The Real Cost to New Jersey of Being an Outlier

The Impact of Steep Corporate Tax Rates

COMPARATIVE CASE STUDIES AND RECOMMENDATIONS FOR TAX REFORM

GARDEN STATE INITIATIVE

MARCH 2023

Mission

The Garden State Initiative is a 501(c)3 nonprofit organization dedicated to strengthening New Jersey by providing an alternative voice and commonsense policy solutions that promote new investment, the growth of jobs, the creation of economic opportunities and innovation to benefit all New Jerseyans.

Research

The research herein was sponsored by Garden State Initiative and includes data – as cited- from the Internal Revenue Service, The Tax Foundation, The New Jersey State Policy Lab at Rutgers University, the US Census Bureau, the Bureau of Labor and Statistics, the Bureau of Economic Analysis, and the New Jersey Division of Taxation. Independent research and extensive analysis was also included from Dr. Arthur Laffer and Associates. Arthur B. Laffer is a public policy expert, an academic economist and professor. Laffer was a consultant to Secretaries of the Treasury George Shultz and William Simon, and Chief of Staff and Secretary of Defense Donald Rumsfeld and was Chief Economist at the Office of Management and Budget under Mr. Shultz from October 1970 to July 1972.

Dr. Laffer was a member of President Reagan's Economic Policy Advisory Board (1981-1989). He also advised Prime Minister Margaret Thatcher on fiscal policy in the U.K. during the 1980s.

Dr. Laffer has been widely acknowledged for his economic achievements. A March 1999 *Time Magazine* cover story "The Century's Greatest Minds" deemed the Laffer Curve one of "a few advances that powered this extraordinary century." Laffer and Associates provides research and investment management services to a diverse group of clients, which includes institutions, pension funds, corporations, endowments, foundations, individuals and others.

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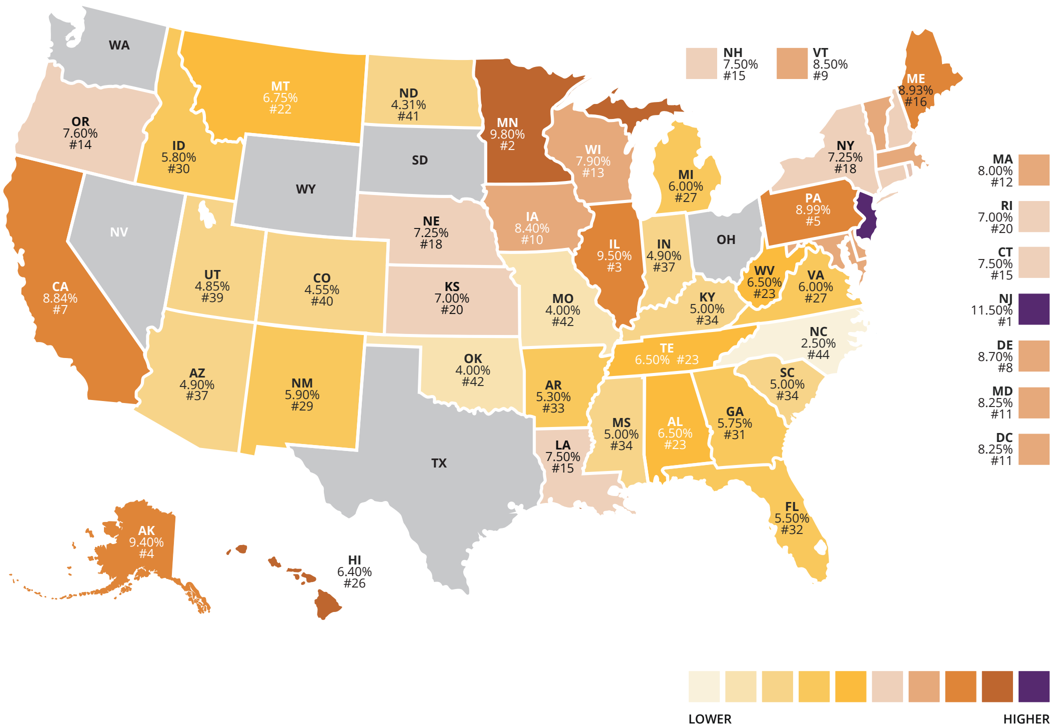
New Jersey is an Outlier

At the current rate of 11.5%, no state in the country has a more punitive tax on its home-based corporations than does New Jersey. As the chart from the Tax Foundation demonstrates, no other state exceeds 10%. The New Jersey tax rate is roughly twice as high as the 50-state average and only contributes 4% to 7% of total revenues to the state depending on the year.

