

54: 10A-5

LEGISLATIVE HISTORY CHECKLIST
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(Taxation of S corporations)

NJSA: 54:10A-5

LAWS OF: 1997 **CHAPTER:** 40

BILL NO: S231

SPONSOR(S): Inverso

DATE INTRODUCED: Pre-filed

COMMITTEE: ASSEMBLY: Appropriations

SENATE: State Government; Budget

AMENDED DURING PASSAGE: Yes Amendments denoted by asterisks
Third reprint enacted

DATE OF PASSAGE: ASSEMBLY: December 12, 1996 Re-enacted 3-24-97

SENATE: June 20, 1996 Re-enacted 3-24-97

DATE OF APPROVAL: March 27, 1997

FOLLOWING STATEMENTS ARE ATTACHED IF AVAILABLE:

SPONSOR STATEMENT: Yes Also attached: statement with
floor amendments, adopted
6-13-96

COMMITTEE STATEMENT: ASSEMBLY: Yes

SENATE: Yes 3-14-96 & 5-2-96

FISCAL NOTE: No

VE TO MESSAGE: Yes

MESSAGE ON SIGNING: No

FOLLOWING WERE PRINTED:
REPORTS: No

HEARINGS: No

KBP:pp

[Third Reprint]
SENATE, No. 231

STATE OF NEW JERSEY

PRE-FILED FOR INTRODUCTION IN THE 1996 SESSION

By Senators INVERSO, ADLER, Lipman, Scott, Bubba,
Assemblyman DeSopo and Senator Casey

1 AN ACT concerning the taxation of S corporations under the
2 corporation business tax, amending P.L.1945, c.162.

3

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

6

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

9 5. The franchise tax to be annually assessed to and paid by each
10 taxpayer shall be the sum of the amount computed under subsection
11 (a) hereof, or in the alternative to the amount computed under
12 subsection (a) hereof, the amount computed under subsection (f)
13 hereof, and the amount computed under subsection (c) hereof:

14 (a) That portion of its entire net worth as may be allocable to this
15 State as provided in section 6, multiplied by the following rates: 2
16 mills per dollar on the first \$100,000,000.00 of allocated net worth;
17 4/10 of a mill per dollar on the second \$100,000,000.00; 3/10 of a mill
18 per dollar on the third \$100,000,000.00; and 2/10 of a mill per dollar
19 on all amounts of allocated net worth in excess of \$300,000,000.00;
20 provided, however, that with respect to reports covering accounting
21 or privilege periods set forth below, the rate shall be that percentage
22 of the rate set forth in this subsection for the appropriate year:

23

24 Accounting or Privilege

25 Periods Beginning on or

26 After:

27 April 1, 1983

28 July 1, 1984

The Percentage of the Rate

to be Imposed Shall Be:

75%

50%

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

Matter underlined thus is new matter.

Matter enclosed in superscript numerals has been adopted as follows:

¹ Senate SSG committee amendments adopted March 14, 1996.

² Senate floor amendments adopted June 13, 1996.

³ Senate amendments adopted in accordance with Governor's recommendations March 10, 1997.

1 July 1, 1985 25%

2 July 1, 1986 0

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

4 (c) (1) For a taxpayer that is not a New Jersey S corporation, 3¼%
5 of its entire net income or such portion thereof as may be allocable to
6 this State as provided in section 6 of P.L.1945, c.162 (C.54:10A-6);
7 provided, however, that with respect to reports covering accounting
8 or privilege periods or parts thereof ending after December 31, 1967,
9 the rate shall be 4¼%; and that with respect to reports covering
10 accounting or privilege periods or parts thereof ending after
11 December 31, 1971, the rate shall be 5½%; and that with respect to
12 reports covering accounting or privilege periods or parts thereof
13 ending after December 31, 1974, the rate shall be 7½%; and that with
14 respect to reports covering accounting or privilege periods or parts
15 thereof ending after December 31, 1979, the rate shall be 9%;
16 provided however, that for a taxpayer that has entire net income of
17 \$100,000 or less for a privilege period the rate for that privilege period
18 shall be 7½%.

