



TaxNewsFlash

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New Jersey: Corporation business tax changes enacted

Assembly Bill 5323, which makes significant revisions to New Jersey's Corporation Business Tax (CBT) laws, including further refinements to the state's combined reporting provisions, was signed into law on July 3, 2023.

Economic nexus

Although New Jersey courts have upheld the imposition of economic nexus for CBT purposes, New Jersey does not have a bright-line CBT economic nexus standard. Assembly Bill 5323 adopts an economic nexus standard that is similar to those applied by many states for sales and use tax nexus purposes. Notably, a corporation that derives receipts exceeding \$100,000 from in-state sources or that has 200 or more separate transactions delivered to New Jersey customers during the taxable year will be deemed to have substantial nexus with New Jersey. The bill makes clear a corporation with sales/transactions below these thresholds may still have New Jersey nexus if the corporation's exercise of its franchise in New Jersey is otherwise sufficient to establish jurisdiction.

Entire net income changes and conformity changes

Assembly Bill 5323 makes numerous changes to the definition of "entire net income," which is generally the amount of income reported on a taxpayer's the federal income tax return subject to certain statutory adjustments and before apportionment. Certain aspects of New Jersey's conformity to the Tax Cuts and Jobs Act are also modified under the bill.

Repeal of the related party intangible expense and interest addback statute: For privilege periods and taxable years ending on or after July 31, 2023, the bill repeals N.J.S.A. 54:10A-4.4, which addressed the statutory requirement to add back intangible expenses and related interest paid or accrued to a related member and modifies N.J.S.A. 54:10A-4(k)(2)(l), which addressed traditional interest expense paid or accrued to a related member. Since New Jersey moved to combined reporting, transactions between unitary group members have been eliminated. However, intangible expenses and interest paid to non-group affiliates remained subject to addback.

Revised dividends-received exclusion: Previously, entire net income excluded 95% of dividends paid or deemed paid to the taxpayer by one or more 80% or more owned subsidiaries. For privilege periods ending on or after July 31, 2023, entire net income excludes 100% of dividends or deemed dividends from 80% or more owned subsidiaries. Further, the dividends-received exclusion is now allowed after the modifications are made that increase entire net income—but before the modifications that reduce entire net income (e.g., NOLs) and before entire net income is apportioned to New Jersey—which is a shift from the former policy whereby taxpayers eligible for the dividends exclusions were forced to “burn” NOLs before deducting any dividends. The dividends-received exclusion is reduced by expenses and deductions attributed to dividends or deemed dividends, which must equal 5% of all dividends and deemed dividends received.

Treatment of GILTI: Under prior law, any amount included in entire net income under IRC section 951A (GILTI) was not considered to be a dividend or deemed dividend. Assembly Bill 5323 treats amounts included in income under IRC section 951A as a dividend for privilege periods ending on and after July 31, 2023.

Foreign treaty-protected income excluded: For privilege periods ending on and after July 31, 2022, the entire net income of any corporation that is incorporated or formed in a foreign country that has a comprehensive tax treaty with the U.S. and is not a member of a New Jersey worldwide group does not include any income exempted from federal taxable income under the terms of the treaty. For a foreign corporation that files a federal tax return and is not part of a New Jersey combined group, only effectively connected income will be included in entire net income.

Treatment of research and experimental (R&E) expenditures: Historically, under New Jersey law, no deduction was allowed for R&E expenditures to the extent that those R&E expenditures were qualified research expenses or basic research payments for which an amount of credit was claimed under N.J.S.A. 54:10A-5.24, unless those R&E expenditures were also used to compute a federal credit claimed under IRC section 41.

Assembly Bill 5323 provides that for privilege periods beginning on and after January 1, 2022, a deduction for R&E expenditures is allowed during the same privilege period for which a credit is claimed under N.J.S.A. 54:10A-5.24. This apparent change marks a policy shift from New Jersey’s requirement that taxpayers add back expenses used to calculate the New Jersey R&D credit. This deduction is allowed notwithstanding the timing schedule required under IRC section 174 for the deduction of specified R&E expenditures. The New Jersey Division of Taxation has confirmed on its website that, in the Division’s view, only New Jersey qualified research expenditures may be deducted in the year incurred, assuming a credit is claimed. Non-New Jersey research expenditures are deductible in the same manner and with the same timing as they are for federal purposes (i.e., amortized over a five- or fifteen-year period).

Application of the IRC section 163(j) limitation: For privilege periods after December 31, 2017, and ending on or after July 31, 2022, the IRC section 163(j) limitation applies to a combined group as though it had filed a federal consolidated return. For the purposes of applying the limitation with regard to affiliates that were members of the federal consolidated return but were not members of the New Jersey combined group, the combined group and the affiliates will also be treated as having filed one federal consolidated return. This legislative change codifies the Division of Taxation’s current policy as set forth in TB-87(R).

