

**ASSEMBLY, No. 4393**

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**STATE OF NEW JERSEY**

**218th LEGISLATURE**

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INTRODUCED SEPTEMBER 13, 2018

**Sponsored by:**

**Assemblyman JOHN J. BURZICHELLI**

**District 3 (Cumberland, Gloucester and Salem)**

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**District 16 (Hunterdon, Mercer, Middlesex and Somerset)**

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**District 16 (Hunterdon, Mercer, Middlesex and Somerset)**

**Co-Sponsored by:**

**Assemblymen DePhillips, Space and Wirths**

**SYNOPSIS**

Allows deduction from New Jersey gross income of certain capital gains from sale or exchange of New Jersey qualified small business stock held for more than five years.

**CURRENT VERSION OF TEXT**

As introduced.



**(Sponsorship Updated As Of: 6/28/2019)**

1    **AN ACT** allowing a deduction from New Jersey gross income of  
2        certain capital gains from sale or exchange of New Jersey  
3        qualified small business stock held for more than five years,  
4        supplementing Title 54A of the New Jersey Statutes.

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

8  
9        1.    a.    Notwithstanding the provisions of N.J.S.54A:5-1, a  
10       taxpayer who is an individual shall be allowed to deduct from the  
11       taxpayer's gross income in a taxable year the eligible gain from the  
12       sale or exchange of New Jersey qualified small business stock held  
13       for more than five years.

14       b.    (1) If the taxpayer has eligible gain for the taxable year from  
15       one or more dispositions of stock issued by any corporation, the  
16       aggregate amount of the gain from dispositions of stock issued by  
17       the corporation which may be taken into account under subsection  
18       a. for the taxable year shall not exceed the greater of either of the  
19       following:

20       (a) Ten million dollars (\$10,000,000) reduced by the aggregate  
21       amount of eligible gain taken into account by the taxpayer under  
22       subsection a. for prior taxable years and attributable to dispositions  
23       of stock issued by the corporation.

24       (b) Ten times the aggregate adjusted bases of qualified small  
25       business stock issued by the corporation and disposed of by the  
26       taxpayer during the taxable year. For purposes of this subparagraph  
27       (b), the adjusted basis of any stock shall be determined without  
28       regard to any addition to basis after the date on which the stock was  
29       originally issued.

30       (2) For purposes of this subsection b., the term "eligible gain"  
31       means any gain from the sale or exchange of qualified small  
32       business stock held for more than five years.

33       (3) (a) In the case of a married individual filing a separate  
34       return, subparagraph (a) of paragraph (1) of this subsection shall be  
35       five million dollars (\$5,000,000).

36       (b) In the case of a married taxpayer filing a joint return, the  
37       amount of gain taken into account under subsection a. shall be  
38       allocated equally between the spouses for purposes of applying this  
39       subsection to subsequent taxable years.

40       c.    As used in this section:

41       (1) "Qualified small business stock" means any stock in a C  
42       corporation which is originally issued after the effective date of  
43       P.L.     , c. (C.     ) (pending before the Legislature as this bill), if  
44       both of the following apply:

45       (a) As of the date of issuance, the corporation is a qualified  
46       small business.

1 (b) Except as provided in subsections e. and g., the stock is  
2 acquired by the taxpayer at its original issue (directly or through an  
3 underwriter) in either of the following manners:

4 (i) In exchange for money or other property (not including  
5 stock).

6 (ii) As compensation for services provided to the corporation  
7 (other than services performed as an underwriter of the stock).

8 (2) (a) Stock in a corporation shall not be treated as qualified  
9 small business stock unless, during substantially all of the  
10 taxpayer's holding period for the stock, the corporation meets the  
11 active business requirements of subsection d. of this section and the  
12 corporation is a C corporation.

13 (b) (i) Notwithstanding subsection d. of this section, a  
14 corporation shall be treated as meeting the active business  
15 requirements of subsection d. for any period during which the  
16 corporation qualifies as a specialized small business investment  
17 company.

