held corporations. Under subchapter S of the federal Internal Revenue Code, business corporations with 35 or fewer shareholders (who must each be U.S. resident individuals, estates or certain trusts) may elect special tax treatment, including the exemption of most of their corporate income from taxation at the corporate level (the shareholders of those corporations pay personal income taxes on the income they receive or are deemed to have received).

Generally, S corporations are not taxed at the corporate level for federal tax purposes. Instead, the income "flows through" to the individual shareholders who are then taxed on the income under the personal income tax. Thus, the federal S corporation tax treatment eliminates the double taxation of income for most income earned by S corporations. The majority of states have adopted similar provisions for S corporations.

Historically, New Jersey has not recognized the S corporation concept for corporations operating in New Jersey which has added greater complexity for the taxation of those corporations because of the need to handle tax planning in one manner for federal tax purposes and in a different manner for New Jersey tax purposes. Frequently, that tax planning reflects and poses difficulties for the corporation.

The bill differs from the federal S corporation treatment for two significant reasons. First, New Jersey is one of two states that uses a "gross income" measure for determining personal income tax liability rather than the more common "net income" measure. Thus, net losses from S corporations are not utilized against other income. Second, the extreme revenue impact of eliminating all corporate level taxes for S corporations makes that elimination impractical. Accordingly, a corporate level tax is retained which is similar to the treatment provided by New York State.

This bill provides a special corporation business tax rate for the federally exempt income of corporations that have made a valid federal subchapter S election and that elect similar special treatment for New Jersey tax purposes. That tax rate is equal to the difference between the corporation business tax rate (currently 9%) and the highest marginal rate under the New Jersey gross income tax (currently 7%), or 2%. A surtax is imposed under the corporation business tax (currently 0.375%); that surtax would still apply to electing subchapter S corporations. Under current tax rates, this bill reduces the total corporate business tax rate on an electing subchapter S corporation from 9.375% to 2.375%. In order

to qualify for the reduced corporate level tax rate, each corporation will be required to make a New Jersey S corporation election. To the extent that federal tax laws impose a corporate level tax on certain S corporation income, the New Jersey tax will "piggyback" upon the federal provisions so as to impose the full 9.375% New Jersey corporate level tax.

Currently, individuals are taxed under the gross income tax only at the time of the payment of dividends by the corporations. This bill also provides for the more effective taxation of the shareholders of S corporations on the income they receive or are deemed to have received. This bill changes the time of the taxation of shareholders from the current system of taxing distributions at the time they are distributed to a system like the federal system, which taxes the shareholders of electing corporations on their New Jersey source income at the time the S corporation earns income, whether the income is distributed or not.

Taxation of "dividends" of S corporations will now be eliminated under this bill in all cases other than:

1. dividend payments attributable to years prior to the effective date of this legislation; and
2. dividends attributable to corporate income allocable to New Jersey earned by federal S corporations which do not elect to be New Jersey S corporations.

Non-residents of New Jersey are taxed under this bill upon their pro rata share of S corporation income from New Jersey S corporations allocable to New Jersey.

New Jersey residents will generally be taxed on all of their S corporation income regardless of its source. All of the items of income, loss and deduction of S corporations are passed through to shareholders and netted in a single New Jersey gross income tax category.

Under this bill, it is intended that the tax basis of the stock will be adjusted in a manner consistent with the federal tax law, taking into account:

1. that a corporation might not be a New Jersey S corporation for all of the time that it is a federal S corporation; and
2. that S corporation shareholders will receive no tax benefit for their share of new pro rata S corporation losses.

This bill also makes adjustment under the corporation business tax for certain expenses of generating income that are not subject to taxation by New Jersey. First, the bill disallows the deduction of the taxes of other United States taxing jurisdictions in calculating the "entire net income" of a corporation that is allocated to New Jersey for corporation business tax purposes. New Jersey uses a formula to determine the percentage of the total income of a corporation that is fairly related to the corporation's activity in New Jersey. Only that part of the total of a corporation's income that is related to activities in New Jersey is subject to tax; effectively, the rest of the corporation's income is exempt from New Jersey tax. If the deduction of the taxes of other jurisdictions is allowed, corporations which do business in several states pay a lower effective rate of tax on their New Jersey activities than do corporations which only do business in New Jersey. This bill ends that tax rate discrimination.

