

**CONTINUE TO REPEAL UNFAIR BUSINESS TAX POLICIES:
REPEAL THE THROW-OUT RULE TAX ON OUT-OF-STATE
INCOME****DESCRIPTION**

Repeal the throw-out rule used to allocate sales income under the Corporation Business Tax

BACKGROUND

New Jersey, like all states with business taxes, determines its tax share of a multi-state corporation's profits by using an allocation formula. In New Jersey, the formula begins by calculating New Jersey's share of a company's business activities: i.e., the New Jersey portion of a company's national payroll, its national sales and its national property holdings. The New Jersey business-activity factor is then applied to a company's national profits to determine New Jersey's share of taxable income.

In cases of inter-state sales, most states have agreed to attribute sale income to the destination state (i.e. the state in which the purchaser lives), not the one in which the shipper is located. However, situations can arise where the sales income goes untaxed, such as when the destination state cannot or does not tax the business making the sale. For state tax purposes, these sales are termed "nowhere sales."

In 2002, New Jersey went one step further in adopting its throw-out rule, effectively increasing New Jersey's share of a multi-state corporation's tax base by any sales income that is untaxed by any another state, regardless of New Jersey's relationship to the sale. In effect, New Jersey attributes to itself a portion of the sales activity that occurred in another state.

In an effort to tax these "nowhere sales," about half the states have imposed recapture rules allowing them to count "nowhere sales" income from sales originating in their states.

NJBIA POSITION

NJBIA supports continued repeal of McGreevey's 2002 business tax hikes as a necessary first step in improving our business climate.

ARGUMENTS IN SUPPORT OF REPEALING THE THROW OUT RULE

New Jersey's business tax and business climate continually ranks as among the nation's worst, due primarily to former Governor James McGreevey's business

tax hikes of 2002. These tax policies were widely viewed as arbitrary, unfair and far worse than business tax policies in other states, making New Jersey unattractive to companies looking to locate or expand operations here.

Since 2005, New Jersey's Governor and State Legislature have rolled back two of these most onerous corporate tax policies: the alternate minimum assessment gross receipts tax and the suspension of net operating loss use. They should also repeal the McGreevey throw-out rule for the same reasons.

The throw-out rule is not only unfair but probably unconstitutional. Some of New Jersey's largest companies, like pharmaceutical giant Pfizer, are legally challenging the throw-out rule and expect to win.

McGreevey's own Corporation Business Tax Study Commission in June 2004 recommended repeal of the throw-out rule.

Under the throw-out rule, any out-of-state income which is not taxed by another state is deemed subject to New Jersey taxes. This applies whether the other state has no corporation business tax (such as Nevada) or the other state's business tax simply does not apply to the company.

While many states have similar rules governing the taxation of income from interstate sales that either originate or end in a state, New Jersey's throw-out rule is unique because it taxes income from sales which have absolutely no nexus to New Jersey—sales that neither originate nor end in New Jersey.

Imposing the throw out rule has made New Jersey unpopular and uncompetitive with many major employers.

COST

The Corporation Business Tax Study Commission in 2004 estimated the actual revenue gain associated with imposition of the throw-out rule at \$31 million annually, about 60 percent less than originally anticipated.

LEGISLATIVE HISTORY

The throw out rule was imposed under the Business Tax Reform Act of 2002.

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