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LEGISLATIVE FISCAL ESTIMATE
[First Reprint]
SENATE, No. 3246
STATE OF NEW JERSEY
218th LEGISLATURE

DATED: JANUARY 4, 2019

SUMMARY

Synopsis: Establishes elective pass-through business alternative income tax and allows refundable gross income tax credit for taxpayers earning income from pass-through businesses in taxable year.

Type of Impact: Annual State expenditure increase. Possible annual shift of State revenue from Property Tax Relief Fund to General Fund.

Agencies Affected: Department of the Treasury.

Office of Legislative Services Estimate

Fiscal Impact	FY 2019 and Thereafter
State Expenditure Increase	Indeterminate

- The Office of Legislative Services (OLS) anticipates that the bill will be revenue-neutral to the State, but the State may incur an annual expenditure increase related to the administration of the new elective pass-through business alternative income tax. The permissive nature of the bill precludes the OLS from quantifying these impacts.

- To the extent that pass-through entities elect to pay the pass-through business alternative income tax, State revenue will shift from the Property Tax Relief Fund to the General Fund.

- The bill provides a tax credit equal to a member's pro rata share of the tax liability incurred from the entity-level tax, which can then be applied against the member's gross income tax liability. This tax credit is provided to offset a member's gross income tax liability on the member's pro rata share of distributive proceeds of the pass-through entity since the pass-through entity would be paying the entity-level tax on those proceeds.

- The Division of Taxation in the Department of the Treasury may incur increased costs to implement and administer the pass-through business alternative income tax, which the department may be able to absorb within its existing budget.

BILL DESCRIPTION

This bill permits a pass-through business, at its election, to shift the obligation to pay New Jersey tax on the business' New Jersey income from the members of the business to the business. Doing so will preserve the full deductibility under federal tax laws of New Jersey income taxes paid on the pass-through business' New Jersey income. The bill responds to the federal "Tax Cuts and Jobs Act" of 2017, which newly limits to $10,000 the annual deductibility of State and local tax payments under the federal personal income tax for individual taxpayers, while retaining the unrestricted deductibility of State and local tax payments for businesses. In general, members of a pass-through entity report the entity's taxable income on their income tax returns.

The bill establishes two instruments to effect the optional shift of the New Jersey income tax payment obligation from members of a pass-through business to the business, an optional entity-level tax on pass-through businesses and an offsetting gross income tax credit for members of pass-through businesses making that election.

Specifically, at the election of the business, the tax is levied on a pass-through business that has at least one partner, shareholder, or member that owes New Jersey gross income tax on income received from the pass-through business, and sourced to the State, in the tax year (the "distributive proceeds"). To calculate the amount of tax due, the pass-through business is first required to determine the amount of distributive proceeds that each member receives from the business in the tax year. Then, each member's pro rata share of the distributive proceeds is multiplied by: (i) 5.525 percent, if the distributive proceeds of the pass-through business are less than $250,000 in the tax year; (ii) 6.37 percent, if the distributive proceeds are between $250,000 and $1 million; (iii) 8.97 percent, if the distributive proceeds are between $1 million and $3 million; and (iv) 10.75 percent, if the distributive proceeds are more than $3 million (the "taxed share"). Finally, the pass-through business adds together each member's taxed share to determine its pass-through business alternative income tax liability for the tax year. However, if a member's tax liability is less than $1, then that member's amount of distributive proceeds is disregarded for purposes of calculating the pass-through tax liability.

The bill provides a refundable gross income tax credit to members of a pass-through business that opts to pay the pass-through tax. The amount of this credit is equal to that member's pro rata taxed share, provided that the credit is not available for members whose pro rata taxed share is less than $1. The credit may only be claimed by a qualifying taxpayer after the application of all other credits allowed by law.

The Division of Taxation in the Department of the Treasury is to develop and promulgate rules, regulations, procedures, and forms for the administration of the tax and tax credit.

The bill applies to taxable years of pass-through entities beginning on or after January 1, 2018.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS anticipates that the bill will be revenue-neutral to the State, but the State may incur an annual expenditure increase related to the administration of the new pass-through business alternative income tax. The permissive nature of the bill precludes the OLS from quantifying these impacts.

A pass-through entity, with at least one member who is liable pursuant to the "New Jersey Gross Income Tax Act," N.J.S.54A:1-1 et seq., may elect to pay an entity-level tax on the sum of each member's pro rata share of distributive proceeds attributable to the pass-through entity for the taxable year. The bill provides a tax credit equal to a member's pro rata share of the tax liability incurred from the entity-level tax, which can then be applied against the member's gross income tax liability. This tax credit is provided to offset a member's gross income tax liability on the member's pro rata share of distributive proceeds of the pass-through entity since the pass-through entity would be paying the entity-level tax on those proceeds.

The OLS notes that to the extent that pass-through entities elect to pay the pass-through business alternative income tax, State revenue will shift from the Property Tax Relief Fund to the General Fund.

The OLS further notes that the Division of Taxation in the Department of the Treasury may incur increased costs to implement and administer the pass-through business alternative income tax, which the department may be able to absorb within its existing budget.

Section:	*Revenue, Finance and Appropriations*
Analyst:	*Jordan M. DiGiovanni* *Revenue Analyst*
Approved:	*Frank W. Haines III* *Legislative Budget and Finance Officer*

This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).