Second, the United States Supreme Court recently determined in the Allied-Signal, Inc. case that a corporation may have certain types of corporate income that have no relationship with the corporation's activities in a particular state and which therefore may not be included in the income that is subject to allocation and taxation by that state. This bill makes technical changes to the determination of the allocation of entire net income to make certain that the expenses of generating income that cannot be taxed by New Jersey are not deducted from the income that is taxable by New Jersey and to fairly allocate the income of a corporation that New Jersey may tax.

This bill phases in over four years an increase in the minimum corporation business tax liability of corporations to \$200 for each fiscal or calendar privilege period, and provides for an adjustment for inflation each five years thereafter. Currently, the minimum tax is \$25 for a domestic corporation or \$50 for a foreign corporation for each privilege period or part thereof, one of the lowest minimum taxes in the region.

This bill also makes various technical changes to the New Jersey gross income tax to provide for the taxation of S corporation shareholders, to codify certain portions of the Tax Court's holding in the Walsh case, 10 N.J.Tax 447, and to clarify the information to be contained in partnership information returns.

FISCAL IMPACT:

This bill provides a reduced corporation business tax rate which, if elected by all qualifying corporations, would reduce corporation business tax revenue by an amount estimated by the Division of Taxation to be approximately \$111 million annually. The Division of Taxation has estimated that improved taxpayer compliance under the gross income tax with an S election that includes shareholder consent to taxation will increase gross income tax revenues by approximately \$41 million annually. Disallowing the deduction of taxes paid to other jurisdictions and disallowing the expense of generating tax exempt income have been estimated by the division to increase corporation business tax revenues respectively by \$25 million annually and \$25 million annually. When fully phased in, the increase in the minimum corporation business tax will increase revenue under that tax by approximately \$22 million annually. Improved partnership information reporting will allow improved gross income tax auditing with revenue increases that have not yet been determined.

JOINT LEGISLATIVE COMMITTEE
ON ECONOMIC RECOVERY

STATEMENT TO
ASSEMBLY COMMITTEE SUBSTITUTE FOR
ASSEMBLY, Nos. 273 and 1870

STATE OF NEW JERSEY

DATED: JUNE 2, 1993

The Joint Legislative Committee on Economic Recovery reports favorably an Assembly Committee Substitute for Assembly Bill Nos. 273 and 1870.

This substitute bill provides for a special corporation business tax rate on certain closely held corporations. Under subchapter S of the federal Internal Revenue Code, business corporations with 35 or fewer shareholders (who must each be U.S. resident individuals, estates or certain trusts) may elect special tax treatment, including the exemption of most of their corporate income from taxation at the corporate level (the shareholders of those corporations pay personal income taxes on the income they receive or are deemed to have received).

Generally, S corporations are not taxed at the corporate level for federal tax purposes. Instead, the income "flows through" to the individual shareholders who are then taxed on the income under the personal income tax. Thus, the federal S corporation tax treatment eliminates the double taxation of income for most income earned by S corporations. The majority of states have adopted similar provisions for S corporations.

Historically, New Jersey has not recognized the S corporation concept for corporations operating in New Jersey which has added greater complexity for the taxation of those corporations because of the need to handle tax planning in one manner for federal tax purposes and in a different manner for New Jersey tax purposes. Frequently, that tax planning reflects and poses difficulties for the corporation.

The bill differs from the federal S corporation treatment for two significant reasons. First, New Jersey is one of two states that uses a "gross income" measure for determining personal income tax liability rather than the more common "net income" measure. Thus, net losses from S corporations are not utilized against other income. Second, the extreme revenue impact of eliminating all corporate level taxes for S corporations makes that elimination impractical. Accordingly, a corporate level tax is retained which is similar to the treatment provided by New York State.

This substitute provides a special corporation business tax rate for the federally exempt income of corporations that have made a valid federal subchapter S election and that elect similar special treatment for New Jersey tax purposes. That tax rate is equal to the difference between the corporation business tax rate (currently 9%) and the highest marginal rate under the New Jersey gross income tax (currently 7%), or 2%. A surtax is imposed under the corporation business tax (currently 0.375%); that surtax would still apply to electing subchapter S corporations. Under current tax rates, this substitute reduces the total corporate business tax rate on an electing subchapter S corporation from 9.375% to 2.375%. In

order to qualify for the reduced corporate level tax rate, each corporation will be required to make a New Jersey S corporation election. To the extent that federal tax laws impose a corporate level tax on certain S corporation income, the New Jersey tax will "piggyback" upon the federal provisions so as to impose the full 9.375% New Jersey corporate level tax.

