ASSEMBLY APPROPRIATIONS COMMITTEE

STATEMENT TO

ASSEMBLY, No. 1884

STATE OF NEW JERSEY

DATED: JUNE 3, 1996

The Assembly Appropriations Committee reports favorably Assembly Bill No.1884.

Assembly Bill No.1884 changes the procedure that corporations use to elect New Jersey S corporation status. The bill also repeals the current requirement that electing S corporations make gross income tax payments for nonconsenting nonresident shareholders, replacing it with a new requirement for S status election, that every shareholder consent to gross income tax jurisdiction; and eliminates the "split" of resident shareholders' S corporation income.

Subchapter S of the federal Internal Revenue Code allows certain qualified corporations to elect special tax treatment, including the exemption of most of their corporate income from taxation at the corporate level. The shareholders of those corporations pay personal income taxes on their proportional share of the income of the corporation, whether or not the corporation has made any distribution of that income to them, in the same year in which the corporation earns the income. New Jersey currently allows corporations electing federal S corporation status to elect New Jersey S corporation status, allowing the electing corporation a reduced State corporate tax rate.

This bill replaces the current election of New Jersey S status, which can be entered and then revoked at any time before the end of the tax year, with an election modeled on the federal election. Under the bill, a corporation that revokes its S corporation status is forbidden from reelecting S status for 5 years. However, because the consequences of revocation are severe, the bill also provides relief provisions, again based on the federal model, for inadvertent terminations of New Jersey S corporation status.

The bill repeals the requirement that a corporation electing New Jersey S corporation status pay the gross income taxes of each nonresident shareholder who does not consent to personal income taxation by New Jersey. However, a new condition is required for S corporation election: every shareholder, resident and nonresident, must consent to paying New Jersey gross income taxes.

The bill eliminates a "split" in the taxation of the S corporation income of New Jersey residents that can occur when some of the S corporation income is taxed when earned by the corporation and some of the income is taxed when distributed.

FISCAL IMPACT:

While there are no data available to make specific estimates of the revenue impact of the bill, the new election procedure reduces taxpayer ability to make last minute decisions to reduce tax liability, and should therefore have a positive effect on total revenue. The repeal of the requirement that a corporation pay the gross income taxes of nonconsenting nonresident shareholders is replaced by a less cumbersome requirement that all shareholders consent to personal jurisdiction, which should decrease administrative and compliance costs at no loss of revenue. The elimination of the income split may allow New Jersey resident shareholders of S corporations that are not doing business in New Jersey to defer recognition of some income.