

ASSEMBLY, No. 1884

STATE OF NEW JERSEY

INTRODUCED MAY 6, 1996

By Assemblyman BAGGER

1 AN ACT concerning New Jersey S corporation election procedures and
2 tax consequences, amending P.L.1945, c.162, P.L.1993, c.173, and
3 Title 54A of the New Jersey Statutes and repealing section 4 of
4 P.L.1993, c.173.

5

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

8

9 1. Section 3 of P.L.1993, c.173 (C.54:10A-5.22) is amended to
10 read as follows:

11 3. a. A corporation may elect, in accordance with the provisions
12 of this section, to be a New Jersey S corporation. In order for an
13 election to be valid, the corporation and each of its shareholders [on
14 the day on which the election is made (hereinafter "initial
15 shareholders") must] shall consent to such election and the
16 jurisdictional requirements of becoming a New Jersey S corporation.
17 The form of the election and consent to jurisdictional requirements and
18 the place for filing shall be as prescribed by the Director of the
19 Division of Taxation.

20 b. Each [initial] person who was a shareholder during the privilege
21 period and the corporation shall consent to the following jurisdictional
22 requirements:

23 (1) That this State shall have the right and jurisdiction to tax and
24 collect the tax on each shareholder's S corporation income as defined
25 pursuant to section 12 of P.L.1993, c.173 (C.54A:5-10); and

26 (2) That New Jersey's right and jurisdiction to tax the income as
27 set forth in paragraph (1) of this subsection shall not be affected by a
28 change of a shareholder's residency, except as provided by the "New
29 Jersey Gross Income Tax Act," N.J.S.54A:1-1 et seq.[]; and]

30 (3) [If shareholders that are not initial shareholders of the
31 corporation, while the corporation is a New Jersey S corporation, fail
32 to consent to New Jersey's jurisdiction to tax S corporation income to
33 such shareholders, this State shall have the right and jurisdiction to
34 collect a payment of tax each year directly from the corporation equal

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.

1 to the S corporation income allocated to this State, as defined
2 pursuant to section 12 of P.L.1993, c.173 (C.54A:5-10), of the
3 nonconsenting shareholders for the accounting or privilege period
4 multiplied by the maximum tax bracket rate provided under
5 N.J.S.54A:2-1 for the accounting or privilege period. In such case,
6 the corporation shall have the right, but not the obligation, to recover
7 payments made by the corporation pursuant to this paragraph from
8 each nonconsenting shareholder.] (Deleted by amendment, P.L. ____,
9 c.)(now pending before the Legislature as this bill)

10 c. A corporation may make an election to become a New Jersey S
11 corporation with respect to [an accounting or] a privilege period for
12 which the corporation is or will be an S corporation. The election for
13 [an accounting or] a privilege period, along with the consents to
14 jurisdictional requirements, shall be filed within one calendar month of
15 the time at which a federal S corporation election would be required
16 if such [accounting or] privilege period were a "taxable year" for
17 which a federal S corporation election were to be made pursuant to
18 section 1362 of the federal Internal Revenue Code of 1986, 26 U.S.C.
19 §1362. Such elections may only be revoked pursuant to subsection d.
20 of this section. Such election shall terminate immediately upon the
21 corporation's failure to satisfy the definition of a New Jersey S
22 corporation pursuant to paragraph (p) of section 4 of P.L.1945, c.162
23 (C.54:10A-4).

24 d. A corporation may revoke an election pursuant to this section
25 on or before the last day of the first [accounting or] privilege period
26 to which the election would otherwise apply. The form, requirements
27 and place of filing the revocation shall be as prescribed by the Director
28 of the Division of Taxation.

29 e. If a corporation revokes its election pursuant to subsection d. of
30 this section, the corporation is prohibited from making an election to
31 be a New Jersey S corporation for the five privilege periods that begin
32 after the privilege period for which the revocation is effective.

33 f. (1) (a) If an election under this section is terminated because a
34 New Jersey S corporation has failed to be included in the federal
35 definition of an "S corporation" pursuant to section 1361 of the federal
36 Internal Revenue Code of 1986, 26 U.S.C. §1361, under paragraph (2)
37 or (3) of subsection (d) of section 1362 of the federal Internal
38 Revenue Code of 1986, 26 U.S.C. §1362, or

39 (b) if an election under this section is terminated by the failure to
40 make the necessary consents pursuant to subsection b. of this section;
41 and

42 (2) (a) the director determines that the termination was inadvertent
43 and that no later than a reasonable period of time after the discovery
44 of the event or failure to act that resulted in the termination steps were
45 taken to restore the corporation to compliance with the requirements
46 for New Jersey S corporation status, and

1 **(b) the corporation, and each shareholder for the privilege periods**
2 **for which the inadvertently terminated election is to be continued**
3 **pursuant to this subsection, agrees to make those adjustments as may**
4 **be required by the director with respect to those privilege periods;**
5 **then:**