Currently, individuals are taxed under the gross income tax only at the time of the payment of dividends by the corporations. This substitute also provides for the more effective taxation of the shareholders of S corporations on the income they receive or are deemed to have received. This substitute changes the time of the taxation of shareholders from the current system of taxing distributions at the time they are distributed to a system like the federal system, which taxes the shareholders of electing corporations on their New Jersey source income at the time the S corporation earns income, whether the income is distributed or not.

Taxation of dividends of S corporations will now be eliminated under this substitute in all cases other than:

1. dividend payments attributable to years prior to the effective date of this legislation; and
2. dividends attributable to corporate income allocable to New Jersey earned by federal S corporations which do not elect to be New Jersey S corporations.

Non-residents of New Jersey are taxed under this substitute upon their pro rata share of S corporation income from New Jersey S corporations allocable to New Jersey.

New Jersey residents will generally be taxed on all of their S corporation income regardless of its source. All of the items of income, loss and deduction of S corporations are passed through to shareholders and netted in a single New Jersey gross income tax category.

Under this substitute, it is intended that the tax basis of the stock will be adjusted in a manner consistent with the federal tax law, taking into account:

1. that a corporation might not be a New Jersey S corporation for all of the time that it is a federal S corporation; and
2. that S corporation shareholders will receive no tax benefit for their share of new pro rata S corporation losses.

This substitute also makes adjustment under the corporation business tax for certain expenses of generating income that are not subject to taxation by New Jersey. First, the bill disallows the deduction of the taxes of other United States taxing jurisdictions in calculating the "entire net income" of a corporation that is allocated to New Jersey for corporation business tax purposes. New Jersey uses a formula to determine the percentage of the total income of a corporation that is fairly related to the corporation's activity in New Jersey. Only that part of the total of a corporation's income that is related to activities in New Jersey is subject to tax; effectively, the rest of the corporation's income is exempt from New Jersey tax. If the deduction of the taxes of other jurisdictions is allowed, corporations which do business in several states pay a lower effective rate of tax on their New Jersey activities than do corporations which only do business in New Jersey. This substitute ends that tax rate discrimination.

Second, the United States Supreme Court recently determined in

the Allied-Signal, Inc. case that a corporation may have certain types of corporate income that have no relationship with the corporation's activities in a particular state and which therefore may not be included in the income that is subject to allocation and taxation by that state. This substitute makes technical changes to the determination of the allocation of entire net income to make certain that the expenses of generating income that cannot be taxed by New Jersey are not deducted from the income that is taxable by New Jersey and to fairly allocate the income of a corporation that New Jersey may tax.

This substitute phases in over four years an increase in the minimum corporation business tax liability of corporations to \$200 for each fiscal or calendar privilege period, and provides for an adjustment for inflation each five years thereafter. Currently, the minimum tax is \$25 for a domestic corporation or \$50 for a foreign corporation for each privilege period or part thereof, one of the lowest minimum taxes in the region.

This substitute also makes various technical changes to the New Jersey gross income tax to provide for the taxation of S corporation shareholders, to codify certain portions of the Tax Court's holding in the Walsh case, 10 N.J.Tax 447, and to clarify the information to be contained in partnership information returns.

FISCAL IMPACT:

This substitute provides a reduced corporation business tax rate which, if elected by all qualifying corporations, would reduce corporation business tax revenue by an amount estimated by the Division of Taxation to be approximately \$111 million annually. The Division of Taxation has estimated that improved taxpayer compliance under the gross income tax with an S election that includes shareholder consent to taxation will increase gross income tax revenues by approximately \$41 million annually. Disallowing the deduction of taxes paid to other jurisdictions and the expense of generating tax exempt income have been estimated by the division to increase corporation business tax revenues respectively by \$25 million annually and \$25 million annually. When fully phased in, the increase in the minimum corporation business tax will increase revenue under that tax by approximately \$22 million annually. Improved partnership information reporting will allow improved gross income tax auditing with revenue increases that have not yet been determined.