18 (ii) For purposes of subparagraph (i) of this subparagraph,  
19 the term "specialized small business investment company" means  
20 any eligible corporation (as defined in paragraph (4) of subsection  
21 d. of this section) that is licensed to operate under Section 301(d) of  
22 the federal Small Business Investment Act of 1958 (as in effect on  
23 May 13, 1993).

24 (3) (a) Stock acquired by the taxpayer shall not be treated as  
25 qualified small business stock if, at any time during the four-year  
26 period beginning on the date two years before the issuance of the  
27 stock, the corporation issuing the stock purchased (directly or  
28 indirectly) any of its stock from the taxpayer or from a related  
29 person to the taxpayer. For the purposes of this subparagraph,  
30 "related person" means a corporation, partnership, association or  
31 trust controlled by the taxpayer; an individual, corporation,  
32 partnership, association or trust that is in the control of the  
33 taxpayer; a corporation, partnership, association or trust controlled  
34 by an individual, corporation, partnership, association or trust that  
35 is in the control of the taxpayer; or a member of the same controlled  
36 group as the taxpayer.

37 (b) Stock issued by a corporation shall not be treated as  
38 qualified small business stock if, during the two-year period  
39 beginning on the date one year before the issuance of the stock, the  
40 corporation made one or more purchases of its stock with an  
41 aggregate value (as of the time of the respective purchases)  
42 exceeding five percent of the aggregate value of all of its stock as of  
43 the beginning of the two-year period.

44 (c) If any transaction is treated under section 304(a) of the  
45 Internal Revenue Code (26 U.S.C. s.304(a)) as a distribution in  
46 redemption of the stock of any corporation, for purposes of  
47 subparagraphs (a) and (b), the corporation shall be treated as  
48 purchasing an amount of its stock equal to the amount treated as a

1 distribution in redemption of the stock of the corporation under  
2 section 304(a) of the Internal Revenue Code (26 U.S.C. s.304(a)).

3 (4) “Qualified small business” means any domestic corporation  
4 (as defined in section 7701(a)(4) of the Internal Revenue Code (26  
5 U.S.C. s.7701(a)(4))) which is a C corporation, if all of the  
6 following apply:

7 (a) The aggregate gross assets of the corporation (or any  
8 predecessor thereof) at all times on or after the effective date of  
9 P.L. , c. (C. ) (pending before the Legislature as this bill),  
10 and before the issuance did not exceed \$50,000,000;

11 (b) The aggregate gross assets of the corporation immediately  
12 after the issuance (determined by taking into account amounts  
13 received in the issuance) do not exceed \$50,000,000, where  
14 “aggregate gross assets” mean the amount of cash and the aggregate  
15 adjusted basis of other property held by the corporation, but the  
16 adjusted basis of any property contributed to the corporation (or  
17 other property with a basis determined in whole or in part by  
18 reference to the adjusted basis of property so contributed) shall be  
19 determined as if the basis of the property contributed to the  
20 corporation immediately after the contribution was equal to its fair  
21 market value as of the time of the contribution; and

22 (c) Has fewer than 225 employees and at least 80 percent of the  
23 corporation’s payroll, as measured by total dollar value, is  
24 attributable to employment located within this State.

25 Provided, however, that all corporations which are members of the  
26 same parent-subsidiary controlled group shall be treated as one  
27 corporation for purposes of this subsection, where “parent-  
28 subsidiary controlled group” means any controlled group of  
29 corporations as defined in section 1563(a)(1) of the Internal  
30 Revenue Code (26 U.S.C. s.1563(a)(1)), except that that  
31 percentages of ownership and value that control shall exist in  
32 situations involving at least 50 percent of ownership and value as  
33 otherwise provided involving at least 80 percent required by section  
34 1563(a)(1) (26 U.S.C. s.1563(a)(1)), and section 1563(a)(4) of the  
35 Internal Revenue Code (26 U.S.C. s.1563(a)(4)) shall not apply.