19 (2) For a taxpayer that is a New Jersey S corporation, for privilege
20 periods ²beginning ending on or² before ²July 1, 1996 June 30,
21 ³1997²1998³ the rate determined by subtracting the maximum tax
22 bracket rate provided under N.J.S.54A:2-1 for the privilege period
23 from the tax rate that would otherwise be applicable to the taxpayer's
24 entire net income for the privilege period if the taxpayer were not an
25 S corporation provided under paragraph (1) of this subsection for the
26 privilege period and for privilege periods ²beginning on or ending²
27 ³on or³ after ²July 1, 1996 ³June 30, 1997² July 1, 1998³ the rate
28 shall be 2%, provided however that for a taxpayer that has entire net
29 income of \$100,000 or less for a privilege period ³beginning ending³
30 on or after July 1, ³1996³1998³, the rate for that privilege period
31 shall be 0.5%, multiplied by its entire net income that is not subject to
32 federal income taxation or such portion thereof as may be allocable to
33 this State pursuant to sections 6 through 10 of P.L.1945, c.162
34 (C.54:10A-6 through 54:10A-10); plus

35 (3) For a taxpayer that is a New Jersey S corporation, the tax rate
36 that would otherwise be applicable to the taxpayer's entire net income
37 for the privilege period if the taxpayer were not an S corporation
38 provided under paragraph (1) of this subsection for the privilege
39 period multiplied by its entire net income that is subject to federal
40 income taxation or such portion thereof as may be allocable to this
41 State pursuant to sections 6 through 10 of P.L.1945, c.162
42 (C.54:10A-6 through 54:10A-10).

43 (d) Provided, however, that the franchise tax to be annually
44 assessed to and paid by any investment company or real estate
45 investment trust, which has elected to report as such and has filed its
46 return in the form and within the time provided in this act and the rules

1 and regulations promulgated in connection therewith, shall, in the case
 2 of an investment company, be measured by 25% of its entire net
 3 income and 25% of its entire net worth, and in the case of a real estate
 4 investment trust, by 4% of its entire net income and 15% of its entire
 5 net worth, at the rates hereinbefore set forth for the computation of
 6 tax on net income and net worth, respectively, but in no case less than
 7 \$250.00, and further provided, however, that the franchise tax to be
 8 annually assessed to and paid by a regulated investment company
 9 which for a period covered by its report satisfies the requirements of
 10 Chapter 1, Subchapter M, Part I, Section 852(a) of the federal Internal
 11 Revenue Code shall be \$250.00.

12 (e) The tax assessed to any taxpayer pursuant to this section shall
 13 not be less than \$25.00 in the case of a domestic corporation, \$50.00
 14 in the case of a foreign corporation, or \$250.00 in the case of an
 15 investment company or regulated investment company. Provided
 16 however, that for accounting or privilege periods beginning in calendar
 17 year 1994 and thereafter the minimum taxes for taxpayers other than
 18 an investment company or a regulated investment company shall be as
 19 provided in the following schedule:

20

21	Period Beginning	Domestic	Foreign
22	In Calendar Year	Corporation	Corporation
23		Minimum Tax	Minimum Tax
24	1994	\$ 50	\$100
25	1995	\$100	\$200
26	1996	\$150	\$200
27	1997	\$200	\$200

28

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

37 (f) In lieu of the portion of the tax based on net worth and to be
 38 computed under subsection (a) of this section, any taxpayer, the value
 39 of whose total assets everywhere, less reasonable reserves for
 40 depreciation, as of the close of the period covered by its report,
 41 amounts to less than \$150,000.00, may elect to pay the tax shown in
 42 a table which shall be promulgated by the director.¹

43 (cf: P.L.1995, c.246, s.1)

44

45 2. This act shall take effect immediately.

S231 [3R]

4

1

2

3 Changes corporation business tax rate for S corporations to 2%, or

4 .5% for S corporations with \$100,000 or less annual income.

1 not be less than \$25.00 in the case of a domestic corporation, \$50.00
2 in the case of a foreign corporation, or \$250.00 in the case of an
3 investment company or regulated investment company. Provided
4 however, that for accounting or privilege periods beginning in calendar
5 year 1994 and thereafter the minimum taxes for taxpayers other than
6 an investment company or a regulated investment company shall be as
7 provided in the following schedule:

8

9	Period Beginning	Domestic	Foreign
10	In Calendar Year	Corporation	Corporation
11		Minimum Tax	Minimum Tax
12	1994	\$50	\$100
13	1995	\$100	\$200
14	1996	\$150	\$200
15	1997	\$200	\$200

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

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

30 (cf: P.L.1993, c.173, s.2)

31

32 2. This act shall take effect immediately.

33

34

35

STATEMENT

36

37 This bill changes the reduced corporation business tax rate on S
38 corporations to a fixed rate of 2% over two years.

39 Under subchapter S of the federal Internal Revenue Code, certain
40 business corporations with 35 or fewer shareholders may elect special
41 tax treatment of most of their corporate income. Currently, New
42 Jersey allows corporations that have elected the federal S corporation
43 treatment to also elect special New Jersey taxation, including a
44 reduced tax rate. The corporation business tax rate for S corporation
45 income is determined as the difference between the regular corporation
46 business tax rate (currently 9%) and the highest marginal rate under

1 the New Jersey gross income tax (currently 6.58%), so the S
2 corporation tax rate will be 2.42% for the 1995 taxable year.