LEGISLATIVE FISCAL ESTIMATE TO
ASSEMBLY COMMITTEE SUBSTITUTE FOR
ASSEMBLY, Nos. 273 and 1870
STATE OF NEW JERSEY

DATED: June 29, 1993

The Assembly Committee Substitute for Assembly Bill Nos. 273 and 1870 provides for a special corporation business tax rate on S corporations. Under subchapter S of the federal Internal Revenue Code, business corporations with 35 or fewer shareholders (who must each be U.S. resident individuals, estates or certain trusts) may elect the exemption of most of their corporate income from taxation at the corporate level. The income "flows through" to the individual shareholders who are then taxed on the income under the personal income tax.

The bill provides a reduced rate under the corporation business tax instead of a full exemption for electing corporations that are also electing federal S corporations equal to the difference between the corporation business tax rate (currently 9 percent) and the highest marginal rate under the New Jersey gross income tax (currently 7 percent), or 2 percent, plus the surtax (currently 0.375 percent) reducing the total corporate business tax rate on an electing New Jersey S corporation from 9.375 percent to 2.375 percent. To the extent that federal tax laws impose a corporate level tax on certain S corporation income, the New Jersey tax will "piggyback" upon the federal provisions so as to impose the full 9.375 percent New Jersey corporate level tax.

Currently, S corporation shareholders are taxed on the income of their S corporations at the time the income is actually paid out to them, and that income is treated for gross income tax purposes as "dividends." Nonresident taxpayers are not taxed on dividends. The bill changes the time of the taxation of shareholders from the current system of taxing distributions at the time they are distributed to a system like the federal system, which taxes the shareholders of electing corporations at the time the S corporation earns income, whether the income is distributed or not. Under the bill, non resident shareholders of New Jersey S corporations are taxed on their pro rata share of the corporate income derived from New Jersey sources. New Jersey residents are taxed on all of their S corporation income.

The bill makes adjustments under the corporation business tax for certain expenses of generating income that are not subject to taxation by New Jersey. First, the bill disallows the deduction of the taxes of other United States taxing jurisdictions in calculating the "entire net income" of a corporation that is allocated to New Jersey for corporation business tax purposes. Second, the bill makes technical changes to the calculation and allocation of entire net income that assure that the expenses of generating income that cannot be taxed by New Jersey under the recent Allied-Signal, Inc. case are not deducted from the income that is taxable by New Jersey or used to allocate income of a corporation that New Jersey may tax.

The bill phases in over four years an increase in the minimum corporation business tax liability of corporations to \$200 for each fiscal or calendar privilege period, and provides for an adjustment for inflation each five years thereafter. Currently, the minimum tax is \$25 for a domestic corporation or \$50 for a foreign corporation for each privilege period or part thereof, one of the lowest minimum taxes in the region.

This bill also makes various technical changes to the New Jersey gross income tax to provide for the taxation of S corporation shareholders, to codify certain portions of the Tax Court's holding in the Walsh case, 10 N.J.Tax 447, and to clarify the information to be contained in partnership information returns.

The Office of Legislative Services (OLS) notes that without specific data concerning: the relative contribution of federally electing S corporations to total corporation business tax revenue; statistics of allocation percentages, taxes paid to other jurisdictions and post-Allied-Signal, Inc. income classifications; and gross income tax statistics of S corporation income and distributions, it is not possible to determine specifically the revenue impact of the bill. However, in discussions relating to the Joint Legislative Committee on Economic Recovery substitute and in testimony before that committee, the Division of Taxation, Department of the Treasury, estimated that the reduced corporation business tax rate, if elected by all qualifying corporations, would reduce corporation business tax revenue by approximately \$111 million annually.

The Division of Taxation further estimated that changes to the treatment of S corporation shareholder income and improved taxpayer compliance under the gross income tax (including an election of New Jersey S treatment requiring shareholder consent to taxation) will increase gross income tax revenues by approximately \$41 million annually. The Division of Taxation estimates that disallowing the deduction of taxes paid to other jurisdictions increases corporation business tax revenues by \$25 million annually and disallowing the expense of generating tax exempt income increases corporation business tax revenues by \$25 million annually. When fully phased in, the increase in the minimum corporation business tax will increase revenue under that tax by approximately \$22 million annually. The total final positive revenue effects of the bill are expected to be \$113 million annually.

