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STATE OF NEW JERSEY

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SYNOPSIS

Allows deduction from New Jersey gross income of certain capital gains from sale or exchange of New Jersey qualified small business stock held for more than five years.

CURRENT VERSION OF TEXT

Introduced Pending Technical Review by Legislative Counsel.



(Sponsorship Updated As Of: 12/2/2021)

1 **AN ACT** allowing a deduction from New Jersey gross income of
2 certain capital gains from sale or exchange of New Jersey
3 qualified small business stock held for more than five years,
4 supplementing Title 54A of the New Jersey Statutes.

5
6 **BE IT ENACTED** *by the Senate and General Assembly of the State*
7 *of New Jersey:*

8
9 1. a. Notwithstanding the provisions of N.J.S.54A:5-1, a
10 taxpayer who is an individual shall be allowed to deduct from the
11 taxpayer's gross income in a taxable year the eligible gain from the
12 sale or exchange of New Jersey qualified small business stock held
13 for more than five years.

14 b. (1) If the taxpayer has eligible gain for the taxable year from
15 one or more dispositions of stock issued by any corporation, the
16 aggregate amount of the gain from dispositions of stock issued by
17 the corporation which may be taken into account under subsection
18 a. for the taxable year shall not exceed the greater of either of the
19 following:

20 (a) Ten million dollars (\$10,000,000) reduced by the aggregate
21 amount of eligible gain taken into account by the taxpayer under
22 subsection a. for prior taxable years and attributable to dispositions
23 of stock issued by the corporation.

24 (b) Ten times the aggregate adjusted bases of qualified small
25 business stock issued by the corporation and disposed of by the
26 taxpayer during the taxable year. For purposes of this subparagraph
27 (b), the adjusted basis of any stock shall be determined without
28 regard to any addition to basis after the date on which the stock was
29 originally issued.

30 (2) For purposes of this subsection b., the term “eligible gain”
31 means any gain from the sale or exchange of qualified small
32 business stock held for more than five years.

33 (3) (a) In the case of a married individual filing a separate
34 return, subparagraph (a) of paragraph (1) of this subsection shall be
35 five million dollars (\$5,000,000).

36 (b) In the case of a married taxpayer filing a joint return, the
37 amount of gain taken into account under subsection a. shall be
38 allocated equally between the spouses for purposes of applying this
39 subsection to subsequent taxable years.

40 c. As used in this section:

41 (1) “Qualified small business stock” means any stock in a C
42 corporation which is originally issued after the effective date of
43 P.L. , c. (C.) (pending before the Legislature as this bill), if
44 both of the following apply:

45 (a) As of the date of issuance, the corporation is a qualified
46 small business.

1 (b) Except as provided in subsections e. and g., the stock is
2 acquired by the taxpayer at its original issue (directly or through an
3 underwriter) in either of the following manners:

4 (i) In exchange for money or other property (not including
5 stock).

6 (ii) As compensation for services provided to the corporation
7 (other than services performed as an underwriter of the stock).

8 (2) (a) Stock in a corporation shall not be treated as qualified
9 small business stock unless, during substantially all of the
10 taxpayer's holding period for the stock, the corporation meets the
11 active business requirements of subsection d. of this section and the
12 corporation is a C corporation.

13 (b) (i) Notwithstanding subsection d. of this section, a
14 corporation shall be treated as meeting the active business
15 requirements of subsection d. for any period during which the
16 corporation qualifies as a specialized small business investment
17 company.

18 (ii) For purposes of subsubparagraph (i) of this subparagraph,
19 the term "specialized small business investment company" means
20 any eligible corporation (as defined in paragraph (4) of subsection
21 d. of this section) that is licensed to operate under Section 301(d) of
22 the federal Small Business Investment Act of 1958 (as in effect on
23 May 13, 1993).

24 (3) (a) Stock acquired by the taxpayer shall not be treated as
25 qualified small business stock if, at any time during the four-year
26 period beginning on the date two years before the issuance of the
27 stock, the corporation issuing the stock purchased (directly or
28 indirectly) any of its stock from the taxpayer or from a related
29 person to the taxpayer. For the purposes of this subparagraph,
30 "related person" means a corporation, partnership, association or
31 trust controlled by the taxpayer; an individual, corporation,
32 partnership, association or trust that is in the control of the
33 taxpayer; a corporation, partnership, association or trust controlled
34 by an individual, corporation, partnership, association or trust that
35 is in the control of the taxpayer; or a member of the same controlled
36 group as the taxpayer.

