

New Jersey Budget Includes So-called Loophole Closers Sought by Administration

July 7, 2014

Overview

On June 30, 2014, New Jersey Governor Chris Christie signed into law the Fiscal 2015 Budget, including Assembly Bill No. 3486¹ (“A.B. 3486” or “the new law”). The Governor’s proposed budget, under the heading of “Creating Tax Fairness and Making Sure Businesses Play by the Same Rules,” had identified the following tax reform goals:

Ensure Out-of-State Online Businesses Collect the Same Sales Taxes as New Jersey Businesses. This proposal will level the playing field for out-of-state on-line retailers active in New Jersey, extending to them the same obligation that other New Jersey businesses already have to collect sales tax on sales to New Jersey customers.

Close Loopholes to Prevent Windfall Tax Refunds to Out-of-state Businesses that Don’t Pay New Jersey Taxes. This proposal would clarify the existing tax law to close a loophole that allows out-of-state partners in New Jersey partnerships to be eligible for tax refunds, even if they didn’t pay any taxes to begin with.

Close Loopholes that Allow Corporations to Shelter Income. These proposals would close loopholes to prevent the sheltering of business income from a “deemed asset sale” and conform with federal tax law regarding adjustments to net operating losses when businesses shed certain debts.²

In close adherence to the Governor’s goals, the new law contains the following changes:

- Corporate Business Tax Act
 - Amends the statutory definition of “operational” versus “nonoperational” (business versus nonbusiness) income
 - Places restrictions on when a nonresident owner of a “pass-through entity” may receive a refund of income taxes withheld on that owner’s share of “pass-through entity” income
 - Provides an adjustment to net operating loss (“NOL”) for certain debt cancellation
- Sales and Use Tax Act
 - Expands the definition of nexus for sales tax collection responsibility to include “click-through” nexus

The changes to the Corporate Business Tax Act are applicable to privilege periods (taxable years) ending on or after July 1, 2014.³ The change to the Sales and Use Tax Act is applicable to sales made and other taxable transactions occurring on or after July 1, 2014.⁴ These changes are more fully explained below.

Amends the Statutory Definition of “Operational Income”

A.B. 3486 amends the definition of “Operational income’ subject to allocation to New Jersey” by changing what had been a three-part standard into a standard where any one of three alternative factors, if satisfied, would result in treatment of income as “operational” (i.e., business or apportionable) income. Prior to the adoption of A.B. 3486, “operational income” was defined as “income from . . . property if the acquisition, management, **and** disposition” of that property constitute “integral parts of the taxpayer’s regular trade or business operations”⁵ The new law changes the conjunctive “and” to a disjunctive “or,” thus permitting income from property to be treated as

¹ Assembly, No. 3486, State of New Jersey, 216th Legislature. The bill can be located at: http://www.njleg.state.nj.us/2014/Bills/A3500/3486_I1.PDF.

² See, The Governor’s FY 2015 Budget Summary, page 31 at <http://www.state.nj.us/treasury/omb/publications/15bib/BIB.pdf>.

³ A.B. 3486 Section 5.

⁴ *Id.*

⁵ N.J. Stat. Ann. § 54:10A-6.1.a (2014) (emphasis added).

“operational income” if the “acquisition, management, **or** disposition” of such property “constitutes an integral part” of the taxpayer’s business.⁶

Restricts Refunds/Credits for Taxes Withheld by Pass-throughs on Behalf of Nonresident Owners

A.B. 3486 provides that only those nonresident partners that file a New Jersey tax return and report income subject to New Jersey tax may apply, against each such partner’s tax liability, the tax paid by their respective partnerships⁷ that has been credited to each such partner’s partnership account.⁸ The new law provides further that a partnership cannot “claim a refund of payments credited to any of its nonresident partners.”⁹

Provides an Adjustment to NOLs for Certain Debt Cancellation

The new law adds new subparagraph (F) to N.J. Stat. Ann. § 54:10A-4(k)(6), stating that the amount excluded from federal taxable income by reason of discharge of indebtedness described in I.R.C. § 108(a)(1) (A), (B), or (C) will correspondingly reduce an NOL for any privilege period ending after June 30, 2014, and any NOL carryover to such period.¹⁰

Expands Sales Tax Nexus to Include “Click-through” Nexus

The new law broadens New Jersey’s sales and use tax nexus standard by creating a rebuttable presumption that a taxpayer is soliciting business, and is therefore a “seller” required to collect and remit sales and use tax, if:

- That taxpayer enters into an agreement with an independent contractor or other representative having physical presence in New Jersey; and
- For a commission or other consideration, such independent contractor or representative directly or indirectly refers potential customers to the taxpayer by way of an Internet link or otherwise.¹¹

This presumption applies only where the taxpayer’s cumulative gross receipts from sales to customers in New Jersey who were referred by all such independent contractors or other representatives exceed \$10,000 during the preceding four quarters.¹² The amended statute provides further that the presumption may be rebutted by proof that during the four quarters at issue the independent contractor or other representative did not engage in any solicitation in New Jersey that would satisfy the nexus requirements under the U.S. Constitution.¹³

ASC 740 Treatment

Pursuant to ASC 740, “Income Taxes,” companies are required to account for the effect of a change in income tax law in the period that includes the enactment date of that law change. Therefore, the enactment of A.B. 3486 could have significant financial statement implications in the reporting period that includes the June 30, 2014 enactment date. ASC 740 does not apply to accounting for sales taxes. Companies may wish to consult with applicable advisors for guidance regarding the ASC 740 effect of these law changes.

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⁶ A.B. 3486 Section 1, amending N.J. Stat. Ann. § 54:10A-6.1.a (emphasis added). Note that the definition of “operational income,” prior to amendment by A.B. 3486, was addressed in *McKesson Water Products Company v. Division of Taxation*, 408 N.J. Super. 213, 217-221 (2009), where the court held that gain from an I.R.C. § 338(h)(10) deemed asset sale did not constitute “operational income.”

⁷ See, N.J. Stat. Ann. § 54:10A-15.11.a.(1) (2014), regarding required payment by partnerships.

⁸ A.B. 3486 Section 2, amending N.J. Stat. Ann. § 54:10A-15.11.b.

⁹ *Id.* Note that this law change would arguably appear to preclude a refund of tax under facts similar to those addressed in *BIS LP, Inc., v. Director, Division of Taxation*, Superior Court of New Jersey, Appellate Division, No. A-1647-12T3 (Apr. 11, 2014). The amended law would not, however, appear to change the nexus standard for partners in partnerships or LLC members.

¹⁰ A.B. 3486 Section 3, amending N.J. Stat. Ann. § 54:10A-4.

¹¹ A.B. 3486 Section 4, amending N.J. Stat. Ann. § 54:32B-2(i)(1)(C).

¹² *Id.*

¹³ *Id.*

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