OLS notes further that the clarification of partnership information report contents may allow improved gross income tax auditing of partner returns, with revenue increases that have not yet been determined.

This legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note.

This fiscal estimate has been prepared pursuant to P.L.1980, c.67.



Committee Meeting

before

JOINT LEGISLATIVE COMMITTEE ON ECONOMIC RECOVERY

"Factors influencing business retention and expansion,
and the attraction of new business to the State"

LOCATION: East Brunswick
Public Library
East Brunswick, New Jersey

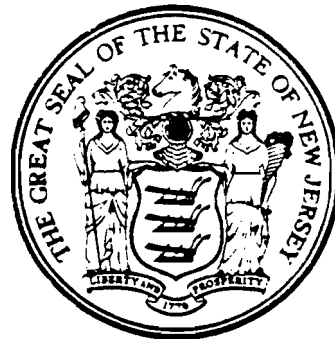
DATE: February 17, 1993
10:30 a.m.

MEMBERS OF JOINT COMMITTEE PRESENT:

Senator Jack Sinagra, Chairperson
Assemblywoman Harriet Derman, Vice-Chairperson
Senator Peter Inverso
Senator John H. Adler
Assemblyman Steve Corodemus

ALSO PRESENT:

Christopher R. Berry
Gregory L. Williams
Office of Legislative Services
Aides, Joint Legislative Committee
on Economic Recovery



Hearing Recorded and Transcribed by
The Office of Legislative Services, Public Information Office,
Hearing Unit, State House Annex, CN 068, Trenton, New Jersey 08625

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SENATOR SINAGRA: Okay. Thank you. Are there any other questions? (no response) Thank you very much.

MR. GOLDIN: Thank you very much.

SENATOR SINAGRA: Ted? Good morning.

Z. THADDEUS ZAWACKI: Good morning, Mr. Chairman. Good morning, Committee.

This morning I am here on behalf of the New Jersey State Society of Certified Public Accountants, which approximates 13,000 professional people within the State of New Jersey.

SENATOR INVERSO: May I interrupt you? Would you like us to stand and salute to that? (laughter)

MR. ZAWACKI: No, sir. Senator, you may be seated for the rest of the time.

SENATOR INVERSO: Thank you. That's my leader.

MR. ZAWACKI: For a couple more months only.

As a Society of CPAs, we strongly support the enactment of legislation authorizing "S corporations" and also LLCs. I think it is time that the State of New Jersey becomes competitive with our neighboring states. New York has it; Pennsylvania has it; Delaware has it; and I think we are just lagging behind. I know the State Society has addressed this issue for about 15 years hence, and it seems that we have been fighting a losing battle. Every time we go back to the archives and pull out some of our information, it is the same old thing -- double taxation. Where is all of our business going but across the rivers to the other states that give a small businessperson an opportunity to reinvest in their own companies by utilization of an "S corporation."

I mentioned to avoid double taxation. Just as an example, the State of New Jersey does not recognize "S" presently, so therefore if you elect "S" status, and you are doing business in the State of New Jersey, or you are a New Jersey corporation, you have a flow-through provision on the

Federal basis whereby it would flow through to you on your individual tax return. On the State of New Jersey, you have to file a New Jersey corporation business tax, or be taxed as a straight "C corporation."

You have a two-edged sword here. You are paying tax on the income that is derived and also you would be paying personal income tax if there was a dividend declared. For example, if you have a New Jersey business that has a \$1000 profit in the year 1992, presently they would pay a tax at the corporate level on that. If it was not distributed in '92, there would be no personal income tax. Let's say in 1993 the same corporation has a \$500 taxable income. They would pay a tax on a straight corporation business tax return. And let's say they determine that they are going to distribute approximately \$2000 to their shareholders, whatever number that may be. Under the New Jersey base which you have, they are under the FIFO -- first in, first out. It is not coming from earnings and profits that you accumulated that current year, but it goes back to the built-in profits that were there. So with the first in, first out method, you would take 1992's income, and that is where the distribution would be made. So you would have a double taxation there. You have it on the corporation itself, and you also have it on the individuals.