36 d. (1) The active business requirements of paragraph (2) of  
37 subsection c. shall be met by a corporation for any period if during  
38 that period:

39 (a) At least 80 percent (by value) of the assets of the corporation  
40 are used by the corporation in the active conduct of one or more  
41 qualified trades or businesses; and

42 (b) The corporation is a domestic corporation, but shall not  
43 include any of the following: (i) a domestic international sales  
44 corporation (DISC) or former DISC; (ii) A corporation with respect  
45 to which an election under section 936 of the Internal Revenue  
46 Code (26 U.S.C. s.936) is in effect or which has a direct or indirect  
47 subsidiary with respect to which the election is in effect; (iii) A  
48 regulated investment company, real estate investment trust (REIT),

1 or real estate mortgage investment conduit (REMIC); or (iv) A  
2 cooperative.

3 (2) For purposes of this paragraph (2), if, in connection with any  
4 future qualified trade or business, a corporation is engaged in:

5 (a) Startup activities described in section 195(c)(1)(A) of the  
6 Internal Revenue Code (26 U.S.C. s.195(c)(1)(A)),

7 (b) Activities resulting in the payment or incurring of  
8 expenditures which may be treated as research and experimental  
9 expenditures under section 174 of the Internal Revenue Code (26  
10 U.S.C. s.174), or

11 (c) Activities with respect to in-house research expenses  
12 described in section 41(b)(4) of the Internal Revenue Code (26  
13 U.S.C. s.41(b)(4)), then assets used in those activities shall be  
14 treated as used in the active conduct of a qualified trade or business.  
15 Any determination under this paragraph (1) shall be made without  
16 regard to whether a corporation has any gross income from those  
17 activities at the time of the determination.

18 (3) For purposes of this subsection d., “qualified trade or  
19 business” means any trade or business other than any of the  
20 following:

21 (a) Any trade or business involving the performance of services  
22 in the fields of health, law, engineering, architecture, accounting,  
23 actuarial science, performing arts, consulting, athletics, financial  
24 services, brokerage services, or any trade or business where the  
25 principal asset of the trade or business is the reputation or skill of  
26 one or more of its employees.

27 (b) Any banking, insurance, financing, leasing, investing, or  
28 similar business.

29 (c) Any farming business (including the business of raising or  
30 harvesting trees).

31 (d) Any business involving the production or extraction of  
32 products of a character with respect to which a deduction is  
33 allowable under section 613 or 613A of the Internal Revenue Code  
34 (26 U.S.C. s.613 or s.613A).

35 (e) Any business of operating a hotel, motel, restaurant, or  
36 similar business.

37 (4) (a) For purposes of this subsection d., stock and debt in any  
38 subsidiary corporation shall be disregarded and the parent  
39 corporation shall be deemed to own its ratable share of the  
40 subsidiary’s assets, and to conduct its ratable share of the  
41 subsidiary’s activities.

42 (b) A corporation shall be treated as failing to meet the  
43 requirements of paragraph (1) of this subsection d. for any period  
44 during which more than 10 percent of the value of its assets (in  
45 excess of liabilities) consists of stock or securities in other  
46 corporations which are not subsidiaries of the corporation (other  
47 than assets described in paragraph (5) of this subsection).

1 (c) For purposes of this paragraph (4), a corporation shall be  
2 considered a subsidiary if the parent owns more than 50 percent of  
3 the combined voting power of all classes of stock entitled to vote,  
4 or more than 50 percent in value of all outstanding stock, of the  
5 corporation.

6 (5) For purposes of subparagraph (a) of paragraph (1) of this  
7 subsection d., the following assets shall be treated as used in the  
8 active conduct of a qualified trade or business:

9 (a) Assets that are held as a part of the reasonably required  
10 working capital needs of a qualified trade or business of the  
11 corporation.

12 (b) Assets that are held for investment and are reasonably  
13 expected to be used within two years to finance research and  
14 experimentation in a qualified trade or business or increases in  
15 working capital needs of a qualified trade or business. For periods  
16 after the corporation has been in existence for at least two years, in  
17 no event may more than 50 percent of the assets of the corporation  
18 qualify as used in the active conduct of a qualified trade or business  
19 by reason of this paragraph.