FIGURE 1. HOW HIGH ARE CORPORATE INCOME TAX RATES IN YOUR STATE?

TOP MARGINAL CORPORATE TAX RATES AS OF JANUARY 1, 2023



Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Delaware, Oregon, and Tennessee have gross receipts taxes in addition to corporate income taxes, as do several states like Pennsylvania, Virginia, and West Virginia, which permit gross receipts taxes at the local (but not state) level.

Connecticut has historically charged a 10% surtax on a business's tax liability if it has gross proceeds of $100 million or more, or if it files as part of a combined unitary group. This surtax expired on January 1. Legislators have extended the surtax in the past and will decide whether to do so again this session.

Illinois' rate includes two separate corporate income taxes, one at a 7% rate and one at a 2.5% rate.

In New Jersey, the rates indicated apply to a corporation's entire net income rather than just income over the threshold. A temporary and retroactive surcharge is in effect from 2020 through 2023, bringing the rate to 11.5% for businesses with income over $1 million.

Sources: Tax Foundation; state tax statutes, forms, and instructions; Bloomberg Tax.

- Six states – including Nevada, Ohio, Texas and Washington - impose no corporate income tax at all. (These states impose lower rate “gross receipts” taxes on their businesses.) In other words, many businesses could increase their after-tax profits year after year by up to 10% by moving to a no-corporate tax state.
- Garden State businesses are also competing against those in China, India, Europe and Mexico – to name a few. Because the United States imposes a fairly high statutory federal tax rate on American corporations (21%), New Jersey’s combined federal-state rate is 31%. From a tax perspective, New Jersey is one of the most expensive places on the planet for a corporation to call home. In contrast, Ireland has a flat rate income tax of 12.5%, which means that a company could cut its tax penalty by almost two-thirds by relocating in Dublin.
- Taxes are a fixed “cost of doing business” in New Jersey. With widespread expectation of economic turbulence ahead, firms strive to locate where they can reduce fixed expenses to protect their competitiveness.
- New Jersey has clear competitive advantages – including a well-educated work force, world class universities, extensive transportation networks, and its proximity to the global financial center New York City and the historic city of Philadelphia. But too often the state’s combination of high state personal income and corporate taxes measurably reduces or completely cancels out these advantages.

Excessive State Corporate Taxes Inhibit Overall Growth

The New Jersey corporate tax structure has become an albatross around the neck of New Jersey’s economy. The negative impacts include:

- The number of Fortune 500 companies headquartered in New Jersey fell from 22 in 2006 to 15 in 2021.[1]
- The state has lost between $350 and $400 billion in personal income since 1990 due to outward migration. The state’s total personal income would be about 30% larger today if not for people and businesses leaving.
- Between 2005 and 2020 New Jersey has lost population and income to all but two of the other 49 states.
- The state’s population has fallen every year relative to the rest of the nation in every year for the last three decades.
- In 2022, a U-Haul moving trucks analysis found that New Jersey had the 6th largest percentage of trips outbound rather than inbound.

1 Tom Bergeron, “Fortune 500: How does N.J. rate with its competitor states? Not great”, ROI-NJ, June 3, 2021.

Alternative Solutions and Recommendations

The economic damage has been severe, but several high-profile reforms could redirect New Jersey toward a more vibrant path. Tax reform at the state level is an obvious opportunity.[2]

The tax burden chases away new businesses and economic development with new high-paying jobs. By any reasonable calculus, the Garden State would be more prosperous by taking four immediate actions:

