LEGISLATIVE FISCAL ESTIMATE

SENATE, No. 982

STATE OF NEW JERSEY
217th LEGISLATURE

DATED: MARCH 1, 2016

SUMMARY

Synopsis: Requires members of unitary business groups to file combined reports of corporation business tax.

Type of Impact: Annual increase in General Fund revenues and certain Constitutionally dedicated revenues.

Agencies Affected: Department of the Treasury. Department of Environmental Protection.

Office of Legislative Services Estimate

Fiscal Impact	Annual Impact
State Revenue Increase	Uncertain and variable $110 million to $290 million
State Expenditure Increase	Uncertain and variable 4 percent of Total Revenue Increase Through FY 2019, 6 percent of Total Revenue Increase Thereafter

- The Office of Legislative Services (OLS) estimates a potential State revenue increase that may range between $110 million and $290 million annually. However, the OLS cautions that corporate tax revenues are historically highly variable. The inherent variability in corporate tax collections coupled with the potential tax revenue impact of combined reporting therefore produces a relatively broad range of revenue estimates.

- The OLS notes that 4 percent of any revenue increase would be constitutionally dedicated to certain environmental programs through FY 2019, increasing to a 6 percent dedication beginning in FY 2020 and thereafter. State expenditures would thus increase by amounts corresponding to those percentages of increased annual revenue.

BILL DESCRIPTION

Senate Bill No. 982 of 2016 updates the New Jersey corporation business tax reporting system to require related corporations to file a combined income report.

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Most large businesses are structured as a family of corporations under common ownership and control. The combined income reporting system required by the bill treats a group of interrelated companies as a single company for determining income under the corporation business tax. A share of this combined income is then apportioned to New Jersey, allocated among the corporation business taxpayers, the same taxpayers as under current law, and each corporation files its own corporation business tax return.

The bill allows one of the members of the corporate group, selected because it is the controlling "parent" corporation in the corporate tax structure or chosen by the other group members, to become the managerial member of the group. This managerial member has the key responsibility for filing the combined income report for the group, and may, pursuant to regulations to be developed by the Director of the Division of Taxation, elect or be assigned other administrative responsibilities for the other members of the group.

The bill gives the managerial member the power to elect a more limited form of combined measurement, the so-called "water's edge" approach, which omits from the combined report foreign corporations that do not independently conduct activity in New Jersey and that do very little business in the United States. However, the bill requires a corporate group that elects water's edge treatment to include in its combined tax report a related company that does business in a "tax haven" jurisdiction. Such a company may be excluded from the combined report only if it is proven, to the satisfaction of the Director of the Division of Taxation, that its business in that jurisdiction is outside the scope of the laws, provisions, and practices that cause the jurisdiction to meet the bill's definition of a tax haven.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS estimates a potential State revenue increase that may range between $110 million and $290 million annually. However, the OLS cautions that corporate tax revenues are historically highly variable. The inherent variability in corporate tax collections coupled with the potential tax revenue impact of combined reporting therefore produces a relatively broad range of revenue estimates.

Significantly, the OLS does not have access to corporate tax return data that might allow for an analysis of the specific conditions of New Jersey corporate taxpayers relative to a requirement for combined reporting. Lacking such data, the OLS only has information from other states that have adopted combined reporting. But even that data has limited applicability to New Jersey, as each state's corporate environment is different, and each state that has adopted combined reporting began from a unique tax structure that is not the same as New Jersey's current structure. For example, some states are single sales factor states like New Jersey, but many are not. Moreover, New Jersey's corporate tax reforms of 2002 previously addressed some of the issues involving corporate tax shelters, including limits on the deductibility of royalties when paid to certain affiliates and additionally granted the authority to the Director of the Division of Taxation to compel combined reporting under certain conditions. However, it is unknown the extent to which the Director may currently use this authority.

The information from other states may be illustrative of the potential tax revenue impact in New Jersey, but are not a guarantee of the potential effect. Projected revenue growth rates between 5 percent and 20 percent from other states illustrate both the range of revenue potential and the large uncertainty as a result of mandated combined reporting. According to the Center on Budget and Policy Priorities, most states project that the adoption of combined reporting may increase corporate tax revenues by between 10 percent and 20 percent annually. A 2014 report by the Rhode Island Department of Revenue estimated an approximate 20 percent revenue gain, when isolating combined reporting from other tax law changes involving three-factor and single sales factor apportionment systems. Connecticut's consensus revenue forecast for FY 2016 estimates a revenue gain of approximately 5 percent from implementing mandatory combined reporting as one part of a major corporate tax reform in that state. In 2008, New York State's Division of the Budget estimated an increase of 8 percent for combined reporting. However, a report commissioned for the National Conference of State Legislatures in 2010 found little impact in the initial years of combined reporting reforms in New York and Vermont. The Massachusetts Department of Revenue originally estimated 26 percent revenue growth in FY 2009 from combined reporting, although total corporate revenues grew by closer to 17 percent that first year and Massachusetts did not isolate how much was due to the tax change compared to economic conditions. Massachusetts also reduced the corporate tax rate during that period.

Given that the prior New Jersey corporation business tax reforms of 2002 were also intended to limit the use of some corporate tax shelters, it is reasonable to anticipate that the potential revenue impact of mandatory combined reporting may be closer to the low end of the wide range estimated in other states. Accordingly, the OLS believes a potential corporation tax revenue increase ranging between 5 percent and 10 percent annually is possible, but also highly uncertain.

New Jersey corporation business tax revenues in recent years have varied between about $2.2 billion (FY 2012) and $2.9 billion (FY 2015), from a total of on-budget General Fund and off-budget components, including banks and financial institutions. At the low end of the range, 5 percent of $2.2 billion would yield $110 million as a potential State revenue gain. At the high end of the range, 10 percent of $2.9 billion would yield $290 million as a potential revenue gain. Corporate tax revenues are historically highly variable, and the inherent uncertainty of the potential tax revenue impact from combined reporting therefore produces a very broad range of revenue estimates.

In addition, the OLS notes that 4 percent of any revenue increase would be constitutionally dedicated to certain environmental programs through FY 2019, with dedication increasing to 6 percent in FY 2020 and thereafter. State expenditures would thus increase by amounts corresponding to those percentages of increased annual revenue.

Section:	*Revenue, Finance, and Appropriations*
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This legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note.

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