6 **(3) notwithstanding the termination, the corporation shall be**
7 **treated as continuing to be a New Jersey S corporation for such**
8 **privilege periods as the director shall determine.**

9 (cf: P.L.1993, c.173, s.3)

10
11 2. Section 18 of P.L.1945, c.162 (C.54:10A-18) is amended to
12 read as follows:

13 18. a. The [commissioner] Director of the Division of Taxation
14 shall design a form of return and forms for such additional statements
15 or schedules as [he] the director may require to be filed therewith.
16 Such forms shall provide for the setting forth of such facts as the
17 [commissioner] director may deem necessary for the proper
18 enforcement of this act. [He] The director shall cause a supply thereof
19 to be printed and shall furnish appropriate blank forms to each
20 taxpayer upon application or otherwise as [he] the director may deem
21 necessary. Failure to receive a form shall not relieve any taxpayer
22 from the obligation to file a return under the provisions of this act.
23 Each such return shall have annexed thereto a certification by the
24 president, vice-president, comptroller, secretary, treasurer, assistant
25 treasurer, accounting officer of the taxpayer or any other officer of the
26 taxpayer duly authorized so to act to the effect that the statements
27 contained therein are true. The fact that an individual's name is signed
28 on a certification of the report shall be prima facie evidence that such
29 individual is authorized to sign and certify the report on behalf of the
30 corporation. In the case of a corporation in liquidation or in the hands
31 of a receiver or trustee, certification shall be made by the person
32 responsible for the conduct of the affairs of such corporation.

33 b. The return of [an] a New Jersey S corporation shall, in addition
34 to any information set forth pursuant to subsection a. of this section,
35 set forth with respect to each shareholder: the shareholder's name,
36 address and federal taxpayer identification number (social security
37 number or employer identification number); whether the shareholder
38 is a resident of this State; [whether the shareholder has filed a consent
39 to jurisdictional requirements pursuant to section 3 or section 4 of
40 P.L.1993, c.173 (C.54:10A-5.22 or C.54:10A-5.23);] the allocation
41 factor determined pursuant to sections 6 through 10 of P.L.1945,
42 c.162 (C.54:10A-6 through 54:10A-10); the amount of any
43 distribution made to the shareholder[, including any amount paid on
44 behalf of the shareholder pursuant to subsection c. or d. of section 4
45 of P.L.1993, c.173 (C.54:10A-5.23)]; the balance of the accumulated
46 earnings and profits account; the balance of the accumulated

1 adjustments account described in section 16 of P.L.1993, c.173
2 (C.54A:5-14), which account the corporation shall maintain; and such
3 other information as the director may prescribe by regulation. [The]
4 A New Jersey S corporation shall, on or before the day on which such
5 return is required to be filed, furnish to each person who was a
6 shareholder during the [accounting or] privilege period a copy of such
7 information shown on the return as the director may by regulation
8 prescribe.

9 (cf: P.L.1993, c.173, s.6)

10

11 3. N.J.S.54A:4-1 is amended to read as follows:

12 54A:4-1. Resident credit for tax of another state. (a) A resident
13 taxpayer shall be allowed a credit against the tax otherwise due under
14 this act for the amount of any income tax or wage tax imposed for the
15 taxable year by another state of the United States or political
16 subdivision of such state, or by the District of Columbia, on income
17 from sources within that jurisdiction with respect to income which is
18 also subject to tax under this act, except as provided by subsections
19 (c) [and], (d) and (e) of this section.

20 (b) The credit provided under this section shall not exceed the
21 proportion of the tax otherwise due under this act that the amount of
22 the taxpayer's income subject to tax by the other jurisdiction bears to
23 [his] the taxpayer's entire New Jersey income.

24 (c) No credit shall be allowed against the tax otherwise due under
25 this act for the amount of any income tax or wage tax imposed for the
26 taxable year on New Jersey S corporation income allocated to this
27 State.

28 (d) No credit shall be allowed for the amount of any taxes paid or
29 accrued for the taxable year on or measured by profits or income
30 imposed on or paid on behalf of a person other than the taxpayer,
31 whether or not the taxpayer may be held liable for the tax.

32 (e) No credit shall be allowed against the tax otherwise due under
33 this act for the amount of any income tax or wage tax imposed for the
34 taxable year on income from S corporations that are not New Jersey
35 S corporations.

36 (f) Readjustment of the tax of another state or political subdivision
37 thereof--if the taxpayer is allowed credit under this section for more
38 or less of the tax of another state or political subdivision thereof than
39 [he] the taxpayer is finally required to pay, the taxpayer shall send
40 notice of the difference to the director who shall redetermine the tax
41 for any years affected regardless of any otherwise applicable statute of
42 limitations.