1. The temporary 2.5% corporate tax "surcharge" must be entirely and immediately eliminated without any further delays. This surtax on corporate income greater than $1 million was adopted in 2018 and had been scheduled to decrease to 1.5% for 2020, then sunset following tax year 2021. The surtax was retroactively kept at 2.5% and extended through tax year 2023.
2. The New Jersey corporate income tax then should be ratcheted down over a two to five year phase down to match the national average rate of 5 to 6%.
3. To pay for reductions in the tax rate, the state should repeal most of the $1.2 billion in revenue lost by special interest or questionable write-offs and special interest exemptions. These loopholes reduce collections from the CBT by 20% to pass favor to certain companies rather than making a stronger and fairer tax structure. That revenue loss is more than the State spends on the Department of Health.
4. For maximum economic benefit to the state, lawmakers in New Jersey should consider eliminating the CBT altogether. The tax reduces New Jersey Gross State Product by almost $8 billion a year. Eliminating the tax altogether would raise the rate of growth in personal income by roughly 30%.
5. A key characteristic of an efficient, fair, and neutral tax regime is that like activity receives like treatment. Yet with the current New Jersey tax code and incentive programs, there is vastly disparate taxation for different types of corporations, depending upon the type of investment they wish to make and whether or not they are already in the State. New Jersey should simultaneously eliminate all tax incentive programs and consider cancellation of any grants or credits already awarded but not yet used. While certain companies will protest the elimination of existing incentives, everyone will benefit from the elimination of the CBT, creating a level playing field for all companies and a more vibrant economy moving forward.

Taxes are, of course, only one of many costs of doing business and only one of many factors that determine where businesses choose to locate. It is also true that taxes pay for vital government services – from roads to schools to hospitals to police protection – that clearly benefit local companies and their employees. But as this study and other studies show, there is very little evidence that New Jersey's higher taxes lead to better public services than in many lower tax states. In other words,

2 Of course, corporate income taxes are but one portion of a state's tax and regulatory climate that impacts business formation and state competitiveness. Amongst other considerations are personal income taxes (for pass-through entities, as well as the owners of corporations), sales taxes, property taxes, unemployment insurance, workers compensation, and regulatory burden. As New Jersey has a high burden across effectively all of these other variables (indeed, the Tax Foundation rates New Jersey's business tax climate dead last amongst the 50 states when taking all these considerations into account), there is much work to do all around, but corporate tax reform would be a powerful first step. https://files.taxfoundation.org/20220104110127/2022-State-Business-Tax-Climate-Index3.pdf

with good management, New Jersey could cut its tax intake without impairing important state and municipal services.

This study finds that over a short period of time any revenue loss from the reduction in the tax on New Jersey businesses would be in part or nearly fully offset by the improvement in economic conditions. A tax that raises only 7% of total revenue but does so much demonstrable harm to the state economy is hardly an effective way to raise revenue for the state. We recommend that the surtax be eliminated immediately and that the state responsibly move to reduce the tax rate to the national average, and if possible, to eliminate the tax altogether.

A Short History of New Jersey’s Taxes and Economic Performance

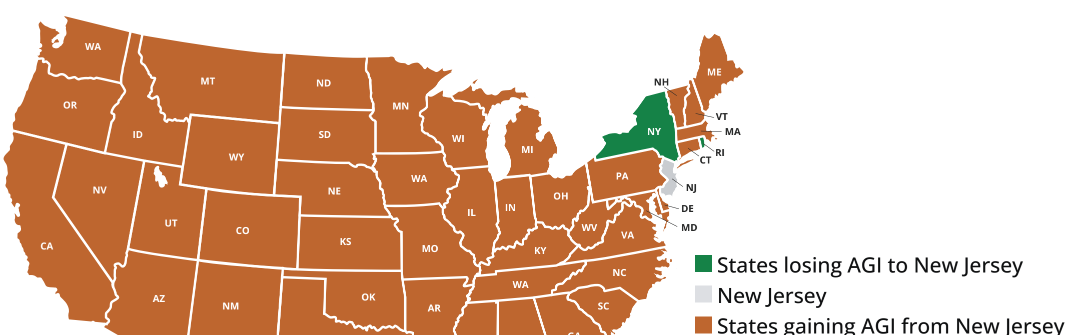
It seems hard to believe today, but fifty years ago, New Jersey had neither an income tax nor a sales tax. Yet the state was one of the richest with a steady rise in population and personal income. Trenton consistently recorded budget surpluses. Today, after adopting both a sales tax and income tax and continually raising income, corporate and sales taxes, and fees, New Jersey is one of the slowest growing states. New Jersey has tried to tax its way to prosperity, and that clearly hasn’t worked.

Any observer can clearly see New Jersey’s long, secular decline relative to the rest of the nation in the map below, where states colored red are attracting Net Adjusted Gross Income (AGI) from New Jersey over the period 2015 to 2020. Those in green are losing net AGI to New Jersey. New Jersey is losing income to EVERY state except New York, Rhode Island, and Alaska.