20 (6) A corporation shall not be treated as meeting the  
21 requirements of paragraph (1) of this subsection d. for any period  
22 during which more than 10 percent of the total value of its assets  
23 consists of real property that is not used in the active conduct of a  
24 qualified trade or business. For purposes of the preceding sentence,  
25 the ownership of, dealing in, or renting of, real property shall not be  
26 treated as the active conduct of a qualified trade or business.

27 (7) For purposes of paragraph (1) of this subsection, rights to  
28 computer software that produces active business computer software  
29 royalties (within the meaning of section 543(d)(1) of the Internal  
30 Revenue Code (26 U.S.C. s.543(d)(1))) shall be treated as an asset  
31 used in the active conduct of a trade or business.

32 e. If any stock in a corporation is acquired solely through the  
33 conversion of other stock in the corporation that is qualified small  
34 business stock in the hands of the taxpayer, the stock so acquired  
35 shall be treated as qualified small business stock in the hands of the  
36 taxpayer and the stock so acquired shall be treated as having been  
37 held during the period during which the converted stock was held.

38 f. (1) If any amount included in gross income by reason of  
39 holding an interest in a pass-through entity meets the requirements  
40 of paragraph (2) of this subsection f., the following shall apply:

41 (a) The amount shall be treated as gain described in subsection  
42 a. of this section; and

43 (b) For purposes of applying subsection b. of this section, the  
44 amount shall be treated as gain from a disposition of stock in the  
45 corporation issuing the stock disposed of by the pass-through entity  
46 and the taxpayer's proportionate share of the adjusted basis of the  
47 pass-through entity in the stock shall be taken into account.

1       (2) An amount shall meet the requirements of paragraph (1) of  
2 this subsection f. if:

3       (a) The amount is attributable to gain on the sale or exchange by  
4 the pass-through entity of stock that is qualified small business  
5 stock in the hands of the entity (determined by treating the entity as  
6 an individual) and that was held by that entity for more than five  
7 years; and

8       (b) The amount is includable in the gross income of the taxpayer  
9 by reason of the holding of an interest in the entity that was held by  
10 the taxpayer on the date on which the pass-through entity acquired  
11 the stock and at all times thereafter before the disposition of the  
12 stock by the pass-through entity.

13 Provided however, that paragraph (1) of this subsection f. shall not  
14 apply to any amount to the extent the amount exceeds the amount to  
15 which that paragraph (1) would have applied if the amount was  
16 determined by reference to the interest the taxpayer held in the  
17 pass-through entity on the date the qualified small business stock  
18 was acquired. Provided further, that “pass-through entity” means  
19 any of the following: a partnership; an S corporation; a regulated  
20 investment company; or a common trust fund.

21       g. For purposes of this section:

22       (1) In the case of a transfer described in paragraph (2) of this  
23 subsection, the transferee shall be treated as meeting both: having  
24 acquired the stock in the same manner as the transferor; and having  
25 held the stock during any continuous period immediately preceding  
26 the transfer during which it was held (or treated as held under this  
27 subdivision) by the transferor.

28       (2) A transfer is described in this subsection if the transfer is  
29 any of the following:

30       (a) By gift.

31       (b) At death.

32       (c) From a partnership to a partner of stock with respect to  
33 which requirements similar to the requirements of subsection f. of  
34 this section are met at the time of the transfer (without regard to the  
35 five-year holding period requirement).

36       (3) Rules similar to the rules of section 1244(d)(2) of the  
37 Internal Revenue Code (26 U.S.C. s.1244(d)(2)) shall apply for  
38 purposes of this section.

39       (4) (a) In the case of a transaction described in section 351 of  
40 the Internal Revenue Code (26 U.S.C. s.351) or a reorganization  
41 described in section 368 of the Internal Revenue Code (26 U.S.C.  
42 s.368), if qualified small business stock is exchanged for other stock  
43 that would not qualify as qualified small business stock but for this  
44 paragraph (4), the other stock shall be treated as qualified small  
45 business stock acquired on the date on which the exchanged stock  
46 was acquired.