43 (cf: P.L.1993, c.173, s.7)

44

45 4. N.J.S.54A:4-2. is amended to read as follows:

46 54A:4-2. Credit for taxes withheld. a. Any amount of tax actually

1 deducted and withheld by an employer under this act in any calendar
2 year shall be deemed to have been paid to the director on behalf of the
3 person from whom withheld, and such person shall be credited with
4 having paid that amount of tax for the taxable year beginning in such
5 calendar year. For a taxable year of less than 12 months, the credit
6 shall be made under regulations of the director.

7 b. [An amount of tax actually paid to the director by an S
8 corporation pursuant to subsection c. of section 4 of P.L.1993, c.173
9 (C.54:10A-5.23), shall be credited to the shareholder of the S
10 corporation on whose behalf the payment was made as of the date of
11 its receipt by the director, except as otherwise provided by
12 N.J.S.54A:9-11, and the shareholder shall be credited with having paid
13 that amount of tax for the taxable year in which the S corporation's
14 accounting or privilege period ends.] (Deleted by amendment, P.L. .
15 c. .)(now pending before the Legislature as this bill)
16 (cf: P.L.1993, c.173, s.8)

17

18 5. N.J.S.54A:5-1 is amended to read as follows:

19 54A:5-1. New Jersey Gross Income Defined. New Jersey gross
20 income shall consist of the following categories of income:

21 a. Salaries, wages, tips, fees, commissions, bonuses, and other
22 remuneration received for services rendered whether in cash or in
23 property.

24 b. Net profits from business. The net income from the operation
25 of a business, profession or other activity after provision for all costs
26 and expenses incurred in the conduct thereof, determined either on a
27 cash or accrual basis in accordance with the method of accounting
28 allowed for federal income tax purposes but without deduction of the
29 amount of:

30 (1) taxes based on income;

31 (2) a civil, civil administrative, or criminal penalty or fine, including
32 a penalty or fine under an administrative consent order, assessed and
33 collected for a violation of a State or federal environmental law, an
34 administrative consent order, or an environmental ordinance or
35 resolution of a local governmental entity, and any interest earned on
36 the penalty or fine, and any economic benefits having accrued to the
37 violator as a result of a violation, which benefits are assessed and
38 recovered in a civil, civil administrative, or criminal action, or pursuant
39 to an administrative consent order. The provisions of this paragraph
40 shall not apply to a penalty or fine assessed or collected for a violation
41 of a State or federal environmental law, or local environmental
42 ordinance or resolution, if the penalty or fine was for a violation that
43 resulted from fire, riot, sabotage, flood, storm event, natural cause, or
44 other act of God beyond the reasonable control of the violator, or
45 caused by an act or omission of a person who was outside the
46 reasonable control of the violator; and

1 (3) treble damages paid to the Department of Environmental
2 Protection [and Energy] pursuant to subsection a. of section 7 of
3 P.L.1976, c.141 (C.58:10-23.11f), for costs incurred by the
4 department in removing, or arranging for the removal of, an
5 unauthorized discharge upon the failure of the discharger to comply
6 with a directive from the department to remove, or arrange for the
7 removal of, a discharge.

8 c. Net gains or income from disposition of property. Net gains or
9 net income, less net losses, derived from the sale, exchange or other
10 disposition of property, including real or personal, whether tangible or
11 intangible as determined in accordance with the method of accounting
12 allowed for federal income tax purposes. For the purpose of
13 determining gain or loss, the basis of property shall be the adjusted
14 basis used for federal income tax purposes, except as expressly
15 provided for under this act, but without a deduction for penalties,
16 fines, or economic benefits excepted pursuant to paragraph (2), or for
17 treble damages excepted pursuant to paragraph (3) of subsection b. of
18 this section.

19 A taxpayer's net gain or loss on the sale, exchange or other
20 disposition of a share of [an] a New Jersey S corporation shall be
21 calculated by increasing the adjusted basis of the share by an amount
22 equal to the shareholder's net losses and deductions in respect of the
23 share allowed and deducted from income for federal income tax
24 purposes, not including any personal net operating loss deductions, to
25 the extent that such net losses were not offset by the taxpayer's pro
26 rata share of New Jersey S corporation income otherwise subject to
27 taxation pursuant to subsection p. of this section in respect of another
28 New Jersey S corporation, subject to rules of priority and assignment
29 determined by the director.

30 For the tax year 1976, any taxpayer with a tax liability under this
31 subsection, or under the "Tax on Capital Gains and Other Unearned
32 Income Act," P.L.1975, c.172 (C.54:8B-1 et seq.), shall not be subject
33 to payment of an amount greater than the amount he would have paid
34 if either return had covered all capital transactions during the full tax
35 year 1976; provided, however, that the rate which shall apply to any
36 capital gain shall be that in effect on the date of the transaction. To
37 the extent that any loss is used to offset any gain under P.L.1975,
38 c.172, it shall not be used to offset any gain under the "New Jersey
39 Gross Income Tax Act," N.J.S.54A:1-1 et seq.

