

January 27, 1997

SENATE BILL NO. 231
(Second Reprint)

To the Senate:

Pursuant to Article V, Section I, Paragraph 14 of the New Jersey Constitution, I am returning Senate Bill No. 231 (Second Reprint) with my recommendations for reconsideration.

A. Summary of the Bill

This bill changes the way in which an S corporation is taxed. Currently the S corporation tax rate is linked to both the corporation business tax rate and the gross income tax rate. This bill provides lower fixed tax rates for S corporations: 2 percent for a corporation with annual income in excess of \$100,000 and .5 percent for a corporation with annual income of \$100,000 or less.

Under subchapter S of the federal Internal Revenue Code, certain business corporations with 35 or fewer shareholders may elect special tax treatment for most of their corporate income. Each state can establish its own system of taxation of these "S corporations" for state tax purposes. In New Jersey the corporation business tax rate for an S corporation is currently determined as the difference between the corporation business tax rate (currently 9 percent for a corporation with annual income in excess of \$100,000 and 7.5 percent for a corporation with annual income of \$100,000 or less) and the highest marginal rate under the New Jersey Gross Income Tax (currently 6.37 percent). Thus, the S corporation tax rate for the 1996 tax year is 2.63 percent for a corporation with annual income in excess of \$100,000 and 1.13 percent for a corporation with annual income of \$100,000 or less.

B. Recommended Action

I commend the sponsors on the goal of this bill to directly benefit thousands of our small business owners by establishing a lower fixed rate for S corporations. That tax cut will, in turn, help them to create more jobs in New Jersey. As I said in my recent State of the State Address, I look forward to signing legislation that accomplishes this worthwhile objective. I am concerned, however, about the timing of the bill's fiscal impact on the General Fund. It is estimated that the bill would have approximately a \$5 million impact in the State's current fiscal year and might even necessitate tax refunds from the State to some S corporations.

Accordingly, I am recommending that the privilege periods to which the lower fixed rate will apply be postponed for one year so that it will apply to privilege periods ending on or after July 1, 1998.

Therefore, I herewith return Senate Bill No. 231 (Second Reprint) and recommend that it be amended as follows:

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| <u>Page 2, Section 1, Line 19:</u> | Delete "1997" and insert "1998" |
| <u>Page 2, Section 1, Line 24:</u> | After "ending" insert "on or" |
| <u>Page 2, Section 1, Line 25:</u> insert | Delete "June 30, 1997" and "July 1, 1998" |
| <u>Page 2, Section 1, Line 27:</u> | Delete "beginning" and insert "ending"; delete "1996" and insert "1998" |

Respectfully,

/s/ Christine Todd Whitman

Governor

[seal]

Attest:

/s/ Michael P. Torpey

Chief Counsel to the Governor