37 (b) Stock issued by a corporation shall not be treated as
38 qualified small business stock if, during the two-year period
39 beginning on the date one year before the issuance of the stock, the
40 corporation made one or more purchases of its stock with an
41 aggregate value (as of the time of the respective purchases)
42 exceeding five percent of the aggregate value of all of its stock as of
43 the beginning of the two-year period.

44 (c) If any transaction is treated under section 304(a) of the
45 Internal Revenue Code (26 U.S.C. s.304(a)) as a distribution in
46 redemption of the stock of any corporation, for purposes of
47 subparagraphs (a) and (b), the corporation shall be treated as
48 purchasing an amount of its stock equal to the amount treated as a

1 distribution in redemption of the stock of the corporation under
2 section 304(a) of the Internal Revenue Code (26 U.S.C. s.304(a)).

3 (4) “Qualified small business” means any domestic corporation
4 (as defined in section 7701(a)(4) of the Internal Revenue Code (26
5 U.S.C. s.7701(a)(4))) which is a C corporation, if all of the
6 following apply:

7 (a) The aggregate gross assets of the corporation (or any
8 predecessor thereof) at all times on or after the effective date of
9 P.L. , c. (C.) (pending before the Legislature as this bill),
10 and before the issuance did not exceed \$50,000,000;

11 (b) The aggregate gross assets of the corporation immediately
12 after the issuance (determined by taking into account amounts
13 received in the issuance) do not exceed \$50,000,000, where
14 “aggregate gross assets” mean the amount of cash and the aggregate
15 adjusted basis of other property held by the corporation, but the
16 adjusted basis of any property contributed to the corporation (or
17 other property with a basis determined in whole or in part by
18 reference to the adjusted basis of property so contributed) shall be
19 determined as if the basis of the property contributed to the
20 corporation immediately after the contribution was equal to its fair
21 market value as of the time of the contribution; and

22 (c) Has fewer than 225 employees and at least 80 percent of the
23 corporation’s payroll, as measured by total dollar value, is
24 attributable to employment located within this State.

25 Provided, however, that all corporations which are members of the
26 same parent-subsidiary controlled group shall be treated as one
27 corporation for purposes of this subsection, where “parent-
28 subsidiary controlled group” means any controlled group of
29 corporations as defined in section 1563(a)(1) of the Internal
30 Revenue Code (26 U.S.C. s.1563(a)(1)), except that that
31 percentages of ownership and value that control shall exist in
32 situations involving at least 50 percent of ownership and value as
33 otherwise provided involving at least 80 percent required by section
34 1563(a)(1) (26 U.S.C. s.1563(a)(1)), and section 1563(a)(4) of the
35 Internal Revenue Code (26 U.S.C. s.1563(a)(4)) shall not apply.

36 d. (1) The active business requirements of paragraph (2) of
37 subsection c. shall be met by a corporation for any period if during
38 that period:

39 (a) At least 80 percent (by value) of the assets of the corporation
40 are used by the corporation in the active conduct of one or more
41 qualified trades or businesses; and

42 (b) The corporation is a domestic corporation, but shall not
43 include any of the following: (i) a domestic international sales
44 corporation (DISC) or former DISC; (ii) A corporation with respect
45 to which an election under section 936 of the Internal Revenue
46 Code (26 U.S.C. s.936) is in effect or which has a direct or indirect
47 subsidiary with respect to which the election is in effect; (iii) A
48 regulated investment company, real estate investment trust (REIT),

1 or real estate mortgage investment conduit (REMIC); or (iv) A
2 cooperative.

3 (2) For purposes of this paragraph (2), if, in connection with any
4 future qualified trade or business, a corporation is engaged in:

5 (a) Startup activities described in section 195(c)(1)(A) of the
6 Internal Revenue Code (26 U.S.C. s.195(c)(1)(A)),

7 (b) Activities resulting in the payment or incurring of
8 expenditures which may be treated as research and experimental
9 expenditures under section 174 of the Internal Revenue Code (26
10 U.S.C. s.174), or

11 (c) Activities with respect to in-house research expenses
12 described in section 41(b)(4) of the Internal Revenue Code (26
13 U.S.C. s.41(b)(4)), then assets used in those activities shall be
14 treated as used in the active conduct of a qualified trade or business.
15 Any determination under this paragraph (1) shall be made without
16 regard to whether a corporation has any gross income from those
17 activities at the time of the determination.

