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New Jersey: Recently Introduced Legislation Would Make Significant Corporation Business Tax Changes

On March 20, 2023, Assembly Bill 5323 was formally introduced in the New Jersey legislature. If enacted, this bill would make significant changes to New Jersey's Corporation Business Tax (CBT) laws. High-level details of the changes are addressed below.

Entire Net Income Changes: Assembly Bill 5323 makes numerous changes to the definition of "entire net income," which is generally the amount of income reported on the federal income tax return subject to certain statutory adjustments. For privilege periods ending after July 1, 2023, the bill would eliminate the provision that requires taxpayers to add back interest paid or accrued to a related member, unless an exception applies. The legislation would also make changes to New Jersey's dividends-received exclusion. Under current law, entire net income excludes 95 percent of dividends paid or deemed paid to the taxpayer by one or more 80 percent or more owned subsidiaries. For privilege periods ending on or after July 1, 2023, entire net income would exclude 100 percent of dividends from 80 percent or more owned subsidiaries and the dividends received exclusion would be allowed after the modifications that are required to be made that increase federal entire net income but before the modifications that reduce entire net income (e.g., NOLs) and before income is allocated to New Jersey. The dividends-received exclusion would be reduced by expenses and deductions attributed to dividends or deemed dividends, which must equal five percent of all dividends and deemed dividends received.

For privilege periods ending on and after July 31, 2022, the entire net income of any corporation that is incorporated or formed in a foreign country that has a comprehensive tax treaty with the U.S. and is not a member of a New Jersey worldwide group would not include any income exempted from federal taxable income under the terms of the treaty. However, treaty protection would not apply if the corporation was included in the New Jersey worldwide combined group.

Certain aspects of New Jersey's conformity to the Tax Cuts and Jobs Act would be modified under the bill. Under current law, amounts included in entire net income under IRC section 951A (GILTI) is not considered to be a dividend or deemed dividend. Assembly Bill 5323 would treat amounts included in income under IRC section 951A as a dividend for privilege periods ending on and after July 1, 2023.

For privilege periods beginning on and after January 1, 2022, a deduction for research and experimental expenditures would be allowed during the same privilege period for which a credit is claimed under a New Jersey statute, 54:10A-5.24, allowing a credit for research activities. This deduction would be allowed notwithstanding the timing schedule required under IRC section 174, for the deduction of specified research and experimental expenditures.

For privilege periods after December 31, 2017 and ending on or after July 31, 2022, the IRC section 163(j) limitation would apply to a combined group as though it had filed a federal consolidated return. For the purposes of applying the limitation with regard to affiliates that were members of the federal consolidated return but were not members of the New Jersey combined group, the combined group and the affiliates will also be treated as having filed one federal consolidated return. This is not necessarily a change; this would codify the Division of Taxation's current policy set forth in TB-87(R).

NOL changes: For privilege periods ending on and after July 31, 2023, Assembly Bill 5323 would adopt the federal 80 percent limitation on the use of NOLs. Further, the bill would simplify the application of prior NOL conversion carryovers and NOL carryovers for combined groups by allowing pooling for privilege periods ending on and after July 1, 2023.

Deduction To Offset Financial Statement Impact of Combined Reporting: Under New Jersey law, a deduction is allowed to offset the financial statement impact of the state moving to unitary combined reporting for privilege periods beginning on or after January 1, 2019. The deduction is currently to be taken over a 10-year period beginning with the combined group's first privilege period beginning on or after January 1, 2023. Under the bill, for privilege periods beginning on and after January 1, 2023, but before January 1, 2030, the combined group would be allowed to deduct for the privilege period, one percent of the amount necessary to offset the increase in the net deferred tax liability or decrease in the net deferred tax asset. The deduction would increase to five percent for privilege periods beginning on or after January 1, 2030.

Economic Nexus: Although courts have upheld economic nexus for CBT purposes, New Jersey does not have a bright-line CBT economic nexus standard. The bill would adopt an economic nexus standard that is similar to those applied by numerous states for sales and use tax nexus purposes. Notably, a corporation deriving receipts in excess of $100,000 from in-state sources or that had 200 or more separate transactions delivered to New Jersey customers would be deemed to have substantial nexus with New Jersey.

Combined Reporting Changes: The default filing method in New Jersey is water's-edge combined and the combined group includes certain domestic entities (unless they have 80 percent or more of their property or payroll outside the U.S.) and other members regardless of where formed if the member has a certain amount of U.S. property and payroll. Under the bill, a group member, wherever formed or incorporated, that is not otherwise included in the water's-edge combined group, would be included if that member had effectively connected income, but only to the extent of its effectively connected income.

Currently, entities that are filing a water's-edge or worldwide New Jersey combined return use the so-called *Joyce* apportionment rule; the bill would adopt a *Finnigan* approach for combined groups, which is consistent with the approach used by New Jersey affiliated group filers.

Effective for privilege periods ending on and after July 31, 2023, new definitions would apply to "captive real estate investment trusts," "captive regulated investment companies," and "captive investment companies." Once meeting the definitions, these captive entities would be taxed in the same manner as any other C Corporations and would be required to be included as a member of a combined group filing a combined return.

The bill would adopt broad new provisions allowing the Director to combine or decombine taxpayers under certain enumerated circumstances.

Conclusion: The changes discussed above are just an overview of the proposed amendments. KPMG will be tracking the progress of this legislation. Please contact Jim Venere or Andrew Eskola with questions.

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