

Tax Law Update

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Amendment to New Jersey Gross Income Tax Benefits Business Owners

Budd Lerner's tax law department provides sophisticated advice to individuals, closely held businesses, partnerships and public corporations on all aspects of federal and state tax law. Our attorneys address a full spectrum of corporate and personal tax concerns, including:

formation of corporations, partnerships, limited liability companies and other business entities

tax implications of acquiring existing businesses

reorganizations of corporations, partnerships and other entities

tax aspects of corporate and real estate transactions

dissolution and disposition of businesses and assets

federal and state tax litigation

income and sales tax audits.

On April 28, Governor Chris Christie signed S-2754. This change in the law is effective starting January 1, 2012 and will provide tax relief to small business owners. The change in the law phases in the tax savings ten percent (10%) each year for five (5) years beginning January 1, 2012.

New Jersey's gross income tax system (i.e., New Jersey's personal income tax system) requires that individual taxpayers allocate income and losses to among sixteen (16) different categories or baskets. N.J.S.A. 54A:5-1 (a)-(p). Under current law, losses which occur within one category or basket may be applied against income within the same category or basket in the same taxable year, however, a net loss in one category or basket may not be applied against income in another category or basket. N.J.S.A. 54A:5-2.

Accordingly, under current law, a taxpayer who, for example, is a member of a LLC that sold real estate at a loss cannot offset such loss against the net profit allocated to the taxpayer by virtue of the taxpayer's stock interest in a Subchapter S Corporation. Under current law, the taxpayer can only use losses from the LLC to offset income from other LLCs or partnerships.

Furthermore, under current law, to the extent a loss is not able to be used by a taxpayer to calculate his or her gross income, such loss is disregarded for future tax years. Consequently, New Jersey business owners often times pay New Jersey tax on a significantly higher level of income than they do on their Federal tax return and/or other tax returns for other States.

As a result of the change in the law, individual taxpayers will calculate their (1) "regular business income" under current law (i.e., without any "netting" of losses from one category or basket against income from another category or basket) and (2) "alternate business income" under the new law. Regular business income shall equal the sum of a taxpayer's (a) net profits from business, (b) net gain or net income derived from or in the form of rents, royalties, patents and copyrights, (c) distributive share of partnership income and (d) net pro rata share of S Corporation income (the "Applicable Baskets of Income and Loss"). Alternative business income shall equal the sum of a taxpayer's net income from the Applicable Baskets of Income and Loss, however, in calculating the alternative business income a taxpayer (i) can net or offset losses from one

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category or basket among the Applicable Baskets of Income or Loss against income from other categories or baskets among the Applicable Baskets of Income and Loss and (ii) can carryforward and use a loss under the alternative business income calculation for 20 years.

Once a taxpayer's alternative business income and regular business income is calculated, a taxpayer will then subtract alternative business income from regular business income to determine the "business increment". For taxable years beginning in 2012, taxpayers shall subtract from taxable income 10% of the business increment in calculating his or her taxable income. The percentage of business increment (the "business increment percentage") subtracted from taxable income shall increase by 10% each year thereafter (20% for 2013, 30% for 2014, and 40% for 2015) until 2016 when the business increment percentage will cap at 50% and remain for all years thereafter.

This change at 50% in the law will provide taxpayers with a greater ability to utilize tax losses both by allowing unused portion of such losses to be carried forward for twenty (20) years and expanding the range of income that can be offset by such losses. In the example above, under the change in the law, the taxpayer who is a member of a LLC that realized a loss on the sale of real estate will be able to offset such loss (subject to the business increment percentage) against income derived by virtue of his or her interest in a Subchapter S corporation. This is especially important to taxpayers in light of the current economic conditions and real estate market. ■

John K. Bradley, Esq.

Mr. Bradley's practice is concentrated in business planning matters, including representing both buyers and sellers in the acquisition and sale of businesses; counseling clients in regard to the formation of business entities and joint ventures; and providing counsel on general corporate matters including negotiating and preparing employment contracts for executives, designing incentive compensation arrangements and benefit plans and negotiating and structuring financing arrangements.

He also has an expertise in tax matters including, advising on taxable and tax free mergers and acquisitions; counseling closely held corporations, partnerships, limited liability companies and joint ventures; and analyzing tax issues associated with business arrangements. His practice includes representing clients before the Internal Revenue Service, the New Jersey Division of Taxation, other State administrative agencies, Federal Courts and the Tax Court of New Jersey and providing advice regarding the tax consequences of settlements. ■