18 (3) For purposes of this subsection d., “qualified trade or
19 business” means any trade or business other than any of the
20 following:

21 (a) Any trade or business involving the performance of services
22 in the fields of health, law, engineering, architecture, accounting,
23 actuarial science, performing arts, consulting, athletics, financial
24 services, brokerage services, or any trade or business where the
25 principal asset of the trade or business is the reputation or skill of
26 one or more of its employees.

27 (b) Any banking, insurance, financing, leasing, investing, or
28 similar business.

29 (c) Any farming business (including the business of raising or
30 harvesting trees).

31 (d) Any business involving the production or extraction of
32 products of a character with respect to which a deduction is
33 allowable under section 613 or 613A of the Internal Revenue Code
34 (26 U.S.C. s.613 or s.613A).

35 (e) Any business of operating a hotel, motel, restaurant, or
36 similar business.

37 (4) (a) For purposes of this subsection d., stock and debt in any
38 subsidiary corporation shall be disregarded and the parent
39 corporation shall be deemed to own its ratable share of the
40 subsidiary’s assets, and to conduct its ratable share of the
41 subsidiary’s activities.

42 (b) A corporation shall be treated as failing to meet the
43 requirements of paragraph (1) of this subsection d. for any period
44 during which more than 10 percent of the value of its assets (in
45 excess of liabilities) consists of stock or securities in other
46 corporations which are not subsidiaries of the corporation (other
47 than assets described in paragraph (5) of this subsection).

1 (c) For purposes of this paragraph (4), a corporation shall be
2 considered a subsidiary if the parent owns more than 50 percent of
3 the combined voting power of all classes of stock entitled to vote,
4 or more than 50 percent in value of all outstanding stock, of the
5 corporation.

6 (5) For purposes of subparagraph (a) of paragraph (1) of this
7 subsection d., the following assets shall be treated as used in the
8 active conduct of a qualified trade or business:

9 (a) Assets that are held as a part of the reasonably required
10 working capital needs of a qualified trade or business of the
11 corporation.

12 (b) Assets that are held for investment and are reasonably
13 expected to be used within two years to finance research and
14 experimentation in a qualified trade or business or increases in
15 working capital needs of a qualified trade or business. For periods
16 after the corporation has been in existence for at least two years, in
17 no event may more than 50 percent of the assets of the corporation
18 qualify as used in the active conduct of a qualified trade or business
19 by reason of this paragraph.

20 (6) A corporation shall not be treated as meeting the
21 requirements of paragraph (1) of this subsection d. for any period
22 during which more than 10 percent of the total value of its assets
23 consists of real property that is not used in the active conduct of a
24 qualified trade or business. For purposes of the preceding sentence,
25 the ownership of, dealing in, or renting of, real property shall not be
26 treated as the active conduct of a qualified trade or business.

27 (7) For purposes of paragraph (1) of this subsection, rights to
28 computer software that produces active business computer software
29 royalties (within the meaning of section 543(d)(1) of the Internal
30 Revenue Code (26 U.S.C. s.543(d)(1))) shall be treated as an asset
31 used in the active conduct of a trade or business.

32 e. If any stock in a corporation is acquired solely through the
33 conversion of other stock in the corporation that is qualified small
34 business stock in the hands of the taxpayer, the stock so acquired
35 shall be treated as qualified small business stock in the hands of the
36 taxpayer and the stock so acquired shall be treated as having been
37 held during the period during which the converted stock was held.

38 f. (1) If any amount included in gross income by reason of
39 holding an interest in a pass-through entity meets the requirements
40 of paragraph (2) of this subsection f., the following shall apply:

41 (a) The amount shall be treated as gain described in subsection
42 a. of this section; and

43 (b) For purposes of applying subsection b. of this section, the
44 amount shall be treated as gain from a disposition of stock in the
45 corporation issuing the stock disposed of by the pass-through entity
46 and the taxpayer's proportionate share of the adjusted basis of the
47 pass-through entity in the stock shall be taken into account.

1 (2) An amount shall meet the requirements of paragraph (1) of
2 this subsection f. if:

3 (a) The amount is attributable to gain on the sale or exchange by
4 the pass-through entity of stock that is qualified small business
5 stock in the hands of the entity (determined by treating the entity as
6 an individual) and that was held by that entity for more than five
7 years; and

8 (b) The amount is includable in the gross income of the taxpayer
9 by reason of the holding of an interest in the entity that was held by
10 the taxpayer on the date on which the pass-through entity acquired
11 the stock and at all times thereafter before the disposition of the
12 stock by the pass-through entity.