40 The term "net gains or income" shall not include gains or income
41 derived from obligations which are referred to in clause (1) or (2) of
42 N.J.S.54A:6-14 of this act or from securities which evidence
43 ownership in a qualified investment fund as defined in section 2 of
44 P.L.1987, c.310 (C.54A:6-14.1). The term "net gains or net income"
45 shall not include gains or income from transactions to the extent to
46 which nonrecognition is allowed for federal income tax purposes. The

1 term "sale, exchange or other disposition" shall not include the
2 exchange of stock or securities in a corporation a party to a
3 reorganization in pursuance of a plan of reorganization, solely for
4 stock or securities in such corporation or in another corporation a
5 party to the reorganization and the transfer of property to a
6 corporation by one or more persons solely in exchange for stock or
7 securities in such corporation if immediately after the exchange such
8 person or persons are in control of the corporation. For purposes of
9 this clause, stock or securities issued for services shall not be
10 considered as issued in return for property.

11 For purposes of this clause, the term "reorganization" means--

12 (i) A statutory merger or consolidation;

13 (ii) The acquisition by one corporation, in exchange solely for all
14 or part of its voting stock (or in exchange solely for all or a part of the
15 voting stock of a corporation which is in control of the acquiring
16 corporation) of stock of another corporation if, immediately after the
17 acquisition, the acquiring corporation has control of such other
18 corporation (whether or not such acquiring corporation had control
19 immediately before the acquisition);

20 (iii) The acquisition by one corporation, in exchange solely for all
21 or part of its voting stock (or in exchange solely for all or a part of the
22 voting stock of a corporation which is in control of the acquiring
23 corporation), of substantially all of the properties of another
24 corporation, but in determining whether the exchange is solely for
25 stock the assumption by the acquiring corporation of a liability of the
26 other, or the fact that property acquired is subject to a liability, shall
27 be disregarded;

28 (iv) A transfer by a corporation of all or a part of its assets to
29 another corporation if immediately after the transfer the transferor, or
30 one or more of its shareholders (including persons who were
31 shareholders immediately before the transfer), or any combination
32 thereof, is in control of the corporation to which the assets are
33 transferred;

34 (v) A recapitalization;

35 (vi) A mere change in identity, form, or place of organization
36 however effected; or

37 (vii) The acquisition by one corporation, in exchange for stock of
38 a corporation (referred to in this subclause as "controlling
39 corporation") which is in control of the acquiring corporation, of
40 substantially all of the properties of another corporation which in the
41 transaction is merged into the acquiring corporation shall not
42 disqualify a transaction under subclause (i) if such transaction would
43 have qualified under subclause (i) if the merger had been into the
44 controlling corporation, and no stock of the acquiring corporation is
45 used in the transaction;

46 (viii) A transaction otherwise qualifying under subclause (i) shall

1 not be disqualified by reason of the fact that stock of a corporation
2 (referred to in this subclause as the "controlling corporation") which
3 before the merger was in control of the merged corporation is used in
4 the transaction, if after the transaction, the corporation surviving the
5 merger holds substantially all of its properties and of the properties of
6 the merged corporation (other than stock of the controlling
7 corporation distributed in the transaction); and in the transaction,
8 former shareholders of the surviving corporation exchanged, for an
9 amount of voting stock of the controlling corporation, an amount of
10 stock in the surviving corporation which constitutes control of such
11 corporation.

12 For purposes of this clause, the term "control" means the ownership
13 of stock possessing at least 80% of the total combined voting power
14 of all classes of stock entitled to vote and at least 80% of the total
15 number of shares of all other classes of stock of the corporation.

16 For purposes of this clause, the term "a party to a reorganization"
17 includes a corporation resulting from a reorganization, and both
18 corporations, in the case of a reorganization resulting from the
19 acquisition by one corporation of stock or properties of another. In
20 the case of a reorganization qualifying under subclause (i) by reason
21 of subclause (vii) the term "a party to a reorganization" includes the
22 controlling corporation referred to in such subclause (vii).

23 Notwithstanding any provisions hereof, upon every such exchange
24 or conversion, the taxpayer's basis for the stock or securities received
25 shall be the same as the taxpayer's actual or attributed basis for the
26 stock, securities or property surrendered in exchange therefor.

27 d. Net gains or net income derived from or in the form of rents,
28 royalties, patents, and copyrights.

29 e. Interest, except interest referred to in clause (1) or (2) of
30 N.J.S.54A:6-14, or distributions paid by a qualified investment fund
31 as defined in section 2 of P.L.1987, c.310 (C.54A:6-14.1), to the
32 extent provided in that section.