When dealing with a small business -- and I am a sole proprietor; I have my practice in Point Pleasant Beach, and I reside in Holmdel-- I think most of the local practitioners who deal with small businesses-- It is a detriment to us, or I should say to the taxpayers themselves, not to have an "S corp" within the State of New Jersey. When you sit down with the individuals to map out how they are going to do their business, either as a sole proprietor or a partnership or a corporation, you explain the different choices they have and what the pros and cons of them are.

Committee Meeting

of

JOINT LEGISLATIVE COMMITTEE ON ECONOMIC RECOVERY

"General economic conditions in the State and steps the Committee can take to further bolster the economic recovery that is currently underway. Also addressd were various tax incentive proposals deemed beneficial to business expansion and business location in the State"

LOCATION: Marlboro Town Hall
Courthouse
Marlboro, New Jersey

DATE: March 24, 1993
10:00 a.m.

MEMBERS OF JOINT COMMITTEE PRESENT:

Senator Jack Sinagra, Chairperson
Assemblywoman Harriet Derman, Vice-Chairperson
Senator John O. Bennett
Assemblyman Steve Corodemus



ALSO PRESENT:

Assemblyman Thomas R. Smith
District 11

Christopher R. Berry
Office of Legislative Services
Aide, Joint Legislative Committee
on Economic Recovery

Hearing Recorded and Transcribed by

The Office of Legislative Services, Public Information Office,
Hearing Unit, State House Annex, CN 068, Trenton, New Jersey 08625

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\$4000 -- and the cost of workers' compensation. I quote from an article that appeared in the "Kiplinger Washington Letter," dated November 20, 1992: "Employers look to Oregon for ideas in holding down their costs. Workers' comp premiums have dropped 30 percent in the past three years. Those filing claims in Oregon must prove that an injury is work-related. Lawyer fees are limited to 10 percent. Workers must use managed care doctors. Anyone hurt must be rehired, but cannot file a claim for another three years."

In closing, I appreciate the fact that you've given me this opportunity to testify before you today. I trust this testimony will not fall on deaf ears, and that your Committee will take positive action to bring about economic recovery for the State of New Jersey. Thank you.

SENATOR SINAGRA: Thank you. Any questions?

ASSEMBLYWOMAN DERMAN: No. I do want to comment, though, we are working diligently with respect to "S Corporation" legislation. It's my own personal baby, and I'm optimistic that we'll have it at least for January 1, 1994 in some form, perhaps like New York's which is the hybrid system.

MR. HENRY: This is for "S Corps?"

ASSEMBLYWOMAN DERMAN: Yes.

MR. HENRY: Yes. It would be really great if you could just get your system tied to the Federal system. Then you have one tax return and you can send it off to the State and pay the appropriate taxes that are due. But right now, the State does not recognize accelerated depreciation. There are inventory adjustments that you have to make, and it just goes on and on. But we appreciate the fact that you're at least listening to us.

ASSEMBLYWOMAN DERMAN: Oh, no. Considerable effort is being made to find a S bill that can be--

MR. HENRY: I can't hear you because--

generating jobs and private investment in the designated zones. Expanding the classification to Asbury Park, Long Branch, and Lakewood, would provide a badly needed economic boost for those municipalities and their surrounding areas. The key to the success of the program is the tax incentives included in the legislation.

And additional tax incentive which MODC favors is the legislation exempting subchapter "S Corporations" from the corporate income tax. Passage of this legislation would encourage retention of existing small businesses and the startup of new ones. On February 5, MODC adopted a resolution in support of Assembly Bill No. 273, and Senate Bill No. 19, and forwarded that resolution to our legislators.

MODC supports other measures having a positive impact on the economy. On January 3, we adopted a resolution supporting the extension of the commuter rail service from Matawan to Lakewood. Not only would many jobs be created in the expansion process, but congestion on our highways, particularly Route 9, would be reduced.

We also supported a resolution on February 7, 1992 encouraging the legislators to lift the cap on the State Transportation Trust Fund, and we're gratified that the Legislature did so. Part of the purpose of raising the cap was to stimulate the economy. MODC would like to see some of that Trust Fund money spent in Monmouth and Ocean Counties so that more people would be put to work, and soon.