There is no economic metric more central to evaluating New Jersey’s historical performance than Adjusted Gross Income (AGI) as reported to the Internal Revenue Service (IRS) from New Jersey residents. These data are reported with the risk of criminal prosecution if deliberately falsified, assuring their accuracy. AGI is also the single most comprehensive measure of state economic activity, subsuming all lesser measures. It is the basis of tax collections, employment, real incomes, and spending recipients. It is conclusively the most encompassing measure of economic measurements.

FIGURE 2. NEW JERSEY AGGREGATE NET-AGI INFLOW

(2015-2020)

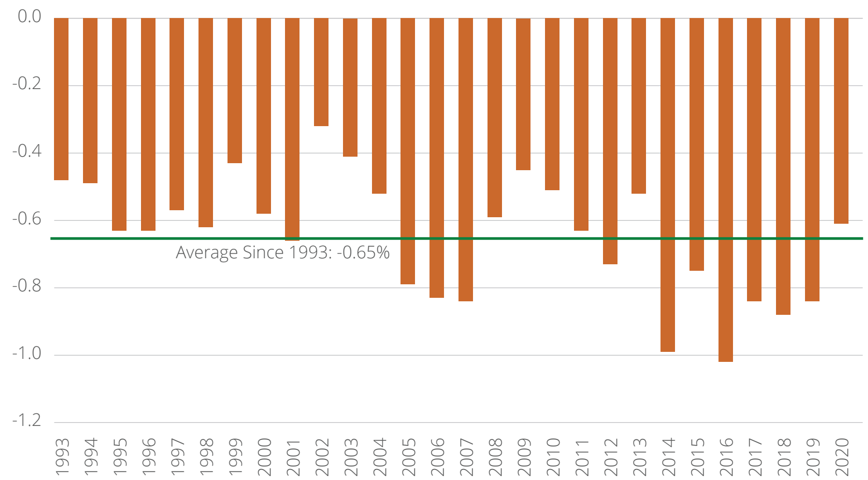


Green indicates New Jersey had a positive net inflow of AGI from the green state. Red indicates New Jersey lost net AGI to the red state.

Figure 2 shows that New Jersey is only able to attract capital in the form of Adjusted Gross Income (AGI) migration from New York, Rhode Island and Alaska. Capital is lost to each of the remaining 47 states. This map illustrates the severity of New Jersey's deteriorating incentive structure. The loss of 0.5% to 1% income annually may seem a minor concern, but the compounding effect means that New Jersey could be at least 30% richer today if these annual losses had not occurred.

FIGURE 3. ANNUAL NEW JERSEY NET INFLOW OF AGI MIGRATION AS A SHARE OF TOTAL NEW JERSEY AGI

(ANNUAL, 1993 THROUGH 2020)



New Jersey has LOST personal income to every state for more than 25 years in a row. Net domestic in-migration of AGI to New Jersey has remained negative since the IRS began tracking the metric in 1992/1993 (Figure X).[3] New Jersey has lost $378 billion of personal income since 1993 and given that the latest Census data for 2001 and 2002 show continued population loss, this number is now almost certainly ABOVE $400 billion.

Remember, loss of income in any one year due to workers or businesses leaving is a loss of income in every subsequent year (assuming they don't move back). Since 1992, a cumulative $46.6 billion AGI has relocated outside of New Jersey.[4] The 2021 and 2022 data show a net loss of at least another 200,000 residents from the Garden State. This suggests that the outward trend is accelerating.

The following two figures reinforce the vivid illustration of New Jersey's remarkable underperformance.

The first chart compares New Jersey's Gross State Product (GSP) – a measure of the state's output – or the sum of value added from all industries in the state. This downward trend is mirrored over the same time period with a decrease in population.

3 The IRS migration data set presents each data point as a pair of years because a migrant is defined as someone who files taxes in one location in one year and a different location the next year. For example, an out-migrant from New Jersey counted in 1992/1993 data means a tax filer who filed taxes in New Jersey in 1992, but filed elsewhere in 1993.

4 The New Jersey State Policy Lab at Rutgers has also called attention to New Jersey's dire performance with regards to taxpayer and income migration in a short piece titled "Interstate Migration: A Lost Cause for New Jersey?" https://policylab.rutgers.edu/interstate-migration-a-lost-cause-for-new-jersey/

FIGURE 4. NEW JERSEY GSP AS A SHARE OF THE U.S.