33 f. Dividends. "Dividends" means any distribution in cash or
34 property made by a corporation, association or business trust that is
35 not [an] a New Jersey S corporation, (1) out of accumulated earnings
36 and profits, or (2) out of earnings and profits of the year in which such
37 dividend is paid, and any distribution in cash or property made by [an]
38 a New Jersey S corporation, as specifically determined pursuant to
39 section 16 of P.L.1993, c.173 (C.54A:5-14).

40 The term "dividends" shall not include distributions paid by a
41 qualified investment fund as defined in section 2 of P.L.1987, c.310
42 (C.54A:6-14.1), to the extent provided in that section.

43 g. Gambling winnings.

44 h. Net gains or income derived through estates or trusts.

45 i. Income in respect of a decedent.

46 j. Amounts distributed or withdrawn from an employee trust

1 attributable to contributions to the trust which were excluded from
2 gross income under the provisions of chapter 6 of Title 54A of the
3 New Jersey Statutes and pensions and annuities except to the extent
4 of exclusions in N.J.S.54A:6-10 hereunder, notwithstanding the
5 provisions of N.J.S.18A:66-51, P.L.1973, c.140, s.41 (C.43:6A-41),
6 P.L.1954, c.84, s.53 (C.43:15A-53), P.L.1944, c.255, s.17
7 (C.43:16A-17), P.L.1965, c.89, s.45 (C.53:5A-45), R.S.43:10-14,
8 P.L.1943, c.160, s.22 (C.43:10-18.22), P.L.1948, c.310, s.22
9 (C.43:10-18.71), P.L.1954, c.218, s.32 (C.43:13-22.34), P.L.1964,
10 c.275, s.11 (C.43:13-22.60), R.S.43:10-57, P.L.1938, c.330, s.13
11 (C.43:10-105), R.S.43:13-44, and P.L.1943, c.189, s.5
12 (C.43:13-37.5).

13 k. Distributive share of partnership income.

14 l. Amounts received as prizes and awards, except as provided in
15 N.J.S.54A:6-8 and N.J.S.54A:6-11 hereunder.

16 m. Rental value of a residence furnished by an employer or a rental
17 allowance paid by an employer to provide a home.

18 n. Alimony and separate maintenance payments to the extent that
19 such payments are required to be made under a decree of divorce or
20 separate maintenance but not including payments for support of minor
21 children.

22 o. Income, gain or profit derived from acts or omissions defined as
23 crimes or offenses under the laws of this State or any other
24 jurisdiction.

25 p. Net pro rata share of New Jersey S corporation income.

26 (cf: P.L.1993, c.173, s.9)

27

28 6. Section 11 of P.L.1993, c.173 (C.54A:5-9) is amended to read
29 as follows:

30 11. [An]A New Jersey S corporation as such shall not be subject
31 to the tax imposed by the "New Jersey Gross Income Tax Act,"
32 N.J.S.54A:1-1 et seq., but the New Jersey S corporation income,
33 dividends and gain of a shareholder of [an] a New Jersey S
34 corporation shall be subject to the tax, and the tax shall be imposed on
35 the shareholder's pro rata share, whether or not distributed, of the
36 New Jersey S corporation income for its taxable year ending within or
37 with the shareholder's taxable year.

38 (cf: P.L.1993, c.173, s.11)

39

40 7. Section 12 of P.L.1993, c.173 (C.54A:5-10) is amended to read
41 as follows:

42 12. For the purposes of the "New Jersey Gross Income Tax Act,"
43 N.J.S.54A:1-1 et seq.:

44 "New Jersey S corporation" means a corporation that is an S
45 corporation; which has made a valid election pursuant to section 3 of
46 P.L.1993, c.173 (C.54:10A-5.22); and which has been an S

1 corporation continuously since the effective date of the valid election
2 made pursuant to section 3 of P.L.1993, c.173 (C.54:10A-5.22).

3 "Pro rata share" means the portion of any items attributable to an
4 S corporation shareholder for a taxable year determined in the manner
5 provided in, and subject to any election made under subsection (a) of
6 section 1377 or subsection (e) of section 1362 of the federal Internal
7 Revenue Code of 1986, 26 U.S.C. §1377 and §1362.

8 "Pro rata share of New Jersey S corporation income" means the
9 sum of the shareholder's proportionate share of: [For a New Jersey S
10 corporation,] the New Jersey S corporation income allocated to this
11 State [of all New Jersey S corporations;] and the New Jersey S
12 corporation income not allocated to this State.

13 "S corporation" means a corporation included in the definition of
14 an "S corporation" pursuant to section 1361 of the federal Internal
15 Revenue Code of 1986, 26 U.S.C. §1361.

