

# NEW JERSEY ENACTS AMENDMENTS TO ITS SALT CAP WORKAROUND

*Hodgson Russ New Jersey Tax Alert*  
January 21, 2022

The New Year is off to an interesting start in New Jersey with amendments to the elective Business Alternative Income Tax (“BAIT”) that were signed into law on January 18, 2022. One of the Legislature’s stated purposes for amending New Jersey’s SALT Cap workaround was to subject more income to the tax in order to allow New Jersey individual taxpayers to obtain a larger benefit for paying the tax. As a reminder, pass-through entities are not subject to the same federal SALT deduction limitation of \$10,000 imposed on individual taxpayers. In that regard, the most notable amendment is the modification to the tax base for partnerships with resident members.

As a result of the amendment, the distributive proceeds that are subject to the partnership level tax have been redefined to include the sum of (i) resident partners’ distributive share of partnership income derived from sources both inside and outside New Jersey, but only with respect to partners who are resident individuals, estates, or trusts; and (ii) the distributive share of partnership income derived from sources inside New Jersey of all partners of the partnership who are not resident individuals, estates, or trusts.

This amendment will provide a greater benefit of the BAIT to resident partners because in years prior to 2022 the definition of distributive proceeds in N.J.S.A. 54A:12-2 was limited to income derived from or connected with New Jersey sources. Since resident partners are subject to New Jersey Gross Income Tax (“GIT”) on all of their partnership income, regardless of source, it makes sense to expand the BAIT tax base to include income from all sources.

Unfortunately, the Legislature did not make the increased BAIT benefit available to S Corporation shareholders. For S Corporations, distributive proceeds that are subject to BAIT are limited to the pro rata share of S Corporation income allocated to New Jersey, as is currently the case in New York.

For purposes of allocating distributive proceeds, a pass-through entity (which is defined to include an S Corporation) must apply the allocation factors determined under the GIT rules for allocation of New Jersey source income to nonresidents. Those GIT rules apply three-factor apportionment. Although the amendment also contains a cross-reference to the S Corporation definitions that incorporate the single-sales factor sourcing rules that normally apply to S Corporations, it is the

## **Attorneys**

Open Weaver Banks  
Debra Herman  
Elizabeth Pascal  
Paul Baldwin Jr.  
Richard Campbell  
Katherine Cauley  
Thomas Collura  
Paul Comeau  
William Comiskey  
Ariele Doolittle  
Christopher Doyle  
Catherine Eberl  
Joseph Endres  
Daniel Kelly  
Joshua Lawrence  
Timothy Noonan  
K. Craig Reilly  
Emma Savino  
Joseph Tantillo

## **Practices & Industries**

State & Local Tax

## NEW JERSEY ENACTS AMENDMENTS TO ITS SALT CAP WORKAROUND

Division's position that S Corporations must use the same three-factor apportionment methodology as partnerships in computing the BAIT for 2022. This stands in contrast to S Corporation sourcing in 2021, when the Division gave S Corporations the option to use either single-sales factor sourcing or three-factor sourcing for purpose of the BAIT. (We are advised that guidance will be posted by the Division addressing the option for tax year 2021, shortly.)

The Legislature also addressed a number of problems with the original BAIT legislation that limited application of payments and credits, including:

- Partnerships with nonresident partner withholding requirements will no longer be required to remit such withholding payments for any nonresident that reasonably expects to be refunded the payment on account of a BAIT credit.
- A pass-through entity that overpays BAIT in one taxable year will now be allowed to apply the overpayment of tax to the subsequent taxable year's estimated entity tax payments.
- The credit mechanism is revised for tiered partnerships. A pass-through entity member that is an entity classified as a partnership for federal tax purposes shall be allowed (a) a refundable credit against the GIT, which credit is allocated among the partners of the partnership, or (b) a refundable credit which may be applied against certain liabilities of the partnership, as well as BAIT liabilities.
- The credit mechanism is also revised for S Corporations that are partners in partnerships. A pass-through entity member that is an S Corporation shall be allowed either (a) a refundable credit against the GIT, which credit is allocated among the shareholders of the corporation or (b) a refundable credit against certain CBT liabilities of the corporation, as well as BAIT liabilities.
- Corporate members of partnerships will now receive a refundable credit instead of a carryover. If a pass-through entity subject to BAIT is owned by both corporate members and non-corporate members, the corporate member will be allowed a refundable tax credit against CBT taxes. However, the credit may not reduce the corporate member's tax liability below the statutory minimum imposed under the CBT.

Finally, the Legislature revised the BAIT tax rates so that if the sum of each member's share of distributive proceeds attributable to the pass-through entity is over \$1 million, the BAIT liability is \$63,087.50 plus 10.9% of the excess over \$1 million. Previously the 10.9% rate only applied to distributive proceeds over \$5 million.

The BAIT, like all of the post-TCJA pass-through entity taxes, is a work in progress, responding to issues raised by taxpayers and practitioners. The new legislation addresses some of the most frequently asked questions and complaints about the BAIT, but there is still room for improvement, particularly with respect to the rules applicable to S Corporations. For S Corporations, the decision whether to elect into the BAIT is more complicated given the narrower benefits afforded S Corporations and their resident shareholders and the ambiguity regarding S Corporation sourcing rules.

Contact [Open Weaver Banks](mailto:openweaver@hodgsonruss.com) (646.218.7524), [Debra Herman](mailto:debra@hodgsonruss.com) (646.218.7532), or [Elizabeth Pascal](mailto:elizabeth@hodgsonruss.com) (716.848.1622) if you have any questions about how these tax updates may impact you or your business.