47       (b) This subsection e. shall apply to gain from the sale or  
48 exchange of stock treated as qualified small business stock by

1 reason of subparagraph (a) of this paragraph only to the extent of  
2 the gain that would have been recognized at the time of the transfer  
3 described in subparagraph (a) of this paragraph if section 351 or  
4 368 of the Internal Revenue Code (26 U.S.C. s.351 or s.368) had  
5 not applied at that time. The preceding sentence shall not apply if  
6 the stock that is treated as qualified small business stock by reason  
7 of subparagraph (a) of this paragraph is issued by a corporation that  
8 (as of the time of the transfer described in that subparagraph (a)) is  
9 a qualified small business.

10 (c) For purposes of this paragraph (4), stock treated as qualified  
11 small business stock under subparagraph (a) shall be so treated for  
12 subsequent transactions or reorganizations, except that the  
13 limitation of subparagraph (b) shall be applied as of the time of the  
14 first transfer to which the limitation applied (determined after the  
15 application of the second sentence of subparagraph (b)).

16 (d) In the case of a transaction described in section 351 of the  
17 Internal Revenue Code (26 U.S.C. s.351), this paragraph shall apply  
18 only if immediately after the transaction the corporation issuing the  
19 stock owns directly or indirectly stock representing control (within  
20 the meaning of section 368(c) of the Internal Revenue Code (26  
21 U.S.C. s.368)) of the corporation whose stock was exchanged.

22 h. For purposes of this section:

23 (1) In the case in which the taxpayer transfers property (other  
24 than money or stock) to a corporation in exchange for stock in the  
25 corporation, the stock shall be treated as having been acquired by  
26 the taxpayer on the date of the exchange and the basis of the stock  
27 in the hands of the taxpayer shall in no event be less than the fair  
28 market value of the property exchanged.

29 (2) If the adjusted basis of any qualified small business stock is  
30 adjusted by reason of any contribution to capital after the date on  
31 which the stock was originally issued, in determining the amount of  
32 the adjustment by reason of the contribution, the basis of the  
33 contributed property shall in no event be treated as less than its fair  
34 market value on the date of the contribution.

35 i. (1) If the taxpayer has an offsetting short position with  
36 respect to any qualified small business stock, subsection a. shall not  
37 apply to any gain from the sale or exchange of the stock unless the  
38 stock was held by the taxpayer for more than five years as of the  
39 first day on which there was such a short position and the taxpayer  
40 elects to recognize gain as if the stock was sold on that first day for  
41 its fair market value.

42 (2) For purposes of paragraph (1) of this subsection, the  
43 taxpayer shall be treated as having an offsetting short position with  
44 respect to any qualified small business stock if any of the following  
45 apply:

46 (a) The taxpayer has made a short sale of substantially identical  
47 property.



1 (b) The taxpayer has acquired an option to sell substantially  
2 identical property at a fixed price.

3 (c) To the extent provided in regulations, the taxpayer has  
4 entered into any other transaction that substantially reduces the risk  
5 of loss from holding the qualified small business stock. For  
6 purposes of the preceding sentence, any reference to the taxpayer  
7 shall be treated as including a reference to any person who is related  
8 (within the meaning of section 267(b) or 707(b) of the Internal  
9 Revenue Code (26 U.S.C. s.267(b) or s.707(b))) to the taxpayer.

10 j. A corporation that issues qualified small business stock  
11 agrees to submit reports to the Director of the Division of Taxation  
12 in the Department of the Treasury and to its shareholders as the  
13 director may require to carry out the purposes of this section.

