LEGISLATIVE FISCAL ESTIMATE
SENATE, No. 4127
STATE OF NEW JERSEY
219th LEGISLATURE

DATED: NOVEMBER 29, 2021

SUMMARY

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.

Type of Impact: Recurring State Revenue loss to the Property Tax Relief Fund beginning in Fiscal Year 2027.

Agencies Affected: Department of the Treasury.

Office of Legislative Services Estimate

Fiscal Impact	**FY 2022 through FY 2026**	**FY 2027 & Thereafter**
Recurring State Revenue Loss	$0	Indeterminate

- The Office of Legislative Services (OLS) finds that the bill will result in a recurring loss of State gross income tax (GIT) revenue beginning in FY 2027, at the earliest, but cannot independently quantify the magnitude of the bill's impact. The recurring revenue loss is attributable to the State providing a GIT deduction equal to 100 percent of the gain from the sale or exchange of certain New Jersey qualified small business (QSB) stock held for more than five years.

- The OLS notes that the bill limits the aggregate amount of excludable gains in a tax year, so certain taxpayers may not be able to deduct 100 percent of their gains from the disposition of QSB stock.

BILL DESCRIPTION

This bill allows for a deduction from a taxpayer's New Jersey gross income of capital gains from the sale or exchange of New Jersey QSB stock held for more than five years. The deduction for these capital gains is modeled on the federal capital gains exclusion for owners of QSB stock under section 1202 of the federal Internal Revenue Code.

For individual taxpayers to qualify for the New Jersey GIT deduction, the QSB stock must be in a domestic C corporation (not an S corporation or LLC) and originally issued after the effective date of the bill. The C corporation may not have more than $50 million in assets as of the date the stock was issued and immediately thereafter, and must remain a C corporation during substantially all the time the individual holds the stock. An individual taxpayer must acquire the stock at its original issue and not from a secondary market. Moreover, during substantially all the time the stock is held, at least 80 percent of the value of the corporation's assets must be used in the active conduct of one or more qualified businesses. Active conduct of one more qualified businesses cannot be an investment vehicle or inactive business.

The New Jersey GIT deduction is not available for stock in a business that is: a service business in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services; a banking, insurance, financing, leasing, investing, or similar business; a farming business; or a business operating a hotel, motel, restaurant, or similar business. In addition, the C corporation must have fewer than 225 employees and at least 80 percent of its payroll, as measured by total dollar value, must be attributable to employment located in New Jersey.

The bill limits the aggregate amount of excludable capital gains for a tax year, in the case of one or more dispositions of QSB stock by a taxpayer, to the greater of $10 million, reduced by the aggregate amount of eligible gain taken into account by the taxpayer for prior tax years and attributable to dispositions of QSB stock, or ten times the aggregate adjusted basis of QSB stock issued by the corporation and disposed of by the taxpayer during the tax year.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS finds that the bill will result in a recurring loss of State GIT revenue beginning in FY 2027 at the earliest, but cannot independently quantify the magnitude of the bill's impact on total collections, which are dedicated to the Property Tax Relief Fund. The recurring revenue loss is attributable to the State providing a GIT deduction equal to 100 percent of the gain from the disposition of certain New Jersey QSB stock held for more than five years. The OLS notes that the bill limits the aggregate amount of excludable gains in a tax year, so certain taxpayers may not be able to deduct 100 percent of their gains from the disposition of QSB stock.

The State revenue loss will not occur prior to FY 2027, at the earliest, because the bill conditions eligibility for the deduction on taxpayers holding QSB stock for at least five years and on the QSB stock being originally issued after the effective date of the bill. If the bill is enacted in calendar year 2021, taxpayers will first be eligible to deduct gains from QSB stock dispositions on their tax year 2026 GIT returns, which are due in FY 2027. In addition, the State will not experience the full annual impact of the bill in the first tax years in which taxpayers may claim a deduction because taxpayers determine when they sell QSB stock and realize capital gains. Although capital gains realized from the disposition of QSB stock will first become eligible for the deduction in the fifth year following the effective date of the bill, only a subset of concerned taxpayers will decide to realize the capital gains in that year as opposed to holding on to the stock and selling it in a subsequent year.

The bill's GIT deduction is based on section 1202 of the federal Internal Revenue Code, which allows for the 100 percent exclusion from taxable income of the gain on the sale or exchange of a QSB stock that was acquired after September 17, 2010 and held for more than five years. The sale or exchange of the QSB stock and the net short- or long-term gains associated with that disposition are reported on Internal Revenue Service Form 8949, Sales and Other Dispositions of Capital Assets, which is used to report sales and exchanges of most capital assets and is not exclusively for the sale or exchange of QSB stocks.

The most recent federal Statistics of Income publication provides national taxpayer data for those returns with income gains from sales of capital assets being reported on Form 8949. However, the data are not disaggregated by capital asset type (e.g. the gain from the sale of a home or the gain from the sale of a QSB stock). Thus, the OLS cannot identify the portion of the total reported gains attributable to the sale of QSB stock and cannot further extrapolate that data to project the magnitude of the impact on New Jersey's GIT revenues from allowing taxpayers to deduct 100 percent of the gains from the sale or exchange of QSB stocks.

In addition, the United States Department of the Treasury estimated in February 2020 that the federal exclusion from taxable income of capital gains from QSB stock dispositions would reduce federal FY 2020 revenue collections by $1.41 billion and that the annual revenue loss would gradually grow to $2.25 billion by FY 2029. These projections, however, do not lend themselves as a starting point to estimate the bill's fiscal impact because they would lead to a significant overestimate of the annual New Jersey revenue loss. This would be so because the federal exclusion is long-standing and aggregates revenue loss from capital gains realized from QSB stocks that were acquired in years with different exclusion rules, whereas New Jersey's GIT deduction will begin to have a fiscal impact in FY 2027 only, at the earliest. It is also unknown to what extent New Jersey taxpayers claim the federal exclusion. Lastly, the New Jersey GIT deduction is only available for QSBs with fewer than 225 employees and have payroll at least 80 percent attributable to employment located within New Jersey. Under the rules of the federal capital gains exclusion, taxpayers qualify as long as the QSB is located in the United States.

Section:	*Revenue, Finance, and Appropriations*
Analyst:	*Scott A. Brodsky* *Principal Fiscal Analyst*
Approved:	*Thomas Koenig* *Legislative Budget and Finance Officer*

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.).