April 19, 2024

<u>Re: Informal Comments in Accordance with the "Advance Notice of Rules" for Proposed Amendments and Proposed New Rule N.J.A.C. 18:7-1.9A, 20.4</u>

Mary Richmond-Michael
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Dear Ms. Richmond-Michael and Division of Taxation of Staff:

On behalf of the NJBIA and New Jersey Chamber of Commerce Joint Taxation and Economic Development Policy Committee (Joint Committee), we appreciate this opportunity to submit comments to Division of Taxation staff (Taxation) on the proposed regulatory changes addressing the corporate business tax reforms signed into law in the summer of 2023. These comments are based on input from our member companies, tax practitioners and business associations.

Our Joint Committee always appreciates the opportunity to collaborate with the Division of Taxation, and we thank you for working with us on the statutory changes that led to the need for these regulations. We hope that our continued partnership will improve these regulations just as it improved our new corporate tax laws last year.

Taxation did an excellent job adhering to what the statute called for and not deviating from or exceeding current law. That being said, there are several areas where our Joint Committee has recommendations that can hopefully improve these draft regulations for both the taxpayers and Taxation.

First, we have two recommendations that we would characterize as clarifications of more ***technical*** matters.

- The Joint Committee asks for the deletion of the nexus examples in proposed N.J.A.C 18:7-1.8, as we believe them to be unnecessary and to potentially overcomplicate the issue.

- We also heard from some businesses that offer insurance products and want clarification on their use of RICs and REITs and their treatment in these proposed regulations. Subsections (a)12, 13 and 14 of draft Regulation 18:7-21.1 are intended to support the statutory intent of N.J.S.A. 54:10A-4(hh), (ii), and (jj). Those statutory provisions were written to ensure an investment company, regulated investment company (RIC) and real estate investment company (REIT) are not considered "captive" if more than 50% of its voting stock is held in a segregated asset account of a life insurance corporation, as described in section 817 of the Internal Revenue Code.

  However, it is possible for liquidity or other business purposes that on any given day an insurance company may own a very small amount of RIC or REIT shares outside of the segregated account. In such a case, an unlikely but possible interpretation of the language in the NJ statute could be read to exclude the shares supporting the Section 817 contracts from the numerator and denominator, in which case the small amount of account ownership outside the segregated account would represent 100% of the shares. That interpretation would result in the regulated investment company or real estate investment trust being considered a "captive" and included in the combined return.

  The inclusion of the following example in Reg. 18:7-21.1 would make clear that operation of the statutory language:

  > Example: The voting stock of REIT ABC is owned as follows: 95% by a life insurance company ("X") in a segregated asset account described in Internal Revenue Code section 817, 1% by X in its general account, and 4% by an unaffiliated insurance company ("Y") in a segregated asset account. REIT ABC is not captive because the voting stock held by X and Y in segregated asset accounts under Internal Revenue Code section 817 are not taken into account in determining the ownership of total voting stock, i.e.,

  $$\frac{\text{1\% voting stock owned by X in general account}}{\text{100\% of REIT voting stock}} = 1\% \ (<50\%)$$

Second, we have two recommendations to ***streamline*** the process that we hope you consider as we know both taxpayers and Taxation staff appreciate a simpler process.

- The Joint Committee seeks clarification in the proposed amendments to N.J.A.C. 18:7-11.13 that will require all amended returns, other than in very limited instances, to be filed electronically. Additional guidance to define those limited circumstances would be helpful. For example, some corporations often file amended returns for years for which the software does not support electronic filing. Can limited circumstances such as that be made clear?

- We have also heard concerns about the Taxation's proposed amendment adding new subsection (d) to N.J.A.C. 18:7-11.6. The proposed addition provides that taxpayers must include the credit forms for tax credits claimed for the privilege period even when the tax credit is not being claimed during that privilege period.

  Under the plain language of the statute, taxpayers are not required to include a tax credit form with their return if the credit is not being claimed during the privilege period.

Further, we understand that Taxation's historical policy did not require a taxpayer to file a credit form with an original or amended return. Rather, consistent with federal law, we understand that Taxation allowed a taxpayer to claim a credit whether or not a tax credit form was filed with the underlying credit year—as long as the credit was being applied in a year that remains open for audit or refund.

In any case, we understand that Taxation is currently litigating a similar issue in the New Jersey Tax Court. It would be inappropriate, therefore, to adopt the proposed language while litigation is still pending. Instead, the Joint Committee requests that Taxation refrain from amending the regulation until that litigation is final, then provide guidance consistent with any final decision from the New Jersey courts. In the meantime, we request that the addition of N.J.A.C. 18:7-11.6(d) be removed from its rule proposal.

Additionally, we have two ***substantive policy recommendations*** including one that goes back to one of the few policy disagreements that this Joint Committee and Taxation had during the crafting of the CBT reform law necessitating these new regulations.