(ANNUAL, 1970-2021)

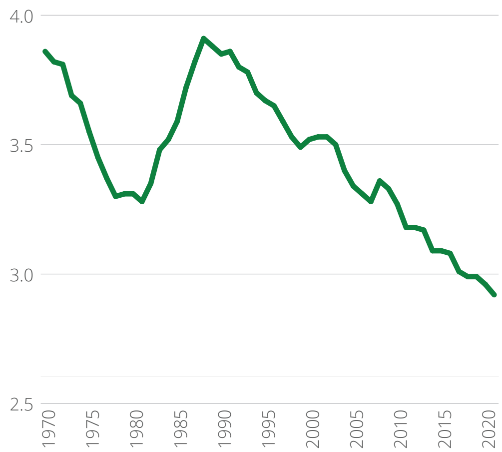
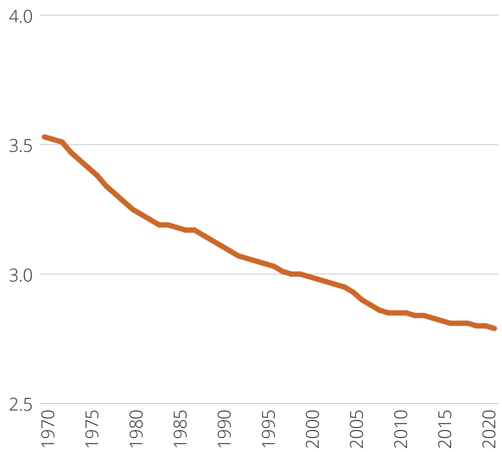


FIGURE 5. NEW JERSEY POPULATION AS A SHARE OF THE U.S.

(ANNUAL, 1970-2021)



Source: BEA

One more data point is highly relevant. New Jersey ranks very poorly in the ALEC-Laffer state economic outlook rating system. As shown below, every year for the past 14 years New Jersey has ranked in the bottom five, sharing company with slow movers like New York, Illinois and Rhode Island.

TABLE 1. RICH STATES POOR STATES: NEW JERSEY ECONOMIC OUTLOOK RANKS, 2008 TO 2022

Year	Economic Outlook Rank	Top Marginal CIT Rank	Top Marginal PIT Rank	PIT Progres-sivity	Property Tax Bur-den	Estate / Inheri-tance Tax
2008	48th	39th	46th	49th	48th	50th
2009	46th	39th	45th	48th	47th	50th
2010	48th	40th	47th	48th	48th	50th
2011	45th	40th	46th	48th	49th	50th
2012	42nd	40th	46th	48th	48th	50th
2013	39th	40th	46th	48th	48th	50th
2014	45th	40th	46th	48th	50th	50th
2015	46th	42nd	46th	48th	50th	50th
2016	48th	42nd	47th	48th	50th	50th
2017	48th	42nd	46th	48th	49th	50th
2018	46th	42nd	46th	48th	48th	50th
2019	46th	45th	48th	47th	48th	50th
2020	48th	45th	48th	47th	48th	50th
2021	48th	46th	47th	46th	48th	50th
2022	49th	46th	47th	46th	47th	50th

Source: Laffer-ALEC

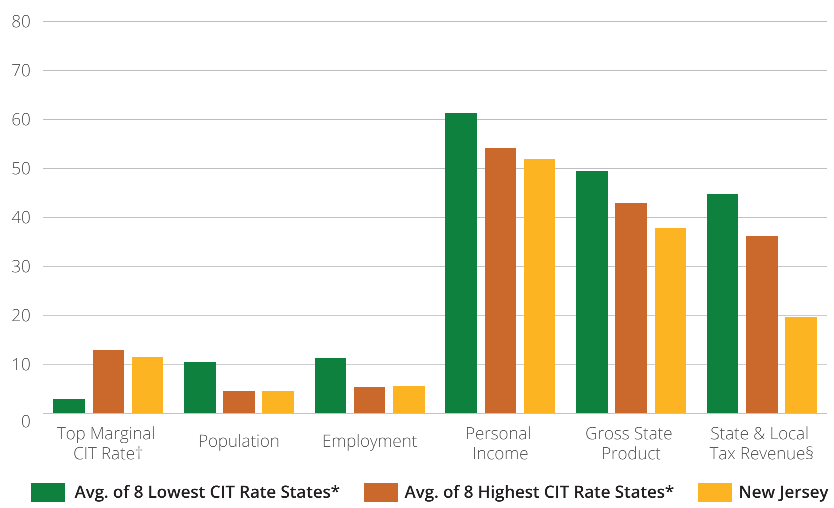
Why Does the State Corporate Income Tax Inhibit Growth?