16 "New Jersey S corporation income" means the net of [an] a New
17 Jersey S corporation's items of income, loss or deduction taken into
18 account by the shareholder in the manner provided in section 1366 of
19 the federal Internal Revenue Code of 1986, 26 U.S.C. §1366; provided
20 however that:

21 a. New Jersey S corporation income shall be determined without
22 the exclusion, deduction or credit of:

23 (1) any dividend exclusion or deduction otherwise allowed
24 pursuant to paragraph 5 of subsection (k) of section 4 of P.L.1945,
25 c.162 (C.54:10A-4);

26 (2) taxes paid or accrued to the United States, a possession or
27 territory of the United States, a state including this State, a political
28 subdivision thereof, or the District of Columbia on or measured by
29 profits or income, or business presence or business activity, of the
30 corporation;

31 (3) any income taxes paid or accrued to the United States, a
32 possession or territory of the United States, a state including this
33 State, a political subdivision thereof, or the District of Columbia paid
34 or accrued by the New Jersey S corporation on behalf of, or in
35 satisfaction of the liabilities of, shareholders of the corporation;

36 (4) interest income on obligations of any state other than this State,
37 or of a political subdivision thereof, or of the federal government,
38 except as deducted pursuant to subsection b. of this section; or

39 (5) interest on indebtedness incurred or continued, expenses paid
40 and incurred to purchase, carry, manage or conserve, and expenses of
41 collection of the income or gain from obligations the income or gain
42 from which is deductible pursuant to subsection b. of this definition;
43 and

44 b. New Jersey S corporation income shall be determined after
45 deduction of any gains or income derived from obligations which are
46 referred to in N.J.S.54A:6-14 or from securities which evidence

1 ownership in a qualified investment fund as defined in section 2 of
2 P.L.1987, c.310 (C.54A:6-14.1), and any interest excluded from gross
3 income pursuant to N.J.S.54A:6-14, or distributions excluded from
4 income pursuant to section 2 of P.L.1987, c.310 (C.54A:6-14.1); and

5 c. The character of any New Jersey S corporation item taken into
6 account by a shareholder of [an] a New Jersey S corporation shall be
7 determined as if such items were received or incurred by the New
8 Jersey S corporation and not its shareholder.

9 "New Jersey S corporation income allocated to this State" means
10 that portion of the New Jersey S corporation income that is allocated
11 to this State by the allocation factor of the corporation for the fiscal
12 or calendar accounting period pursuant to sections 6 through 10 of
13 P.L.1945, c.162 (C.54:10A-6 through 54:10A-10), reduced by any tax
14 imposed pursuant to paragraph (3) of subsection (c) of section 5 of
15 P.L.1945, c.162 (C. 54:10A-5).

16 "New Jersey S corporation income not allocated to this State"
17 means New Jersey S corporation income less New Jersey S
18 corporation income allocated to this State.

19 (cf: P.L.1993, c.173, s.12)

20
21 8. Section 13 of P.L.1993, c.173 (C.54A:5-11) is amended to read
22 as follows:

23 13. a. A resident shareholder of New Jersey S corporation stock
24 held by the shareholder on the first day of the first taxable year
25 following enactment of this section shall have an initial basis in the
26 stock of that New Jersey S corporation and any indebtedness of the
27 New Jersey S corporation equal to the basis of the stock determined
28 as though the stock was stock of a corporation not [an] a New Jersey
29 S corporation plus any indebtedness of the New Jersey S corporation
30 to the shareholder and shall be determined as of the first day of the
31 first taxable year following enactment of this section

32 b. A resident shareholder of New Jersey S corporation stock to
33 which subsection a. of this section does not apply shall have an initial
34 basis in the stock of the New Jersey S corporation and any
35 indebtedness of the New Jersey S corporation as determined pursuant
36 to the federal Internal Revenue Code of 1986, determined as of the
37 date that is the latest to occur of: the date on which the shareholder
38 last became a resident of this State; the date on which the shareholder
39 acquired the stock of the corporation; or the effective date of the
40 corporation's most recent S election under the federal Internal
41 Revenue Code of 1986.

42 c. The initial basis of a resident shareholder in the stock and
43 indebtedness of [an] a New Jersey S corporation shall be adjusted after
44 the date specified in subsections a. or b. of this section in the manner
45 required by section 1011 of the federal Internal Revenue Code of
46 1986, 26 U.S.C. §1011, except that such adjustments shall be limited

1 to that portion of New Jersey S corporation income allocated to this
2 State and New Jersey S corporation income not allocated to this State
3 that is included in the shareholder's pro rata share of New Jersey S
4 corporation income and except that, with respect to any taxable period
5 during which the shareholder is a resident of this State: (1) any
6 modification made pursuant to the definition of New Jersey S
7 corporation income pursuant to section 12 of P.L.1993, c.173
8 (C.54A:5-10) other than those for income exempt from taxation by
9 this State pursuant to paragraph (5) of subsection a. and subsection b.
10 of that definition shall be taken into account; and

11 (2) any adjustments made pursuant to section 1367 of the federal
12 Internal Revenue Code of 1986, 26 U.S.C. §1367, for a taxable period
13 during which this State did not measure the income of a shareholder
14 of [an] a New Jersey S corporation by reference to the New Jersey S
15 corporation's income shall not be taken into account.