3 If the highest marginal rate under the gross income tax is decreased
4 further to 6.37%, the S corporation tax rate will increase to 2.63% for
5 the 1996 taxable year and thereafter.

6 This bill holds the S corporation tax rate at 2.42% for the 1996 tax
7 year and sets the tax rate at 2.00% for tax years thereafter, so that the
8 rate will not increase if the gross income tax rates are again decreased
9 by the Legislature.

10

11

12

13

14 Changes corporation business tax rate for S corporations to fixed 2%
15 rate over two years.

STATEMENT TO
[First Reprint]
SENATE, No. 231

with Senate Floor Amendments
(Proposed By Senator INVERSO)

ADOPTED: JUNE 13, 1996

The purpose of this amendment is to change the date of certain privilege periods for S corporations from before July 1, 1996 or beginning on or after July 1, 1996 to ending on or before June 30, 1997. The purpose of this change is to avoid having the two new tax rates appear on the 1996 tax form.

ASSEMBLY APPROPRIATIONS COMMITTEE

STATEMENT TO

[Second Reprint]

SENATE, No. 231

STATE OF NEW JERSEY

DATED: OCTOBER 7, 1996

The Assembly Appropriations Committee reports favorably Senate Bill No. 231 (2R).

Senate Bill No. 231 (2R) provides fixed tax rates for S corporations, 2% for corporations with annual income in excess of \$100,000 and 0.5% for corporations with annual income of \$100,000 or less.

Under subchapter S of the federal Internal Revenue Code, certain business corporations with 35 or fewer shareholders may elect special tax treatment for most of their corporate income. Currently, New Jersey allows corporations that have elected the federal S corporation treatment to elect special New Jersey taxation, including a reduced tax rate. The corporation business tax rate for S corporation income is currently determined as the difference between the corporation business tax rate (currently 9% for corporations with annual income in excess of \$100,000 and 7.5% for corporations with annual income of \$100,000 or less) and the highest marginal rate under the New Jersey gross income tax (currently 6.37%), so the S corporation tax rate for the 1996 tax year will be 2.63% for corporations with annual income in excess of \$100,000 and 1.13% for corporations with annual income of \$100,000 or less.

The bill sets the tax rate for S corporations at 2% for corporations with annual income in excess of \$100,000 and 0.5% for corporations with annual income of \$100,000 or less for tax years 1997 and thereafter.

This bill is identical to Assembly Bill No. 1827 as amended by the committee.

FISCAL IMPACT:

The New Jersey Division of Taxation has estimated, based on tax information available to it, that the potential fiscal effect of the bill is a loss in corporation business tax revenue of \$5 million for FY1997 and a loss of \$13 million for FY1998.

SENATE STATE GOVERNMENT COMMITTEE

STATEMENT TO

SENATE, No. 231

with committee amendments

STATE OF NEW JERSEY

DATED: MARCH 14, 1996

The Senate State Government Committee reports favorably and with committee amendments Senate, No. 231.

As amended by the committee, the bill provides fixed tax rates for S corporations, 2% for corporations with annual income in excess of \$100,000 and 0.5% for corporations with annual income of \$100,000 or less.

Under subchapter S of the federal Internal Revenue Code, certain business corporations with 35 or fewer shareholders may elect special tax treatment for most of their corporate income. Currently, New Jersey allows corporations that have elected the federal S corporation treatment to elect special New Jersey taxation, including a reduced tax rate. The corporation business tax rate for S corporation income is currently determined as the difference between the corporation business tax rate (currently 9% for corporations with annual income in excess of \$100,000 and 7.5% for corporations with annual income of \$100,000 or less) and the highest marginal rate under the New Jersey gross income tax (currently 6.37%), so the S corporation tax rate for the 1996 tax year will be 2.63% for corporations with annual income in excess of \$100,000 and 1.13% for corporations with annual income of \$100,000 or less.

The bill sets the tax rate for S corporations at 2% for corporations with annual income in excess of \$100,000 and 0.5% for corporations with annual income of \$100,000 or less for tax years 1997 and thereafter.

This bill was prefiled for introduction in the 1996 session pending technical review. As reported, the bill includes the changes required by technical review which has been performed.

COMMITTEE AMENDMENTS

The committee amended the bill to: 1) incorporate changes made by P.L.1995, c.246, which provided a tax rate of 7.5 % for corporations with annual income of \$100,000 or less, 1.5% less than

the regular 9% tax rate for corporations; and 2) provide a tax rate of 0.5%, or 1.5% less than the regular S corporation rate, for S corporations with annual income of \$100,000 or less.

