

SENATE BUDGET AND APPROPRIATIONS COMMITTEE

STATEMENT TO

SENATE, No. 4127

STATE OF NEW JERSEY

DATED: DECEMBER 6, 2021

The Senate Budget and Appropriations Committee reports favorably Senate Bill No. 4127.

This bill allows for a deduction from New Jersey gross income of capital gains from the sale or exchange of New Jersey qualified small business stock held for more than five years. The deduction for these capital gains is modeled on the federal Internal Revenue Code capital gains exclusion for owners of Qualified Small Business Stock (QSBS) under section 1202 of the federal Internal Revenue Code.

For individual taxpayer to qualify for the special capital gains treatment under section 1202 and this New Jersey gross income tax deduction, the stock must be in a domestic C corporation (not an S corporation or LLC), and it must be a C corporation during substantially all the time the individual holds the stock. The C corporation may not have more than \$50 million in assets as of the date the stock was issued and immediately thereafter. The 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 or more qualified businesses cannot be an investment vehicle or inactive business. As under section 1202, the New Jersey gross income tax deduction of capital gains of the sale or exchange of QSBS cannot be 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; a business of operating a hotel, motel, restaurant, or similar business.

If the individual taxpayer holds qualifying stock for at least five years, then the individual taxpayer would be able to exclude the capital gains made on the disposition of the stock, and thus pay no gross income on the capital gains. The special exclusion of capital gains for qualified stock that is held by "pass through entities," that include a partnership, an "S" corporation, a regulated investment company, or a common trust fund, that otherwise meet the requirements of this bill, is available to the individual gross income taxpayers who hold interests in those pass-through entities. The bill limits the aggregate amount of excludable capital gains for a taxable year, in the case of one or more

dispositions of QSBS 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 taxable years and attributable to dispositions of QSBS, or ten times the aggregate adjusted basis of QSBS issued by the corporation and disposed of by the taxpayer during the taxable year. The QSBS must have been acquired in exchange for money or property, or as compensation for services provided to the corporation. At least 80 percent of the corporation's payroll, as measured by total dollar value, must be attributable to employment located within New Jersey.

FISCAL IMPACT:

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.