16 d. A nonresident shareholder of New Jersey S corporation stock
17 shall have an initial basis in the stock of the New Jersey S corporation
18 and any indebtedness of the New Jersey S corporation of zero as of
19 the date that is the latest to occur of: the date on which the
20 shareholder last became a nonresident of this State; the date on which
21 the shareholder acquired the stock of the corporation; the effective
22 date of the corporation's most recent S election under the federal
23 Internal Revenue Code of 1986; or the effective date of the
24 corporation's most recent election pursuant to section 3 of P.L.1993,
25 c.173 (C.54:10A-5.22).

26 e. The initial basis of a nonresident shareholder in the stock and
27 indebtedness of [an] a New Jersey S corporation shall be adjusted after
28 the date specified in subsection d. of this section as provided in section
29 1367 of the of the federal Internal Revenue Code of 1986, 26 U.S.C.
30 §1367, except that such adjustments shall be limited to that portion of
31 New Jersey S corporation income allocated to this State that is
32 included in the shareholder's pro rata share of New Jersey S
33 corporation income. In computing New Jersey S corporation income
34 allocated to this State, any modification made pursuant to the
35 definition of New Jersey S corporation income pursuant to section 12
36 of P.L.1993, c.173 (C.54A:5-10) for income exempt from taxation by
37 this State pursuant to paragraph (5) of subsection a. and subsection b.
38 of that definition shall not be taken into account.

39 f. The basis in the hands of a resident shareholder of [an] New
40 Jersey S corporation in stock of the New Jersey S corporation shall be
41 reduced by the amount of any cash distribution which is not taxable to
42 the shareholder as a result of the application of section 16 of
43 P.L.1993, c.173 (C.54A:5-14).

44 g. For purposes of this section, any person acquiring stock or
45 indebtedness of [an] a New Jersey S corporation by gift shall be
46 considered to have acquired the stock or indebtedness at the time the

1 donor acquired the stock or indebtedness.

2 (cf: P.L.1993, c.173, s.13)

3

4 9. Section 14 of P.L.1993, c.173 (C.54A:5-12) is amended to read
5 as follows:

6 14. a. The aggregate amount of losses or deductions of [an] a
7 New Jersey S corporation taken into account by a shareholder of the
8 New Jersey S corporation for a taxable period pursuant to section 11
9 of P.L.1993, c.173 (C.54A:5-9), shall not exceed the shareholder's
10 combined adjusted basis, determined in accordance with section 13 of
11 P.L.1993, c.173 (C.54A:5-11), in the stock of the New Jersey S
12 corporation and any indebtedness of the New Jersey S corporation to
13 the shareholder.

14 b. Any loss or deduction of [an] a New Jersey S corporation which
15 is disallowed for a taxable period pursuant to subsection a. of this
16 section shall not be treated as incurred by the corporation in any
17 succeeding taxable period with respect to that shareholder.

18 (cf: P.L.1993, c.173, s.14)

19

20 10. Section 15 of P.L.1973, c.173 (C.54A:5-13) is amended to
21 read as follows:

22 15. For purposes of this act, if a shareholder of [an] a New Jersey
23 S corporation is both a resident and a nonresident of this State during
24 any taxable year, the shareholder's pro rata share of the New Jersey S
25 corporation income allocated to this State and New Jersey S
26 corporation income not allocated to this State for the taxable period
27 shall be further prorated between the shareholder's periods of
28 residence and nonresidence during the taxable period, in accordance
29 with the number of days in each period.

30 (cf: P.L.1993, c.173, s.15)

31

32 11. Section 16 of P.L.1993, c.173 (C.54A:5-14) is amended to
33 read as follows:

34 16. a. Subject to subsection c. of this section, a distribution made
35 by [an] a New Jersey S corporation with respect to its stock to a
36 resident shareholder shall be taken into account by the shareholder for
37 purposes of the "New Jersey Gross Income Tax Act," N.J.S.54A:1-1
38 et seq., to the extent that the distribution is treated as a dividend or as
39 gain from the sale or exchange of property in the manner provided by
40 section 1368 of the federal Internal Revenue Code of 1986, 26 U.S.C.
41 §1368.

42 b. Subject to subsection c. of this section, a distribution of money
43 made by a corporation with respect to its stock to a resident
44 shareholder during a post-termination transition period shall not be
45 taken into account by the shareholder for purposes of the "New Jersey
46 Gross Income Tax Act," N.J.S.54A:1-1 et seq., to the extent the

1 distribution is applied against and reduces the adjusted basis of the
2 stock of the shareholder in the manner provided by section 1371(e) of
3 the federal Internal Revenue Code of 1986, 26 U.S.C. §1371.