13 Provided however, that paragraph (1) of this subsection f. shall not
14 apply to any amount to the extent the amount exceeds the amount to
15 which that paragraph (1) would have applied if the amount was
16 determined by reference to the interest the taxpayer held in the
17 pass-through entity on the date the qualified small business stock
18 was acquired. Provided further, that “pass-through entity” means
19 any of the following: a partnership; an S corporation; a regulated
20 investment company; or a common trust fund.

21 g. For purposes of this section:

22 (1) In the case of a transfer described in paragraph (2) of this
23 subsection, the transferee shall be treated as meeting both: having
24 acquired the stock in the same manner as the transferor; and having
25 held the stock during any continuous period immediately preceding
26 the transfer during which it was held (or treated as held under this
27 subdivision) by the transferor.

28 (2) A transfer is described in this subsection if the transfer is
29 any of the following:

30 (a) By gift.

31 (b) At death.

32 (c) From a partnership to a partner of stock with respect to
33 which requirements similar to the requirements of subsection f. of
34 this section are met at the time of the transfer (without regard to the
35 five-year holding period requirement).

36 (3) Rules similar to the rules of section 1244(d)(2) of the
37 Internal Revenue Code (26 U.S.C. s.1244(d)(2)) shall apply for
38 purposes of this section.

39 (4) (a) In the case of a transaction described in section 351 of
40 the Internal Revenue Code (26 U.S.C. s.351) or a reorganization
41 described in section 368 of the Internal Revenue Code (26 U.S.C.
42 s.368), if qualified small business stock is exchanged for other stock
43 that would not qualify as qualified small business stock but for this
44 paragraph (4), the other stock shall be treated as qualified small
45 business stock acquired on the date on which the exchanged stock
46 was acquired.

47 (b) This subsection e. shall apply to gain from the sale or
48 exchange of stock treated as qualified small business stock by

1 reason of subparagraph (a) of this paragraph only to the extent of
2 the gain that would have been recognized at the time of the transfer
3 described in subparagraph (a) of this paragraph if section 351 or
4 368 of the Internal Revenue Code (26 U.S.C. s.351 or s.368) had
5 not applied at that time. The preceding sentence shall not apply if
6 the stock that is treated as qualified small business stock by reason
7 of subparagraph (a) of this paragraph is issued by a corporation that
8 (as of the time of the transfer described in that subparagraph (a)) is
9 a qualified small business.

10 (c) For purposes of this paragraph (4), stock treated as qualified
11 small business stock under subparagraph (a) shall be so treated for
12 subsequent transactions or reorganizations, except that the
13 limitation of subparagraph (b) shall be applied as of the time of the
14 first transfer to which the limitation applied (determined after the
15 application of the second sentence of subparagraph (b)).

16 (d) In the case of a transaction described in section 351 of the
17 Internal Revenue Code (26 U.S.C. s.351), this paragraph shall apply
18 only if immediately after the transaction the corporation issuing the
19 stock owns directly or indirectly stock representing control (within
20 the meaning of section 368(c) of the Internal Revenue Code (26
21 U.S.C. s.368)) of the corporation whose stock was exchanged.

22 h. For purposes of this section:

23 (1) In the case in which the taxpayer transfers property (other
24 than money or stock) to a corporation in exchange for stock in the
25 corporation, the stock shall be treated as having been acquired by
26 the taxpayer on the date of the exchange and the basis of the stock
27 in the hands of the taxpayer shall in no event be less than the fair
28 market value of the property exchanged.

29 (2) If the adjusted basis of any qualified small business stock is
30 adjusted by reason of any contribution to capital after the date on
31 which the stock was originally issued, in determining the amount of
32 the adjustment by reason of the contribution, the basis of the
33 contributed property shall in no event be treated as less than its fair
34 market value on the date of the contribution.

35 i. (1) If the taxpayer has an offsetting short position with
36 respect to any qualified small business stock, subsection a. shall not
37 apply to any gain from the sale or exchange of the stock unless the
38 stock was held by the taxpayer for more than five years as of the
39 first day on which there was such a short position and the taxpayer
40 elects to recognize gain as if the stock was sold on that first day for
41 its fair market value.

42 (2) For purposes of paragraph (1) of this subsection, the
43 taxpayer shall be treated as having an offsetting short position with
44 respect to any qualified small business stock if any of the following
45 apply:

46 (a) The taxpayer has made a short sale of substantially identical
47 property.

1 (b) The taxpayer has acquired an option to sell substantially
2 identical property at a fixed price.

