

LEGISLATIVE FISCAL ESTIMATE
SENATE, No. 1962
STATE OF NEW JERSEY
209th LEGISLATURE

DATED: JANUARY 10, 2001

SUMMARY

Synopsis: Concerns payment obligations of certain partnerships and limited liability companies and certain of their partners and members under the corporation business tax.

Type of Impact: Limits potential decreases in corporation business tax revenue.

Agencies Affected: Department of the Treasury, Division of Taxation.

Office of Legislative Services Estimate

Fiscal Impact	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>
State Revenue	Indeterminate	Indeterminate	Indeterminate

- ! The bill requires limited liability companies and limited partnerships classified as partnerships for federal tax purposes to obtain the consent of each of its non-individual (e.g., incorporated) members or partners to New Jersey taxation. A business that does not have the consent for one of its "non-individual" (usually incorporated) owners must pay corporation business tax on that nonconsenting owner's share of the business' New Jersey income.
- ! The bill forecloses an avenue of corporation business tax avoidance. No information is currently available about the level of business use of the method, so no estimate can be made of the amount of revenue loss curtailed.

BILL DESCRIPTION

Senate Bill No.1962 of 2000 closes a gap in the administration of the taxes imposed on the owners of limited partnerships and limited liability companies.

Limited partnerships and limited liability companies are relatively new forms of business entities that have become popular because they combine some of the tax advantages of a pass-through entity such as a general partnership (e.g., lack of both an entity-level tax and a distributee-level tax on distributed earnings) and the sort of limited liability for owners that is provided by the corporate form of organization.

The bill provides a consent mechanism, similar to that provided by P.L.1993, c.173 to assure the taxation of Subchapter S corporation owners, for the taxation of limited corporate owners of limited liability companies and limited partnerships. A limited liability company, foreign limited liability company, limited partnership or foreign limited partnership that is classified as a partnership for federal tax purposes is required to obtain the consent of each of its owners that are not individuals, trusts or estates subject to the "New Jersey Gross Income Tax Act", N.J.S.54A:1-1 et seq. (for example, each owner that is itself a corporation) to this State's right and jurisdiction to tax the entire income derived from the business. A business that does not have the consent for one of its "non-individual" (usually incorporated) owners must pay corporation business tax on that nonconsenting owner's share of the business' New Jersey income.

A limited liability company, foreign limited liability company, limited partnership or foreign limited partnership (that is classified as a partnership for federal tax purposes) that properly complies with the requirement to obtain consents from its corporate owners and that pays the taxes of any of its corporate owners that do not consent to New Jersey taxation is relieved of any other obligations under the corporation business tax. A limited liability company or limited liability partnership that does not comply with its owners' consent and payment requirements becomes a corporation business taxpayer itself.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The professional literature on state taxation of business organizations and their owners notes that the taxability of the owners of these new business entities, the partners of limited partnerships and the members of limited liability companies, as would be expected of such new business types, is not well established under case law. This literature suggests a number of creative arguments that could be used to dispute the taxability of limited liability company and limited partnership owners under state corporate income tax laws.

While the amount of corporation business tax revenue that would be at risk of challenge is not currently known and cannot be accurately estimated, it is not unreasonable to assume that there would be some challenges to taxation. This bill curtails those routes of tax avoidance.

Section: *Revenue, Finance and Appropriations*

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