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MULTISTATE INCOME/FRANCHISE TAX

New Jersey enacts changes to corporation tax laws

Tax Alert

Overview

On July 3, 2023, New Jersey Assembly Bill 5323 ("A5323") was enacted into law. A5323 makes various changes to the state's corporation business tax rules by revising the state's nexus standard, increasing the state's net GILTI deduction to 95% by treating GILTI as a dividend, amending the state's combined reporting provisions, providing a limited exception for decoupling from Internal Revenue Code ("IRC") section 174, updating the dividends received deduction ("DRD") calculation, changing the net operating loss deduction, and changing the due date of the New Jersey corporate tax return.

This Tax Alert summarizes some of the relevant provisions of A5323.

Corporation Business Tax amendments

Bright-line nexus standard adopted

- Effective for privilege periods ending on or after July 31, 2023, A5323 adopts a bright-line threshold for economic nexus of $100,000 or 200 or more separate transactions.

GILTI and dividends received deduction

- For privilege periods ending on or after July 31, 2023, A5323 changes the method for calculating the dividends received deduction ("DRD"). Under prior law, the DRD was 95% for 80% or greater owned subsidiaries. Although A5323 provides that entire net income excludes 100 percent of dividends (and deemed dividends) that were included in federal taxable income ("FTI") for 80% or greater owned subsidiaries, the bill also states that the DRD must be reduced by five percent to reflect expenses and deductions attributable to such dividends.

- For privilege periods ending on and after July 31, 2023, the DRD must be deducted from entire net income after state addition modifications to FTI, but before other state subtraction modifications. As a result, the DRD will be applied on a pre-apportionment basis.

- For privilege periods ending on and after July 31, 2023, for purposes of the DRD (for both separate and combined filers), GILTI— required to be included in FTI pursuant to IRC section 951A—is considered a dividend.

- For privilege periods ending on or after July 31, 2023, A5323 repealed New Jersey Statutes Annotated section 54:10A-4.15. Therefore, the IRC section 250 deduction for GILTI and FDII are no longer allowed.

IRC section 174

Generally, New Jersey conforms to the current version of the IRC and follows the Tax Cuts and Jobs Act changes to section 174(a)(2)(B). However, A5323 provides a limited exception by providing that for privilege periods beginning on or after January 1, 2022, taxpayers that claim the Corporation Business Tax Research and Development Tax Credit for New Jersey qualified research expenditures can also deduct those New Jersey expenditures on their tax return in the same year as they claim the credit, rather than amortizing the expenditures as required by section 174. The deduction only applies to taxpayers who have New Jersey qualified research expenditures as described in New Jersey Statutes Annotated section 54:10A-5.24.

Combined reporting

- For privilege periods ending on and after July 31, 2023, if a member of a combined group receives income from the unitary business from a partnership, the combined group's entire net income includes the member's direct and indirect distributive share of the partnership's unitary business income. Also, the unitary partnership is not liable for the portion of the tax payment—imposed by New Jersey Statutes Annotated section 54:10A-15.11—that is directly or indirectly attributable to that member.

- A5323 provides several changes to the net deferred tax liability ("DTL") deduction. For group privilege periods beginning on or after January 1, 2023, but before January 1, 2030, the deduction is limited to one percent of the total DTL deduction per period for the first seven group privilege periods. For group privilege periods beginning on or after January 1, 2030, the deduction is limited to five percent of any remaining DTL deduction per period until fully utilized. The deduction limit of one percent or five percent is calculated at the beginning of each deduction period.

- Effective July 31, 2023, A5323 expressly adopts a *Finnigan* sourcing methodology and provides that to compute the receipts factor for the combined group, the combined group—referred to as "one taxpayer" by the bill—must take into account all unitary receipts of all members of the combined group for **all** filing methods.

- For privilege periods ending on and after July 31, 2023, A5323 expands the definition of "unitary business". For privilege periods ending on or after July 31, 2022, A5323 adds a new, single definition for "world-wide basis" and "world-wide group".

    - A unitary business includes business entities under common ownership that are sufficiently interdependent, integrated, or interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value among the separate parts.

    - The world-wide basis includes all of the income and attributes of such members regardless of whether they file federal returns. The members must include all income regardless of any exemption or exclusion provided by a tax treaty. In the case of a member that is a non-U.S. corporation, the member is allowed to take deductions that are allowable to a U.S. corporation.

- For privilege periods ending on and after July 31, 2023, A5323 provides that captive investment companies, captive real estate investment trusts, and captive regulated investment companies are taxed in the same manner as C Corporations and such entities must be included as members of a combined group reported on a combined return. There is an exception to this treatment provided for certain financial institutions with assets that do not exceed $15 billion.

Net operating loss sharing rules for combined groups

- For privilege periods ending on and after July 31, 2023, A5323 makes various changes to the net operating loss ("NOL") rules for combined groups including the following:
    - If a combined group generates an NOL, the combined group may carry over the NOL apportioned to New Jersey and the NOL is deductible from entire net income derived from the unitary business in a future privilege period as long as the carryover and deduction are consistent with New Jersey Statutes Annotated section 54:10A-4(v).
    - Where a taxable member of a combined group has an NOL carryover derived from a loss incurred in a privilege period where the taxpayer was not a member of the combined group, such carryover may be either: (1) pooled with the combined group NOL carryover for use by the combined group or (2) be used by the taxable member that generated the carryover for that member's activities that are independent of the unitary business of the combined group.
    - The limitation of IRC section 172(a)(2), which is 80% of current year income, shall apply.

New Jersey corporate return due date changes

- For privilege periods ending on and after July 31, 2023, A5323 codifies the rules regarding the due date of the New Jersey corporate business tax return by providing that the due date is the 15th day of the month following the month of the original due date or extended due date of the federal return.

Other amendments

- For fiscal or calendar accounting years ending on or after July 31, 2023, taxpayers with a liability of less than $1,500 (applied on a per-member basis for combine filers) are not required to make installment payments other than a 50 percent payment due with the return.

- For privilege periods ending on and after July 31, 2023, but before January 1, 2024, no penalties or interest will be imposed on the underpayment of tax with respect to the A5323's newly enacted provisions if the taxpayer makes estimated payments in accordance with the legislation.

- For privilege periods ending on and after July 31, 2022, A5323 provides that foreign affiliates includable under either a water's edge or an affiliated group filing are includable only to the extent of effectively connected income, subject to treaty limitations.

- A5323 grants the director of the New Jersey Division of Taxation authority to require taxpayers to file (or prevent taxpayers from filing) on a combined basis in certain circumstances.

- For privilege periods ending on or after July 31, 2022, A5323 grants the director the ability to make adjustments to NOLs for closed years in order to determine the correct tax liability for years that remain open to assessment. The ability to make such adjustments is limited to 10 years after the return was filed.

- For privilege periods ending on or after July 31, 2023, A5323 sunsets the related member interest and intangible expense disallowance provisions provided under New Jersey Statutes Annotated sections 54:10A-4(k)(2)(I) and 54:10A-4.4.

Corporate apportionment rules will be required in most circumstances for non-corporate business tax entities

- For privilege periods beginning on or after January 1, 2023, A5323 mandates that the sourcing rules for business receipts for Gross Income Tax purposes will follow the Corporation Business Tax sourcing rules. Therefore, the following taxpayers must source their income consistent with the provisions of the Corporation Business Tax Act: (1) taxpayers subject to the Gross Income Tax Act that engage in a trade or business, regardless of business form or (2) partners or shareholders in partnership or S corporation that conduct business operations partly inside and partly outside New Jersey where the New Jersey income cannot be readily or accurately ascertained.

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