SENATE, No. 61

STATE OF NEW JERSEY

217th LEGISLATURE

PRE-FILED FOR INTRODUCTION IN THE 2016 SESSION

Sponsored by:
Senator RAYMOND J. LESNIAK
District 20 (Union)
Senator LINDA R. GREENSTEIN
District 14 (Mercer and Middlesex)

Co-Sponsored by:
Senator Sarlo

SYNOPSIS

Requires combined reporting of corporation business tax by certain members of unitary business groups.

CURRENT VERSION OF TEXT

Introduced Pending Technical Review by Legislative Counsel.

AN ACT requiring combined reporting of corporation business tax by certain members of unitary business groups, amending P.L.1945, c.162.

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

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

10. a. Whenever it shall appear to the director that any taxpayer fails to maintain its records in accordance with sound accounting principles or conducts its business or maintains its records in such manner as either directly or indirectly to distort its true entire net income or its true entire net worth under this act or the proportion thereof properly allocable to this State, or whenever any taxpayer maintains a place of business outside this State, or whenever any agreement, understanding or arrangement exists between a taxpayer and any other corporation or any person or firm, for the purpose of evading tax under this act, or whereby the activity, business, receipts, expenses, assets, liabilities, income or net worth of the taxpayer are improperly or inaccurately reflected, the director is authorized and empowered, in the director's discretion and in such manner as the director may determine, to adjust and redetermine such items, and to adjust items of gross receipts, tangible or intangible property and payrolls within and without the State and the allocation of entire net income or entire net worth or to make any other adjustments in any tax report or tax returns as may be necessary to make a fair and reasonable determination of the amount of tax payable under this act.

b. Where (1) any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor, or (2) any taxpayer, a substantial portion of whose capital stock is owned either directly or indirectly by or through another corporation, enters into any transaction with such other corporation on such terms as to create an improper loss or net income, the director may include in the entire net income of the taxpayer the fair profits which, but for such agreement, arrangement or understanding, the taxpayer might have derived from such transaction. The director may require any person or corporation to submit such information under oath or affirmation, or to permit

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

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

such examination of its books, papers and documents, as may be necessary to enable the director to determine the existence, nature or extent of an agreement, understanding or arrangement to which this section relates, whether or not such person or corporation is subject to the tax imposed by this act.

c. (1)The entire net income of a taxpayer exercising its franchise in this State that is a member of [an affiliated group or a controlled group pursuant to section 1504 or 1563 of the federal Internal Revenue Code of 1986, 26 U.S.C. s.1504 or 1563,] a combined group shall be determined by totaling the net income or loss of each member of the group derived from a unitary business, eliminating all payments to, or charges by or among, other members of the [affiliated or controlled] combined group [in excess of fair compensation in all inter-group transactions of any kind. Notwithstanding the elimination of all inter-group transactions in excess of fair compensation, if the taxpayer cannot demonstrate by clear and convincing evidence that a report by a taxpayer discloses the true earnings of the taxpayer on its business carried on in this State, the director may, at the director's discretion, require the taxpayer to file a consolidated return of the entire operations of the affiliated group or controlled group, including its own operations and income to the extent permitted under the Constitution and statutes of the United States]. The director shall determine the true amount of entire net income earned by the taxpayer in this State. The [consolidated] entire net income of [the taxpayer] each taxable member of the combined [and of the other members of its affiliated group or controlled] group shall be allocated to this State by use of the applicable allocation formula that the director requires pursuant to P.L.1945, c.162 (C.54A:10A-1 et seq.) be used by the taxpayer; provided however, a taxable member shall use the combined group's denominator for each fraction and each taxable member shall add to the numerator of its sales fraction a share of the aggregate sales of the group's nontaxable members equal to the ratio of the taxable member's sales assigned to this State to the sales assigned to this State of all the taxable members of the combined group. [The return shall include in the allocation formula the property, payrolls, and sales of all corporations for which the return is made.] The director [may] shall require a [consolidated] combined group return under this section without regard to whether the other members of the [affiliated or controlled] combined group [, other than the taxpayer,] are or are not exercising their franchises in this State. Each member of a combined group shall be jointly and severally liable for the tax liability of each member of the combined group.

(2) For the purposes of this subsection:

"Combined group" means the group of all entities that have common ownership and are engaged in a unitary business, if at least one of those entities is subject to the tax imposed pursuant to section 5 of P.L.1945, c.162 (C.54:10A-5);

"Common ownership" means that not less than fifty per cent of the voting control of each member of a combined group is directly or indirectly owned by a common owner or owners, either corporate or noncorporate, whether or not the owner or owners are members of the combined group. Whether voting control is indirectly owned shall be determined pursuant to section 318 of the federal Internal Revenue Code (26 U.S.C. s.318)

"Pass-through entity" means a partnership or a New Jersey S corporation;

"Unitary business" means a single economic enterprise that is made up either of separate parts of a single business entity or of a group of business entities under common ownership, which enterprise is sufficiently interdependent, integrated, or interrelated through its activities so as to provide mutual benefit and produce a significant sharing or exchange of value among such entities, or a significant flow of value among the separate parts. For purposes of this section, a business conducted by a pass-through entity shall be treated as conducted by its members, whether directly held or indirectly held through a series of pass-through entities, to the extent of the member's distributive share of the pass-through entity's income, regardless of the percentage of the member's ownership interest or its distributive or any other share of pass-through entity income, and a business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a pass-through entity if there is a mutual benefit and a significant sharing of exchange or flow of value between the two parts of the business and the two corporations are members of the same group of business entities under common ownership;

[A consolidated return required by this section shall be filed within 60 days after it is demanded, subject to the penalties of the State Uniform Tax Procedure Law, R.S.54:48-1 et seq.

The member of an affiliated group or a controlled group shall incorporate in its return required under this section information needed to determine under this section its taxable entire net income, and shall furnish any additional information the director requires, subject to the penalties of the State Uniform Tax Procedure Law, R.S.54:48-1 et seq. A taxpayer shall furnish any additional information requested within 30 days after it is demanded, subject to the penalties of the State Uniform Tax Procedure Law, R.S.54:48-1 et seq.]

(cf: P.L.2002,c.40, s.10)

2. This act shall take effect immediately and apply to privilege periods ending after its date of enactment.

STATEMENT

This bill provides the corporation business tax with an enhanced compliance tool known as "combined reporting."

Most large businesses are structured as a family of corporations, commonly consisting of a “parent” corporation and its subsidiaries. Many corporate tax shelters depend on the relationship, or legal distance, among related corporations. Combined reporting, by effectively treating the parent and most or all of its subsidiaries as a single corporation for state income tax purposes. wipes out the intercorporate transactions that effectuate these shelters.

More than half of the states with corporate income taxes have adopted combined reporting. A major reason for states' growing interest is their recognition of how badly corporate tax shelters that exploit separate reporting are eroding state corporate income tax payments. Corporations have devised a wide variety of strategies to artificially shift profits to out-of-state subsidiaries to reduce their tax liabilities. Combined reporting largely squelches these strategies by enabling a state to tax a fair share of the profit that would otherwise be shifted into a related, out-of-state corporation.

New Jersey has been a leader in combating avoidance techniques by “traditional” means: case-by-case litigation of particular transactions and the development of anti-shelter legislation targeting classes of abusive inter-corporate arrangements. These traditional means are time consuming and labor intensive. Combined reporting, which eliminates most profit-shifting strategies, can be an important component of maintaining a fair and effective state corporate income tax.