SENATE BUDGET AND APPROPRIATIONS COMMITTEE

STATEMENT TO

[First Reprint]

SENATE, No. 231

STATE OF NEW JERSEY

DATED: MAY 2, 1996

The Senate Budget and Appropriations Committee reports favorably Senate Bill No. 231 (1R).

Senate Bill No. 231 (1R) provides fixed tax rates for S corporations: 2% for corporations with annual income in excess of \$100,000 and 0.5% for corporations with annual income of \$100,000 or less.

Under subchapter S of the federal Internal Revenue Code, certain business corporations with 35 or fewer shareholders may elect special tax treatment for most of their corporate income. Currently, New Jersey allows corporations that have elected the federal S corporation treatment to elect special New Jersey taxation, including a reduced tax rate.

The corporation business tax rate for S corporation income is currently determined as the difference between the corporation business tax rate (currently 9% for corporations with annual income in excess of \$100,000 and 7.5% for corporations with annual income of \$100,000 or less) and the highest marginal rate under the New Jersey gross income tax (currently 6.37%). Therefore, the S corporation tax rate for the 1996 tax year will be 2.63% for corporations with annual income in excess of \$100,000 and 1.13% for corporations with annual income of \$100,000 or less.

The bill sets the tax rate for S corporations at 2% for corporations with annual income in excess of \$100,000 and 0.5% for corporations with annual income of \$100,000 or less for tax years 1997 and thereafter.

As reported, this bill is identical to Assembly Bill No. 1827 of 1996 (DeSopo/Crecco).

FISCAL IMPACT

The Office of Legislative Services (OLS) estimates the enactment of this bill will result in a decrease in corporation business tax revenues of \$11 million annually. This estimate is based on a sample of corporate business taxpayer income analyzed by the Department of Treasury in 1993 and a review of national trends in subchapter S corporation activity. This is a maximum figure that would be reached

of all qualifying S corporations elected New Jersey S corporation status.

SENATE BILL NO. 231
(Second Reprint)

To the Senate:

Pursuant to Article V, Section I, Paragraph 14 of the New Jersey Constitution, I am returning Senate Bill No. 231 (Second Reprint) with my recommendations for reconsideration.

A. Summary of the Bill

This bill changes the way in which an S corporation is taxed. Currently the S corporation tax rate is linked to both the corporation business tax rate and the gross income tax rate. This bill provides lower fixed tax rates for S corporations: 2 percent for a corporation with annual income in excess of \$100,000 and .5 percent for a corporation with annual income of \$100,000 or less.

Under subchapter S of the federal Internal Revenue Code, certain business corporations with 35 or fewer shareholders may elect special tax treatment for most of their corporate income. Each state can establish its own system of taxation of these "S corporations" for state tax purposes. In New Jersey the corporation business tax rate for an S corporation is currently determined as the difference between the corporation business tax rate (currently 9 percent for a corporation with annual income in excess of \$100,000 and 7.5 percent for a corporation with annual income of \$100,000 or less) and the highest marginal rate under the New Jersey Gross Income Tax (currently 6.37 percent). Thus, the S corporation tax rate for the 1996 tax year is 2.63 percent for a corporation with annual income in excess of \$100,000 and 1.13 percent for a corporation with annual income of \$100,000 or less.

B. Recommended Action

I commend the sponsors on the goal of this bill to directly benefit thousands of our small business owners by establishing a lower fixed rate for S corporations. That tax cut will, in turn, help them to create more jobs in New Jersey. As I said in my recent State of the State Address, I look forward to signing legislation that accomplishes this worthwhile objective. I am concerned, however, about the timing of the bill's fiscal impact on the General Fund. It is estimated that the bill would have approximately a \$5 million impact in the State's current fiscal year and might even necessitate tax refunds from the State to some S corporations.

Accordingly, I am recommending that the privilege periods to which the lower fixed rate will apply be postponed for one year so that it will apply to privilege periods ending on or after July 1, 1998.

Therefore, I herewith return Senate Bill No. 231 (Second Reprint) and recommend that it be amended as follows:

<u>Page 2, Section 1, Line 19:</u>	Delete "1997" and insert "1998"
<u>Page 2, Section 1, Line 24:</u>	After "ending" insert "on or"
<u>Page 2, Section 1, Line 25:</u>	Delete "June 30, 1997" and insert "July 1, 1998"
<u>Page 2, Section 1, Line 27:</u>	Delete "beginning" and insert "ending"; delete "1996" and insert "1998"

Respectfully,
/s/ Christine Todd Whitman
GOVERNOR

[seal]

Attest:

/s/ Michael P. Torpey
Chief Counsel to the Governor