3 (c) To the extent provided in regulations, the taxpayer has
4 entered into any other transaction that substantially reduces the risk
5 of loss from holding the qualified small business stock. For
6 purposes of the preceding sentence, any reference to the taxpayer
7 shall be treated as including a reference to any person who is related
8 (within the meaning of section 267(b) or 707(b) of the Internal
9 Revenue Code (26 U.S.C. s.267(b) or s.707(b))) to the taxpayer.

10 j. A corporation that issues qualified small business stock
11 agrees to submit reports to the Director of the Division of Taxation
12 in the Department of the Treasury and to its shareholders as the
13 director may require to carry out the purposes of this section.

14
15 2. The Director of the Division of Taxation in the Department
16 of the Treasury shall prescribe regulations pursuant to the provision
17 of the "Administrative Procedure Act," P.L.1968, c.410 (C.52:14B-
18 1 et seq.) as may be appropriate to carry out the purposes of this act,
19 including any regulations that may conform to those regulations
20 promulgated by the Secretary of the Treasury under section 1202(k)
21 of the Internal Revenue Code (26 U.S.C. s.1202(k)) that shall apply
22 to the extent that those regulations do not conflict with this act, and
23 such further regulation that shall include but be not limited to
24 regulations to prevent the avoidance of the purposes of this act
25 through splitups, shell corporations, partnerships, or otherwise.

26
27 3. This act shall take effect immediately.

28
29
30 STATEMENT

31
32 This bill allows for a deduction from New Jersey gross income
33 of capital gains from the sale or exchange of New Jersey qualified
34 small business stock held for more than five years. The deduction
35 for these capital gains is modeled on the federal Internal Revenue
36 Code capital gains exclusion for owners of Qualified Small
37 Business Stock (QSBS) under section 1202 of the federal Internal
38 Revenue Code. The deduction under this bill will help promote
39 investment in New Jersey based small and medium size companies
40 that find it difficult to attract initial capital investors because these
41 companies are usually not profitable for their first few years.
42 Generally, QSBS stock is originally issued C corporation stock held
43 for at least 5 years in a corporation with no more than \$50 million
44 in assets at issuance. This deduction will apply to C corporations
45 established on and after the enactment of the bill. No New Jersey
46 gross income taxpayer will receive any capital gains benefit without
47 holding the QSBS stock for at least 5 years.

1 For individual taxpayer/investors to qualify for the special
2 capital gains treatment under section 1202 and this New Jersey
3 gross income tax deduction, the stock must be in a domestic C
4 corporation (not an S corporation or LLC), and it must be a C
5 corporation during substantially all the time the individual holds the
6 stock. The C corporation may not have more than \$50 million in
7 assets as of the date the stock was issued and immediately
8 thereafter. The individual taxpayer/investor must acquire the stock
9 at its original issue and not from a secondary market. Moreover,
10 during substantially all the time the stock is held, at least 80% of
11 the value of the corporation's assets must be used in the active
12 conduct of one or more qualified businesses. Active conduct of one
13 or more qualified businesses cannot be an investment vehicle or
14 inactive business. As under section 1202, the New Jersey gross
15 income tax deduction of capital gains of the sale or exchange of
16 QSBS cannot be stock in a business that is: a service business in the
17 fields of health, law, engineering, architecture, accounting, actuarial
18 science, performing arts, consulting, athletics, financial services, or
19 brokerage services; a banking, insurance, financing, leasing,
20 investing, or similar business; a farming business; a business of
21 operating a hotel, motel, restaurant, or similar business.

22 If the individual taxpayer/investor holds qualifying stock for at
23 least five years, then the individual taxpayer/investor would be able
24 to exclude the capital gains made on the disposition of the stock,
25 and thus pay no gross income on the capital gains. The special
26 exclusion of capital gains for qualified stock that is held by "pass
27 through entities," that include a partnership, an "S" corporation, a
28 regulated investment company, or a common trust fund, that
29 otherwise meet the requirements of this bill, is available to the
30 individual gross income taxpayers who hold interests in those pass-
31 through entities. The bill limits the aggregate amount of excludable
32 capital gains for a taxable year, in the case of one or more
33 dispositions of QSBS by a taxpayer, to the greater of \$10 million,
34 reduced by the aggregate amount of eligible gain taken into account
35 by the taxpayer for prior taxable years and attributable to
36 dispositions of QSBS, or ten times the aggregate adjusted basis of
37 QSBS issued by the corporation and disposed of by the taxpayer
38 during the taxable year. The QSBS must have been acquired in
39 exchange for money or property, or as compensation for services
40 provided to the corporation. At least 80% of the corporation's
41 payroll, as measured by total dollar value, must be attributable to
42 employment located within New Jersey.