Taxing corporate profits is a bad way to raise revenues. It punishes companies for being efficient and cost effective in their operations and for providing citizens the goods or services they want at the price the company charges. While the inefficient company that uses the state's public services but loses money or only breaks even, is rewarded with a low or no tax.

It is also a façade that the business pays this tax. They do COLLECT the tax. But the business transfers the cost of the tax to three groups: (1) customers, via higher prices, (2) employees, via lower wages, or (3) shareholders, via decreased profits. For this reason, "corporations don't pay taxes" is a common assertion. Corporations are the mechanisms by which taxes are collected, but the burden is distributed to customers, employees, and shareholders.

The tax does deter economic activity. The following table displays the economic performance over the past decade of the 8 states with the highest corporate income tax rates (a list which includes New Jersey) as compared to the 8 states with the lowest rates. The high corporate income tax states had population AND job growth rates only half as large as the states with the lowest corporate tax.

FIGURE 6. NJ: ECONOMIC PERFORMANCE AND POPULATION GROWTH 2011–2021



* Equal-weighted averages

† Top Marginal CIT Rate is the state top marginal rate on corporate income imposed as of 1/1/2022 plus local rates from each state's largest city. Deductibility of federal taxes from state tax liability included where applicable.

§ State & Local Tax Revenue is the growth in state and local tax revenue from the Census Bureau's State & Local Government Finances survey. These data are 2010 to 2020 due to data release lags.

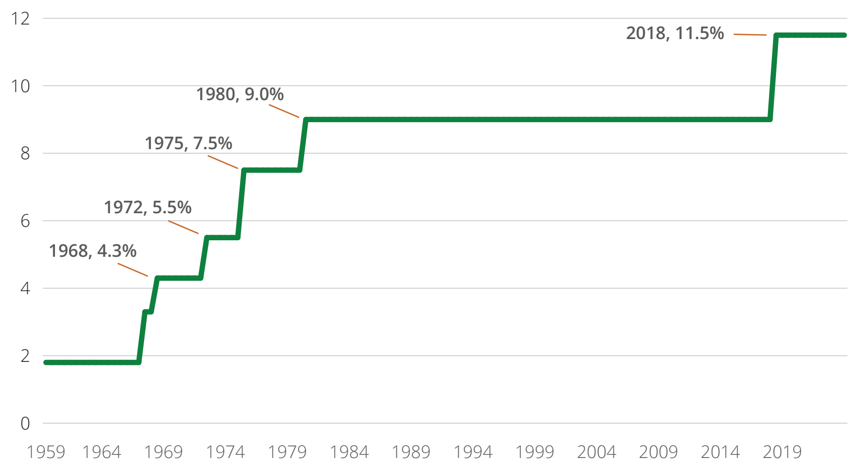
Source: Laffer Associates, U.S. Census Bureau, Bureau of Labor Statistics, Bureau of Economic Analysis

The New Jersey Corporate Tax Keeps Rising Relative to Other States

New Jersey didn't always have the highest business tax rate. Trenton began taxing corporate income at a rate of 1.75% in 1959 (following some 75 years of a franchise tax that taxed corporations based upon their capital stock or net worth). Since the introduction of the income tax on corporations, the Corporation Business Tax (CBT) rate has only moved in one direction – north. The tax rate has been raised on five separate occasions, most recently in 1980, to its current rate of 9% (Figure 7).[5] However, while the CBT still technically carries a highest marginal tax rate of 9%, since 2018 corporations with allocable net income greater than $1 million have also faced a 2.5% surtax, effectively yielding a top tax rate of 11.5%.

FIGURE 7. HIGHEST MARGINAL NEW JERSEY CORPORATION BUSINESS TAX RATE

(ANNUAL, 1959 THROUGH 2023)



The state's introduction of the corporate income tax in 1959 was not successful. The revenues it brought in were not sufficient to prevent the state from adding a sales tax in 1965. Neither was this new tax imposition successful. The revenues it brought in were not sufficient to prevent the state from adding an individual income tax in 1976. After that point, a vast new tax structure in place, the race was on to raise the rates. The essential point is that new tax impositions—as begun in New Jersey in 1959 with the corporate tax—lead to a vicious circle of ever more kinds of taxation and ever higher rates of taxation.