80% NOL limit: For privilege periods ending on and after July 31, 2023, Assembly Bill 5323 adopts the federal 80% limitation on the use of NOLs.

Combined reporting changes

Deduction to offset financial statement impact of combined reporting: New Jersey allows a deduction to offset the financial statement impact of the state moving to unitary combined reporting for privilege periods ending on and after July 31, 2019. The deduction was scheduled to be taken over a 10-year period beginning with the combined group’s first privilege period beginning on or after January

1, 2023. Under Assembly Bill 5323, for privilege periods beginning on and after January 1, 2023, but before January 1, 2030, the combined group may deduct 1% per privilege period of the amount necessary to offset the increase in the net deferred tax liability or decrease in the net deferred tax asset. The deduction increases to 5% per year for privilege periods beginning on or after January 1, 2030.

Composition of the unitary group: The default filing method in New Jersey is water's-edge combined, and the combined group includes certain domestic entities (unless they have 80% or more of their property or payroll outside the U.S.) and other members that have 20% or more of both their property and payroll in the U.S. Under the bill, a group member, wherever formed or incorporated, that is not otherwise included in the water's-edge combined group, is included if that member had effectively connected income, but only to the extent of its effectively connected income.

Assembly Bill 5323 clarifies that for privilege periods ending on and after July 31, 2022, the worldwide combined group includes all of the income and attributes of those members regardless of how or whether those members file federal returns or report or include their income in federal taxable income for federal purposes, and without regard to any exemption or exclusion from federal taxable income under the terms of a tax treaty. Any deductions that are allowed under the IRC that are also allowable under the CBT Act that would apply to a U.S. corporation, but that a non-U.S. corporation is prohibited from claiming for federal income tax purposes, will be allowed for the non-U.S. corporation members of the combined group.

Inclusion of captive entities: Effective for privilege periods ending on and after July 31, 2023, new definitions apply to "captive real estate investment trusts," "captive regulated investment companies," and "captive investment companies." Entities meeting these new definitions are taxed in the same manner as any other C Corporation and are required to be included as a member of a combined group filing a combined return. A captive real estate investment trust, a captive regulated investment company, and a captive investment company does not include any entity of which at least 50% of the shares, by vote or value, is owned or controlled, directly or indirectly, by a state or federally chartered bank, savings bank, or savings and loan association with assets that do not exceed \$15 billion.

Sharing of prior NOL conversion carryovers: When New Jersey moved to combined reporting, NOLs incurred in privilege periods ending prior to July 31, 2019, were converted from pre-apportionment NOLs to post-apportionment NOLs. These so called "prior NOL conversion carryovers" could be deducted only by the combined group member that created the loss; the prior NOL conversion carryovers could not be shared with other members of the combined group.

Assembly Bill 5323 simplifies the application of prior NOL conversion carryovers for combined groups by allowing pooling. Specifically, for privilege periods ending on and after July 31, 2023, the balance of prior NOL conversion carryover deductions of the members of the combined group will be pooled together and allowed to offset the entire net income apportioned to New Jersey of either: the combined group for which the corporation is a member; or, the corporation that created the prior NOL conversion carryover, provided that the corporation has departed the combined group before the corporation's respective prior NOL conversion carryover was completely used.

Finnigan: Previously, entities filing a water's-edge or worldwide New Jersey combined return used the so-called *Joyce* apportionment rule; Assembly Bill 5323 adopts a *Finnigan* approach for combined groups, which is consistent with the approach used by New Jersey filers that have made the affiliated group election.

Discretionary authority: Provisions in earlier versions of the bill that would have allowed the Director of the Division of Taxation to combine or decombine taxpayers under certain enumerated circumstances were stricken.

Managerial member election period: The managerial member of the New Jersey combined group files the mandatory combined return on behalf of the taxable members of the combined group. If the group has a common parent corporation taxable group member, that group member is the managerial

member. If there is no common parent corporation that is a taxable group member, the group may select a taxable group member to be the managerial member. Previously, that election was binding for 10 privilege periods. Assembly Bill 5323 provides that the election of a managerial member is binding for the current privilege period and five successive periods, unless as otherwise provided by the Director.

Underpayment penalties

For privilege periods ending on and after July 31, 2023, but before January 1, 2024, no penalties or interest will accrue for the underpayment of tax due to any provision in Assembly Bill 5323 that creates additional tax liability. For privilege periods ending on and after July 31, 2023, the additional estimated tax payments must be made no later than the second next estimated payment due following the enactment of the bill, or the second estimated payment due after January 1, 2024, whichever due date is later. For calendar year taxpayers, the additional tax payments related to the 2023 privilege period would be due by June 15, 2024.

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