

UPDATES ON THE PASS-THROUGH BUSINESS ALTERNATIVE INCOME TAX (“BAIT”) IN NEW JERSEY

Hodgson Russ Tristate Tax Alert
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On September 29, 2020, the New Jersey Division of Taxation issued some clarifications and FAQs for its new elective Pass-Through entity tax passed earlier this year. Similar to states like Rhode Island and Louisiana, New Jersey enacted its tax as an alternative to paying the tax on the business income of the pass-through entity at the individual owner level, allowing individuals to potentially reduce their overall tax bill by limiting the impact of the federal SALT cap created by the 2017 Tax Cuts and Jobs Act. Unlike Connecticut, which enacted its Pass-Through Entity Tax as a mandatory entity-level tax (but with an alternative base option for calculating the tax), New Jersey allows pass-through entities (other than single member LLCs) to determine whether the BAIT will be tax-advantageous to the entity’s owners. More on that below.

New Jersey’s most recent guidance addresses some issues regarding estimated tax payments and calculating the BAIT. The FAQs state that although an entity electing to be taxed under the BAIT must pay quarterly estimated tax, it must also withhold taxes and pay estimates for its nonresident partners/shareholders, to the extent otherwise required by the pass-through entity. Nonresidents will be required to file a New Jersey personal income tax return if the pass-through entity has New Jersey-source income, but can take a credit for the amount of BAIT paid by the entity on the individual’s distributive share. Even if the nonresident has no tax due after the credit, a return must be filed. Since the entity elects to pay the Pass-Through BAIT on or before the original due date of that year’s return, there could be circumstances, if the entity has not determined whether it will make the election, where it would need to pay estimates on behalf of the entity, and on behalf of the individual nonresident owners until the election is made.

The FAQs also address how pass-through entities apportion income for BAIT. Unlike some states that have adopted market-based sourcing for all entity types, New Jersey only recently adopted market-based sourcing for Corporation Business Taxes only. BAIT taxpayers, even ones owned by corporations subject to CBT, use the place of performance sourcing rules under N.J.S.A. 54A:5-8.

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So, back to the question of when an entity might elect to pay under the BAIT versus allow individual partners and shareholders to shoulder the tax burden. Like most states with an elective pass-through entity tax, New Jersey requires all members to elect in. Often, the most problematic aspect of these new taxes is that nonresident members are not guaranteed a credit for the taxes paid by the entity in their home state as they would ordinarily receive if the tax is only paid at the individual owner level. Thus, the BAIT can be most advantageous where a significant portion of the receipts are sourced to New Jersey and the entity’s owners are New Jersey residents. In that case, the residents get a significant advantage with the entity claiming the federal tax deduction for state taxes paid (not subject to the SALT cap), without having to worry about whether they will be able to claim offsetting credits in home states other than New Jersey. We should note, however, that the IRS has expressed its distaste for SALT cap workarounds. But as of yet, it has not come out with any specific prohibitions against a business deduction for these new state pass-through entity taxes. As we discuss [here](#), the IRS may have difficulty finding the legal basis to deny businesses the deduction for a Connecticut-type mandatory tax, but it remains to be seen whether the voluntary nature of the BAIT and similar pass-through tax schemes will prove as effective a workaround to the federal SALT deduction cap.

If you would like more information about the above tax issues, contact Elizabeth Pascal (716.848.1622) or Debra Herman (646.218.7532).

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