New Jersey's CBT has only become more of an outlier. Surveying the national scene, Iowa used to have the highest corporate income tax rate but has recently enacted legislation reducing its corporate income tax rate for tax year 2022 to 9.8% and, if certain revenue triggers are met, the rate could be reduced to as low as 5.5% in the coming years.[6] In the legislative session earlier this year, Pennsylvania enacted a phased-in corporate tax reform that will reduce its corporate income tax rate from 9.99% to 8.99% for tax year 2023, with a further 0.5% reduction annually until reaching 4.99% in 2031. Thus, in a few short years, New Jersey has gone from having the fifth highest corporate income tax rate nationally in 2017, to having in 2023 the highest rate by 1.7%. The picture is even worse

5 New Jersey Division of Taxation, "Corporation Business Tax Overview", 2/25/20. https://www.state.nj.us/treasury/taxation/corp_over.shtml

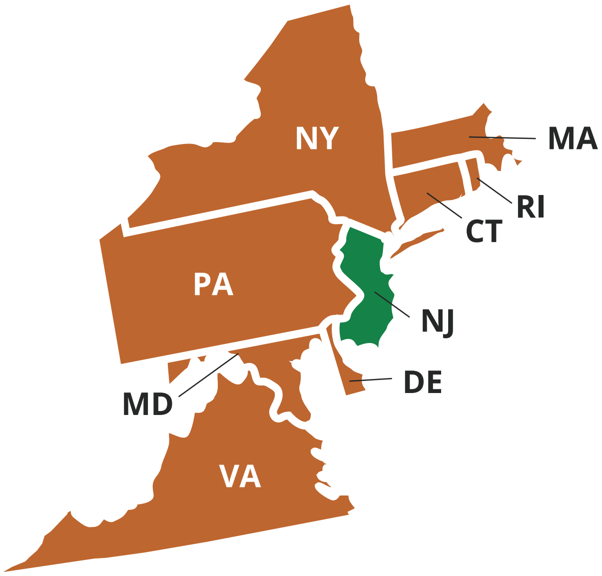
6 Vermeer, Timothy. "State Tax Reform and Relief Enacted in 2022," Tax Foundation, 2022. https://taxfoundation.org/state-tax-reform-relief-enacted-2022/.

regionally, as of January 1st, there is not a regionally competitive state with a corporate income tax rate within 2.5% of New Jersey's top rate (see Table 2).

TABLE 2. REGIONAL HIGHEST CORPORATE INCOME TAX RATES AS OF 1/1/2023

State	Top Rate
New Jersey	48th
Pennsylvania*	46th
Delaware	48th
Maryland	45th
Washington, D.C.	42nd
Massachusetts	39th
Connecticut	45th
New York	46th
Rhode Island	48th
Virginia	48th

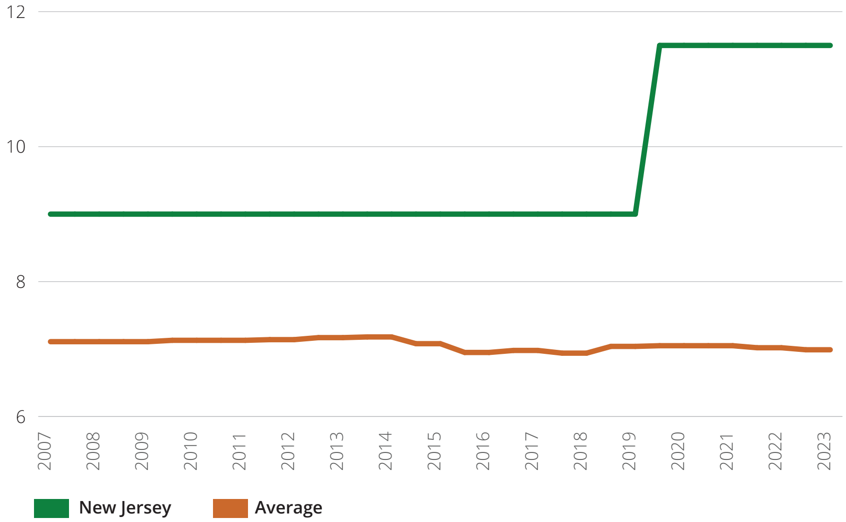
* 8.99% for 2023, then falling 0.5% annually until reaching 4.99% in 2031.[7]



In Figure F, New Jersey's top CBT rate, including the surtax, is plotted alongside the equally weighted 50 state average of top CIT rate.