4 c. In applying sections 1368 and 1371(e) of the federal Internal
5 Revenue Code of 1986, 26 U.S.C. §§1368 and 1371, to any
6 distribution referred to in subsection a. or b. of this section:

7 (1) the term "adjusted basis of the stock" means the shareholder's
8 adjusted basis in the stock of the New Jersey S corporation, as
9 determined under section 13 of P.L.1993, c.173 (C.54A:5-11); and

10 (2) the term "accumulated adjustments account" means an amount
11 that is equal to, and adjusted in the same manner as, the New Jersey
12 S corporation's accumulated adjustments account defined in section
13 1368(e)(1)(A) of the federal Internal Revenue Code of 1986, 26
14 U.S.C. §1368, except that any modifications required to be made
15 pursuant to the definition of S corporation income shall be taken into
16 account.

17 (cf: P.L.1993, c.173, s.16)

18
19 12. Section 4 of P.L.1993, c.173 (C.54:10A-5.23) is repealed.

20
21 13. This act shall take effect immediately; sections 1, 2 and 12 shall
22 apply to privilege periods beginning after its enactment and sections
23 3 through 11 shall apply to taxable years beginning after its enactment.

24 25 26 STATEMENT

27
28 This bill changes the procedure that corporations use to elect New
29 Jersey S corporation status. The bill also repeals the current
30 requirement that electing S corporations make gross income tax
31 payments for nonconsenting nonresident shareholders; establishes a
32 new requirement for S status election, that every shareholder consent
33 to gross income tax jurisdiction; and eliminates the "split" of resident
34 shareholders' S corporation income.

35 Subchapter S of the federal Internal Revenue Code allows business
36 corporations with 35 or fewer shareholders (who must each be U.S.
37 resident individuals, estates or certain trusts) to elect special tax
38 treatment, including the exemption of most of their corporate income
39 from taxation at the corporate level. The shareholders of those
40 corporations pay personal income taxes on their proportional share of
41 the income the corporation, whether or not the corporation has made
42 any distribution of that income to them, in the same year in which the
43 corporation earns the income.

44 The majority of states with personal income taxes have provisions
45 similar to the federal treatment for the taxation of federally electing S
46 corporations. The 1993 New Jersey legislation that first established

1 special State tax treatment for these corporations differs from the
2 federal treatment. New Jersey taxes S corporation income at both the
3 corporate level (at a greatly reduced rate) and the personal level, a
4 system similar to that used by California and New York State.

5 A decision was made in the 1993 S corporation law that all of a
6 New Jersey resident's S corporation income from non-New Jersey
7 sources would be treated like federal S corporation income, subject to
8 taxation in the same year it is earned whether or not the income is
9 distributed, to avoid a theoretical double taxation situation that, in
10 practice, appears to be quite rare. As a consequence, the S
11 corporation income of a New Jersey resident may currently be "split,"
12 with the non-New Jersey source income being treated as currently
13 taxable and the New Jersey source income being treated as taxable
14 when actually paid over to the shareholder. This can be confusing to
15 taxpayers, and it complicates the administration of the tax.

16 This bill eliminates the split by allowing the election of S
17 corporation status to apply to all of the income of the S corporation.
18 For a non-electing S corporation, all of the corporation's New Jersey
19 taxable income would immediately be taxed at the 9% rate (or the
20 7½% for corporations with income less than \$100,000). The
21 corporation's payment of that income over to its shareholders would
22 be treated as dividends, subject to taxation at the time they were paid.
23 For an electing S corporation, the corporation would be subject to a
24 reduced corporate income at the time the income was earned and as
25 flow-through income subject to personal income taxes in that same
26 year.

27 The 1993 S corporation legislation currently requires that a
28 corporation electing New Jersey S corporation status pay the gross
29 income taxes of each nonresident shareholder who does not consent
30 to the jurisdiction of New Jersey to enforce the gross income tax on
31 the shareholder's New Jersey source S corporation income. This bill
32 repeals that unwieldy provision. However, a new condition is required
33 for S corporation election: every shareholder, resident and
34 nonresident, must consent to paying New Jersey gross income taxes.

35 The bill replaces the current S status election procedure. Currently,
36 an election can be entered and then revoked at any time before the end
37 of the tax year. This bill provides an election modeled on the federal
38 election. A corporation that revokes its S corporation status is
39 forbidden from reelecting S status for 5 years. However, because the
40 consequences of revocation are severe, the bill also provides relief
41 provisions, again based on the federal model, for inadvertent
42 terminations of New Jersey S corporation status.

1

2

3 Concerns New Jersey S corporation election procedures and tax
4 consequences.