- Despite some back and forth between the Joint Committee and Taxation concerning the decoupling of section 174 R&D tax deductibility, we were unable to come to complete agreement and hoped to iron out our concerns within this regulatory process. The Joint Committee proposes the following language to effectuate our goal of stimulating the innovation economy in New Jersey and not get bogged down by federal failure to act on these important tax and economic development issues. We also believe that the counterproposal below could help avoid the very type of discrimination found to be unconstitutional in U.S. Supreme Court and state court decisions when expenses in one state are treated more favorably than in another state.
    - For privilege periods beginning on or after January 1, 2022, specified research or experimental expenditures, as defined under I.R.C. § 174, 26 U.S. Code § 174, shall be allowed as a deduction for New Jersey Corporation Business Tax purposes for the same privilege period in which the taxpayer would be permitted to claim a tax credit for qualified research expenses or basic research payments under N.J.S.A. 54:10A-5.24.
    - The amount of the permitted deduction for specified research or experimental expenditures shall be equal to the amount of expenditures charged to a capital account during the privilege period under I.R.C. § 174 regardless of whether the taxpayer or those expenditures qualify for the credit under N.J.S.A. 54:10A-5.24.

  This change would be consistent with the fiscal note for the legislation which provided that "[t]he bill would decouple New Jersey's research and development expense deduction from the federal requirement, allowing firms to continue taking the full deduction in the single year in which qualified expenses were incurred. See Fiscal Note for Senate No. 3737 (June 19, 2023).

- The Joint Committee has also heard concerns about the proposed amendment to the "reasonable approximation" definition set forth in N.J.A.C. 18:7-8.10A(a)3iv(1). Specifically, some businesses are concerned that the proposed amendment is more restrictive than the statute or current regulation with respect to when a taxpayer may use a "reasonable approximation" for purposes of sourcing services receipts. Under N.J.S.A. 54:10A-6(b)(4),

if the benefit of a service is received within and without New Jersey, the sales-fraction numerator is computed "based on the percentage of the total value of the benefit of the service received at a location in this State or a reasonable approximation" thereof. Based on the plain language of the statute, therefore, if a taxpayer knows the actual percentage of benefit received by a customer in New Jersey (or could readily determine that percentage), an approximation method would not meet the test of reasonableness and could not be used. By contrast, if the percentage of benefit received cannot be determined (or could only be determined by incurring significant expense or effort), the statute permits the taxpayer to use an approximation. But even then, any approximation method must still be "reasonable." In this way, the statute provides a flexible framework for allocating services receipts.

The current regulation is similarly flexible. N.J.A.C. 18:7-8.10A(a)3iv clarifies the situations in which a reasonable approximation may be used: if the contract terms, taxpayer's books and records, and nature of the business or service enable the taxpayer to determine the extent of the benefit received in New Jersey, there is no need to use a reasonable approximation. But if those items are inconclusive, the regulation broadly allows "all sources of information" to be considered as long as the result is reasonable and consistent with the activities of the recipient.

Under the Taxation's proposed change, a taxpayer may not use a reasonable approximation "solely as a result of the taxpayer not liking the outcome of the statutory formula where the taxpayer readily knows where the benefit of the service is received." This proposed language may create confusion. The "reasonable approximation method" is specifically provided for in the statute. So, when it is warranted, the reasonable approximation method is the "outcome of the statutory formula" rather than a distinct method. Further, as explained above, using an approximation method would not be "reasonable" if the taxpayer knows where the benefit of the service is actually received. So, the proposed language restricting the use of a reasonable approximation when the taxpayer "readily knows" where the benefit is received does not provide any additional guidance beyond what is already contained in the current regulation.

We are also concerned about the proposed addition of N.J.A.C. 18:7-8.10A(a)3iv(1)(A) to (H). In particular, subparagraph (A) suggests that a taxpayer may use industry standards only upon request. This is inconsistent with the plain language of the statute. In addition, the requirement in subparagraph (G) to file amended returns if a reasonable approximation utilizes artificial intelligence may be overly restrictive given the relative novelty of the technology. As artificial intelligence technology continues to evolve and mature, any bright-line restrictions on its use are premature.

Accordingly, because the statute and current regulations already provide adequate guidance on the use of a reasonable approximation, we request that Taxation remove its proposed amendment to N.J.A.C. 18:7-8.10A(a)iv(1) and revert to the existing regulatory language. (The Joint Committee has no objection to the inclusion of additional examples at N.J.A.C. 18:7-8.10A(a)iv(2).)

Finally, we would like to mention that we are also concerned with the proposed change in language to N.J.A.C. 18:7-8.9(b) and 18:7-8.10A(a) – specifically the insertion of language concerning reliance on methods of accounting. However, at this time we are not sure of what the proposed change in language is intended to accomplish. We are seeking further clarification concerning the Division's

intention with respect to this change in language, and plan to provide supplemental comments on these provisions once we have received that clarification.

We thank you again for considering our comments, and please feel free to email Christopher Emigholz, NJBIA's Chief Government Affairs Officer, at cemigholz@njbia.org to further discuss them or any business tax issue with which we could help.

Sincerely,
NJBIA/NJ Chamber of Commerce Joint Taxation & Economic Development Policy Committee