FISCAL NOTE

[First Reprint]

SENATE, No. 3737

STATE OF NEW JERSEY
220th LEGISLATURE

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SUMMARY

Synopsis: Revises various provisions concerning State tax law.

Type of Impact: Variable net impacts on State revenue collections and State expenditures in any given fiscal year.

Agencies Affected: Department of the Treasury, Department of Environmental Protection, Department of Agriculture, and Department of Community Affairs.

Executive Estimate	
Net State Revenue Impact	Variable in any given year, but essentially neutral in long run

Office of Legislative Services Estimate	
Net State Revenue Impact	Variable in any given year
Net State Expenditure Impact	Variable in any given year

- Without access to taxpayer-specific corporation business tax data, the Office of Legislative Services (OLS) lacks the informational basis to either agree or disagree with the Executive assessment that the numerous countervailing effects of the bill would result in approximate State revenue-neutrality in the long term.

- The OLS, however, notes that in the case of the global intangible low-taxed income and foreign-derived intangible income reform, the Executive's estimate falls within the range of plausible outcomes.

- The OLS notes that the bill may result in indeterminate State administrative cost savings to the extent that the bill's tax administration simplification strategies will decrease the operating expenses of the Department of the Treasury.

- The OLS states that to the extent that the bill changes corporation business tax collections in any given year, it will also proportionately affect State expenditures. The reason is that the

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State Constitution dedicates six percent of annual corporation business tax collections to open space, farmland, and historic preservation, as well as to certain environmental purposes.

BILL DESCRIPTION

The bill makes numerous changes regarding the determination of tax liabilities under and the administration of the corporation business tax beginning in tax year 2023. From a revenue impact perspective, the following revisions are the most significant with additional explanatory details provided in the Executive Branch Fiscal Analysis section below:

- Changes the method for apportioning the taxable income of unitary combined reporting groups to New Jersey from the so-called Joyce rule to the Finnigan rule;
- Ends special treatment, including net income exclusions, of real estate investment trusts, regulated investment companies, and investment companies;
- Eliminates 37.5 percent foreign-derived intangible income deduction;
- Increases from 50 percent to 95 percent the exclusion from New Jersey taxable income of global intangible low-taxed income;
- Establishes new nexus standards by determining that an out-of-state business is subject to the corporation business tax if it derives over $100,000 of its receipts from sales to New Jersey or makes more than 200 sales in New Jersey;
- Shifts the net deferred tax liability deduction from a 10-year amortization schedule to a 27-year amortization schedule;
- Replaces the allocated dividend exclusion with a pre-allocation dividend exclusion;
- Reduces the pre-allocation dividend exclusion by "the amount of the expenses and deductions that are attributable to those dividends and deemed dividends," with expenses and deductions defined as "five percent of all dividends and deemed dividends received by a taxpayer during an income year."
- Decouples from the federal research and development expense deduction so that instead of having to amortize their research and development expense deductions over five years, taxpayers may claim the full deduction for the tax year in which they incur the expenses.

FISCAL ANALYSIS

EXECUTIVE BRANCH

The Department of the Treasury summarizes that the bill contains several revenue-positive provisions, revenue-negative provisions, and provisions that are nominally revenue-neutral in the long run, but have positive or negative revenue implications in the near term. Overall, the department believes it is reasonable to view the bill as "essentially revenue-neutral."

1. Joyce-to-Finnigan Rule Switch – Increase annual revenue by at least $45.4 million

The Department of the Treasury explains that this bill would change the calculation of allocation factors for combined groups from the Joyce rule to the Finnigan rule. The Joyce rule only requires the inclusion of New Jersey receipts from group members with corporation business tax nexus in the numerator of the allocation factor. In contrast, the Finnigan rule includes the New Jersey receipts of all group members in the numerator of the allocation factor.

Using data from combined group corporation business tax filings for tax year 2019, the Department of the Treasury estimates that the switch to Finnigan-rule apportionment would increase State corporation business tax revenues by approximately $45.4 million. The department recognizes that this total may underestimate the actual revenue impact of the switch, if some groups under-report receipts from non-nexus entities.