14  
15 2. The Director of the Division of Taxation in the Department  
16 of the Treasury shall prescribe regulations pursuant to the provision  
17 of the "Administrative Procedure Act," P.L.1968, c.410 (C.52:14B-  
18 1 et seq.) as may be appropriate to carry out the purposes of this act,  
19 including any regulations that may conform to those regulations  
20 promulgated by the Secretary of the Treasury under section 1202(k)  
21 of the Internal Revenue Code (26 U.S.C. s.1202(k)) that shall apply  
22 to the extent that those regulations do not conflict with this act, and  
23 such further regulation that shall include but be not limited to  
24 regulations to prevent the avoidance of the purposes of this act  
25 through splitups, shell corporations, partnerships, or otherwise.

26  
27 3. This act shall take effect immediately.

## 30 STATEMENT

31  
32 This bill allows for a deduction from New Jersey gross income  
33 of capital gains from the sale or exchange of New Jersey qualified  
34 small business stock held for more than five years. The deduction  
35 for these capital gains is modeled on the federal Internal Revenue  
36 Code capital gains exclusion for owners of Qualified Small  
37 Business Stock (QSBS) under section 1202 of the federal Internal  
38 Revenue Code. The deduction under this bill will help promote  
39 investment in New Jersey based small and medium size companies  
40 that find it difficult to attract initial capital investors because these  
41 companies are usually not profitable for their first few years.  
42 Generally, QSBS stock is originally issued C corporation stock held  
43 for at least 5 years in a corporation with no more than \$50 million  
44 in assets at issuance. This deduction will apply to C corporations  
45 established on and after the enactment of the bill. No New Jersey  
46 gross income taxpayer will receive any capital gains benefit without  
47 holding the QSBS stock for at least 5 years.

1 For individual taxpayer/investors to qualify for the special  
2 capital gains treatment under section 1202 and this New Jersey  
3 gross income tax deduction, the stock must be in a domestic C  
4 corporation (not an S corporation or LLC), and it must be a C  
5 corporation during substantially all the time the individual holds the  
6 stock. The C corporation may not have more than \$50 million in  
7 assets as of the date the stock was issued and immediately  
8 thereafter. The individual taxpayer/investor must acquire the stock  
9 at its original issue and not from a secondary market. Moreover,  
10 during substantially all the time the stock is held, at least 80% of  
11 the value of the corporation's assets must be used in the active  
12 conduct of one or more qualified businesses. Active conduct of one  
13 or more qualified businesses cannot be an investment vehicle or  
14 inactive business. As under section 1202, the New Jersey gross  
15 income tax deduction of capital gains of the sale or exchange of  
16 QSBS cannot be stock in a business that is: a service business in the  
17 fields of health, law, engineering, architecture, accounting, actuarial  
18 science, performing arts, consulting, athletics, financial services, or  
19 brokerage services; a banking, insurance, financing, leasing,  
20 investing, or similar business; a farming business; a business of  
21 operating a hotel, motel, restaurant, or similar business.

22 If the individual taxpayer/investor holds qualifying stock for at  
23 least five years, then the individual taxpayer/investor would be able  
24 to exclude the capital gains made on the disposition of the stock,  
25 and thus pay no gross income on the capital gains. The special  
26 exclusion of capital gains for qualified stock that is held by "pass  
27 through entities," that include a partnership, an "S" corporation, a  
28 regulated investment company, or a common trust fund, that  
29 otherwise meet the requirements of this bill, is available to the  
30 individual gross income taxpayers who hold interests in those pass-  
31 through entities. The bill limits the aggregate amount of excludable  
32 capital gains for a taxable year, in the case of one or more  
33 dispositions of QSBS by a taxpayer, to the greater of \$10 million,  
34 reduced by the aggregate amount of eligible gain taken into account  
35 by the taxpayer for prior taxable years and attributable to  
36 dispositions of QSBS, or ten times the aggregate adjusted basis of  
37 QSBS issued by the corporation and disposed of by the taxpayer  
38 during the taxable year. The QSBS must have been acquired in  
39 exchange for money or property, or as compensation for services  
40 provided to the corporation. At least 80% of the corporation's  
41 payroll, as measured by total dollar value, must be attributable to  
42 employment located within New Jersey.