We also support increasing the State budget for tourism promotion. The New Jersey Division of Travel and Tourism released a 1991 study which reported that for every \$1 million invested, \$70 million is generated in increased business. Because of the unfavorable publicity generated by the December 11 northeaster, it is more important than ever that the State increase the tourism budget. Tourism, the No. 2 industry in the State, is vital to the economic life of the



Committee Meeting

of

JOINT LEGISLATIVE COMMITTEE ON ECONOMIC RECOVERY

"The State's ability to retain and attract business"

LOCATION: Committee Room 9
Legislative Office Building
Trenton, New Jersey

DATE: January 28, 1993
1:00 p.m.

MEMBERS OF COMMITTEE PRESENT:

Senator Jack Sinagra, Chairperson
Assemblywoman Harriet Derman, Vice-Chairperson
Senator Peter Inverso
Senator John H. Adler
Assemblyman Jose F. Sosa



ALSO PRESENT:

Christopher R. Berry
Office of Legislative Services
Aide, Joint Committee on Economic Recovery

Hearing Recorded and Transcribed by
The Office of Legislative Services, Public Information Office,
Hearing Unit, 162 W. State St., CN 068, Trenton, New Jersey 08625-0068

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Joint Committee on Economic Recovery 1/28/93

For example, the cost of employee health, which in our company is \$5000 to \$6000 per employee, is two to three times that of South Carolina. Whenever the State mandates changes in regulations affecting business, it affects overhead. Therefore, laws and regulations affecting business should be evaluated for their impact. The general consensus is that small business is the job creator. It must also be agreed that regulations fall disproportionately heavily on small companies, those with less than 500 employees, as the amount of paperwork does not generally change with the size of the company.

It is my belief that our State economy would be best served by inducing responsible manufacturing to locate here. Manufacturing pays higher wages and creates more related jobs than do service functions. This is the manufacturing multiplier.

I would like to address taxes, if I might. Business always targets taxes, and I won't break with the tradition. Most of the discussion seems to center around the division of profits between government and business. Both seem to recognize, somewhat reluctantly, that the other has to get something. The other issues seem to deal with fairness, incentives to invest, and burden on assets.

I won't make any suggestions on the division of profits, but I will address three points for consideration: Domestic international sales corporations' disks, which are established under the Federal Internal Revenue Code to induce export business by providing a partial tax deferral on profits, are fully taxed under New Jersey law.

Another area that does not directly affect our company, but does affect many small companies in our State, is the double taxation of profits of S corporations. I believe New Jersey should be brought in line with Federal tax laws and those of adjoining states.

SENATOR ADLER: That's my bill.

Joint Committee on Economic Recovery 1/28/93

ASSEMBLYWOMAN DERMAN: Excuse me, it's my bill.

MR. GILLESPIE: Congratulations, Senator, and Assemblywoman.

SENATOR ADLER: Actually, yours is a sending bill; mine is a full bill. Yours would bring down the corporate tax rate to just the level to capture the gap between the corporate tax rate and the individual rate. Mine would be, eliminate the taxation for corporations, letting a pure pass-through for just taxation of individuals. They're tough bills. Mine does what he wants to do.

ASSEMBLYWOMAN DERMAN: Except mine is likely to pass. (laughter) With all due respect, mine is a compromise and perhaps more realistic. It would be like a New York system. It would tax the difference between the highest corporate rate and the highest individual rate -- that gap. If I had my druthers, I would recommend Senator Adler's bill.

SENATOR INVERSO: I would rather see a flow-through. I would like to see it just-- You know, we recognize S corporations much like the Federal recognizes S corporations. I think my bill is your bill, which is different than his bill. Do you have a bill, Jack? Maybe we can discuss yours.

ASSEMBLYWOMAN DERMAN: No, but I also know what a disk is. How about that?

SENATOR INVERSO: The message is there, though. You're absolutely right. We're out of pace. We should bring those two together.

MR. GILLESPIE: Thank you.

I would be somewhat remiss if I didn't take this opportunity to voice support for excluding business personal property from local taxes. Income taxes--

SENATOR ADLER: We did that. Didn't we do that?

SENATOR SINAGRA: We did that already. We have taken care of that already.