External Multistate Tax Alert
January 24, 2020

New Jersey establishes elective entity tax for pass-through entities (PTE)

Overview

On January 13, 2020, Governor Phil Murphy signed Senate Bill No. 3246 (S3246), Pass-through Business Alternative Income Tax Act,[1] into law. S3246 establishes a new elective pass-through business alternative income tax (PTE tax) with a corresponding income tax credit for members and applies to taxable years beginning on or after January 1, 2020.

This tax alert provides a summary of the New Jersey PTE tax including election procedures and requirements, as well as overview of member income tax credit.

Entity-level election for pass-through entities

S3246 creates an elective pass-through entity business alternative income tax (PTE tax), which allows pass-through entities (PTEs) to report and pay tax at the entity level. For purposes of this tax, a PTE is a partnership, S corporation, or a limited liability company, with at least one member who is liable for New Jersey tax on distributive proceeds.[2]

In order for a PTE to make an election, the members of the PTE (at the time the election is filed) must execute a consent under penalties of perjury.[3] The PTE election must be made annually on or before the due date of the entity's return.[4] PTEs are allowed to revoke an election until the due date of the return for that tax year.[5]

Tax rate

The PTE tax is imposed on total distributive proceeds, which is the sum of each member's share of distributive proceeds, at the following rates for taxable years beginning on or after January 1, 2020:

- 5.675%, if the distributive proceeds of the PTE are less than or equal to $250,000 in the taxable year;
- $14,187.50 plus 6.52% of the distributive proceeds greater than $250,000, but not over $1,000,000, in the taxable year;
- $63,087.50 plus 9.12% of the distributive proceeds greater than $1,000,000, but not over $5,000,000, in the taxable year; or
- $427,887.50 plus 10.9% of distributive proceeds greater than $5,000,000 in the taxable year.[6]

Filing and payment requirements

Electing PTEs are required to file an entity tax return and make payments on or before the 15th day of the third month following the entity's taxable year for federal income tax purposes.[7] Electing PTEs are required to make estimated PTE tax payments on or before the 15th day of fourth, sixth, and ninth month of the taxable year, and the

[1] Pass-Through Business Alternative Income Tax Act, Bills 2018-2019: S3246 ScaAca (2R). A copy of the enacted legislation is available here, at p.2, line 12.
[2] *Id.*, subsection 2.
[3] *Id.*, subsection 3(b)(1).
[4] *Id.*
[5] *Id.*
[6] *Id.*, subsection 3(b)(3).
[7] *Id.*, subsection 3(d)

first month succeeding the end of the tax year.[8] In addition to entity level filing requirements, PTEs must also report a member's share of distributive proceeds to its members.[9]

Combined returns

An electing PTE "shall be included" in a combined group and file a combined return under the Corporate Business Tax Act (CBTA), unless meeting certain criteria.[10] The PTE may be excluded if (1) all members of the PTE are taxpayers liable for tax under the New Jersey Gross Income Tax Act (e.g. resident individuals) and (2) no business entity taxed as a corporation under the CBTA has a direct, indirect, beneficial or constructive ownership or control of the PTE.[11]

Composite or consolidated PTE return

PTEs under common ownership by an individual, estate, or trust, or a group of related individuals, estates, or trusts, are not precluded from filing a composite or consolidated PTE tax return.[12] The threshold for determining "common ownership" is fifty percent of direct or indirect voting control of each PTE; however, Internal Revenue Code Section 318 shall apply for determining voting control.[13]

Tax credit for members

S3246 provides a refundable tax credit for members of an electing PTE subject to New Jersey gross income tax, such as individuals, which is equal to the member's pro rata share of the PTE tax for that period.[14] The legislation specifies that any credit is only available "after the application of all other credits allowed by law [. . .] and claimed by the taxpayer in the taxable year."[15] If the amount of credit is bigger than that of tax otherwise due, then the excess amount of credit over tax will generally trigger an overpayment (i.e. refund).[16] A trust or estate which receives the credit can allocate the credit to beneficiaries or use against their tax liabilities.[17]

Corporate members

Corporate members of an electing PTE are also entitled to a corresponding tax credit, which is calculated based on its share of the PTE tax.[18] This credit may be applied to the surtax or corporate business tax liability; however the credit may not reduce tax liability below the statutory minimum for non-exempt corporations.[19] Corporate members may carryforward excess credit for up to 20 privilege periods.[20] The legislation also contains specific statutory provisions to allow a unitary group to potentially share the credit with other members in certain situations.[21]

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[8] *Id.*, subsection 3(d)
[9] *Id.,* subsection 3(b)
[10] *Id.*, subsection 3(c)(1).
[11] *Id.*
[12] *Id.*, subsection 3(c)(2)
[13] *Id.*
[14] *Id.*, subsection 5(a).
[15] *Id.,* subsection 5(b).
[16] *Id.,* subsection 5(c).
[17] *Id.,* subsection 5(d). The bill also amends N.J. Stat. Ann. 54A:4-1 surrounding S corporations to allow resident taxpayers the ability to claim a credit, *see* subsection 8.
[18] *Id.*, subsection 11.
[19] *Id.* Special rules apply to exempt entities, which may seek a refund. *Id.*, subsection (11)(e).
[20] *Id.*, subsection 11.
[21] *Id.*, subsection 11(c) and (d).

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