2. Treatment of certain REITs, RICs, and ICs - Increase annual revenue by $60.5 million

Currently, only four percent of real estate investment trust (REIT) net income and 40 percent of investment company (IC) and regulated investment company (RIC) net income are subject to the corporation business tax. This bill would include these entities in combined groups and tax their net income in the same way as other firms, meaning that 100 percent of their net income would be subject to tax.

Based on the tax year 2019, 2020, and 2021 corporation business tax returns filed by REITs and IC/RICs, the Department of the Treasury estimates that the proposed change in the tax rates would result in an increase approximating $60.5 million in corporation business tax revenue annually. However, the department notes that it did not have sufficient data to estimate the impact of the inclusion of these firms in combined groups. The department explained that including these entities in combined groups would affect both the income and allocation factors of the groups, resulting in a possible increase or decrease in the estimate.

3. GILTI/FDII Reform - Decrease annual revenue by at most $122.8 million

The Department of the Treasury states that this bill would decouple from the federal 50 percent deduction for global intangible low-taxed income (GILTI) and 37.5 percent deduction for foreign-derived intangible income (FDII). Consequently, 100 percent of a combined group's FDII would become subject to the corporation business tax. GILTI income, in turn, would be treated in the same way as other dividend income, with 95 percent of holdings in 80 percent-or-more owned subsidiaries and 45 percent of holdings in 50 percent-to-80 percent owned subsidiaries excluded from taxable income.

Due to data limitations, the department's estimate for this change, based on tax year 2019 tax filing data, assumes that all GILTI holdings are in 80 percent-or-more owned subsidiaries. This results in an estimated upper-bound impact of a $122.8 million reduction in annual corporation business tax revenue.

4. Dividend Exclusion – Potential indeterminate decrease in long-term annual revenue

The Department of the Treasury notes that this bill would replace the allocated dividend exclusion with a pre-allocation dividend exclusion.

The department states that sufficient data to evaluate the impact of this provision is not currently available. Because the shift to a pre-allocation exclusion would create the potential for increased net operating loss carryovers, this provision would seemingly have the potential to be revenue negative over time; however, other provisions of the law, which limit utilization of net operating losses would mitigate the adverse revenue impact of this provision.

5. Five Percent Dividend Clawback – Indeterminate increase in annual State revenue

The Department of the Treasury states that the bill reduces the pre-allocation dividend exclusion by "the amount of the expenses and deductions that are attributable to those dividends and deemed dividends," with expenses and deductions defined as "five percent of all dividends and deemed dividends received by a taxpayer during an income year."

The department considers that this provision will have a positive revenue impact. However, other than the amount implicit in the estimated impact of the global intangible low-taxed income (GILTI)/foreign-derived intangible income (FDII) reforms noted above, due to data limitations, the department states that it is not possible to quantify the positive revenue impact.

6. Net Deferred Tax Liability Deduction – Revenue-neutral in long run

The Department of the Treasury explains that the bill would shift the schedule for the net deferred tax liability deduction from a 10 percent annual deduction over 10 years to a more protracted schedule of one percent over each of the first seven years, followed by five percent of the remaining balance over each of the subsequent 20 years.

The department estimates that in nominal dollar terms, this change would have no revenue impact, as it effectively shifts $790.5 million in foregone revenue to future years. In net present value terms, the bill would result in a positive net revenue impact.

7. R&D Expense Deduction: Decoupling from Federal Amortization Requirement – Revenue-neutral in long run

The Department of the Treasury notes that beginning in tax year 2022, for federal tax purposes firms are required to amortize their research and development expense deductions over a five-year period. The bill would decouple New Jersey's research and development expense deduction from the federal requirement, allowing firms to continue taking the full deduction in the single year in which qualified expenses were incurred.

The department estimates that while likely revenue-neutral over time, the decoupling will result in an initial decrease in corporation business tax revenue compared to adoption of the federal amortization schedule. Based on data from the State Science and Technology Institute, the Internal Revenue Service, and the Congressional Joint Committee on Taxation, as well as data on New Jersey's effective tax rates and apportionment factors, the department estimates that decoupling would result in a revenue reduction of between $12.3 million and $36.7 million in tax year 2022.

8. Nexus Clarification - Increase annual revenue by at least $25.5 million

The Department of the Treasury explains that the bill would establish a clearly defined threshold for corporation business tax nexus akin to the sales and use tax standard. That is, firms that derive over $100,000 in receipts or make more than 200 sales in New Jersey would be required to file a corporation business tax return, unless they were subject to federal P.L. 86-272 protection. The department is only able to address a small potential portion of the effect of this proposal that relates to out-of-state sellers that currently remit sales taxes.

The department estimates that if the approximately 1,100 out-of-state sellers that did not file corporation business tax returns in 2019 and did not sell through marketplace facilitators were subject to the minimum tax, this would add an additional $1.2 million to corporation business tax revenues. The department notes that data are not currently available that would allow for an accurate assessment of the number of remote sellers hosted by marketplace facilitators that would be subject to corporation business tax. Assuming that all sellers on the five largest marketplace facilitators (Amazon, Google, Etsy, Walmart, and Ebay) met the nexus threshold of $100,000 in 2019, there would be approximately 32,000 vendors subject to the minimum tax, resulting in an increase of $24.3 million in corporation business tax revenue. The department cautions that these estimates do not account for many categories of receipts and taxable income that are subject to the corporation business tax, but are not subject to the sales and use tax.

OFFICE OF LEGISLATIVE SERVICES

Without access to taxpayer-specific corporation business tax data, the OLS lacks the informational basis to either agree or disagree with the Executive assessment that the numerous countervailing effects of the bill would result in approximate State revenue-neutrality in the long term.

The OLS, however, notes that the Executive's estimates fall within the range of plausible outcomes in the case of the global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII) reforms.

3. GILTI/FDII Reform- Decrease annual revenue collections between $106.6 million and $122.8 million

The OLS agrees with the direction and magnitude of the Executive's revenue impact for the global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII) reforms. The OLS notes that this provision will reduce State annual corporation business tax collections by between $106.6 million and $122.8 million.

Upon request, the Department of the Treasury indicated to the OLS that the taxation of GILTI impacts approximately 1,148 regular corporation business tax filers and 1,821 combined-group filers, for a total of 2,969 filers. Further, the department indicated that the impact of taxing GILTI at current rates (which include a 50 percent deduction) generates approximately $216.0 million annually. However, under current law, the taxation of GILTI and the GILTI deduction are statutorily connected to the deduction for FDII, which creates a net loss of revenue that partly offsets the gain from GILTI. This net loss is estimated to approximate $87.8 million annually. Therefore, the net annual revenue gain under current law of GILTI taxation, the GILTI deduction, and the FDII deduction is approximately $128.2 million annually.

Under the bill, the exclusion from New Jersey taxable income of GILTI increases from 50 percent to 95 percent, offset by the elimination of the 37.5 percent foreign-derived intangible income deduction from the GILTI tax liability. As shown in the table below, the OLS notes that, using the Department of the Treasury's data as a starting point for its own estimate, the low-band estimate for this provision will be approximately $106.6 million in annual revenue loss. The Executive's upper bound estimate totals $122.8 million.

Current Statutory Calculation (In $ Millions)				
GILTI Taxation =	GILTI Tax Liability With 50 Percent Deduction	-	FDII Deduction	Net Collections
	$216.0		($87.8)	$128.2
Under the Bill				
GILTI Taxation =	GILTI Tax Liability with 95 percent Deduction	-	FDII Deduction (Repealed)	Net Collections
	$21.6		$0	$21.6
TOTAL NET REVENUE LOSS (In $ Millions)				**($106.6)**

Administrative Cost Savings

The OLS notes that the bill may result in indeterminate State administrative cost savings to the Department of the Treasury to the extent that the bill's tax administration simplification strategies will decrease the department's operating expenses.

Annual State Expenditure Impact from Constitutionally Dedicated Corporation Business Tax Revenues

The OLS adds that to the extent that the bill changes corporation business tax collections in any given year, it will also proportionately affect State expenditures. The reason is that the State Constitution dedicates six percent of annual corporation business tax collections to open space, farmland, and historic preservation, as well as to certain environmental purposes. These programs are operated by the Departments of Environmental Protection, Agriculture, and Community Affairs.

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This fiscal note has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).