FIGURE 8. AVERAGE STATE CIT RATE VS. NJ CIT RATE

(ANNUAL, 2008 THROUGH 2023)



Source: Tax Policy Center, Laffer-ALEC

In the appendix to this study we present a thorough analysis of the intricacies of the New Jersey CBT and cover a myriad of micro issues with respect to New Jersey's tax system.

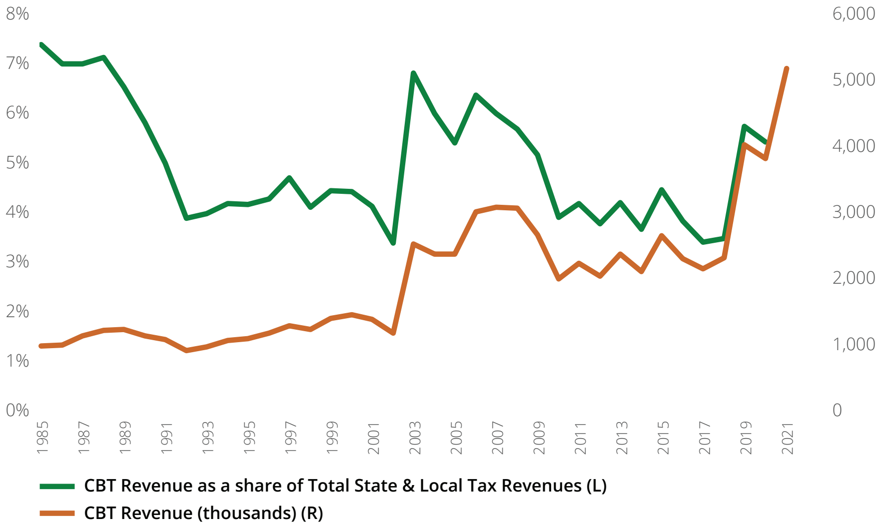
7 Vermeer, Timothy. "Pennsylvania Cuts Corporate Net Income Tax Rate," Tax Foundation, 2022. https://taxfoundation.org/pa-corporate-tax-cut/.

CBT Revenues Are Very Low Relative to Compliance and Economic Costs

A remarkable feature of the New Jersey CBT is that the state adopted a tax that causes so much economic harm for so little revenue raised. The tax only collects about 4% to 7% of total revenues since fiscal year 1985.

FIGURE 9. CORPORATION BUSINESS TAX REVENUE AS A SHARE OF TOTAL NEW JERSEY STATE AND LOCAL REVENUES BY FISCAL YEAR

(FISCAL YEAR, 1985 THROUGH 2021)



Source: New Jersey Department of the Treasury: Division of Taxation, Census Bureau

As can be seen in the chart above, in periods of strong economic growth, CBT revenues often increase as a percentage of total state and local revenues, and then fall during and after recession. In other words, revenues increase during times of economic prosperity, and the revenues fall rapidly during tough times. As such, the volatility of CBT revenues increases New Jersey's overall revenue volatility.

Corporations, particularly large multistate or multinational corporations, are often three steps ahead of state tax and revenue departments when it comes to tax planning. Over time, this tax avoidance strategy by business effectively shrinks the tax base, as corporations find ways to have portions of their income deemed non-taxable. Most damaging for New Jersey is when they avoid nexus with the state altogether. In part due to the tax planning of corporations, corporate tax revenues generally have been shrinking as a share of total tax revenue in New Jersey. In the process, small businesses, locally owned businesses, and individuals are left shouldering a greater and greater proportion of the total state tax burden.

With corporate profits far more volatile than economic output to begin with, the shrinking of the corporate tax base also leads taxable income to be even more volatile. When coupled with a very high tax rate on corporate profits, the volatility is amplified, yielding the large and often unpredictable swings New Jersey has experienced in CBT revenue (Figure 9).

Taking all of this into account, one goal of any corporate tax reform should be to reduce volatility so as to provide a steadier stream of revenue to the State, which would allow for improved fiscal planning for both corporations and the State. By reducing the volatility of tax receipts, the State could reduce the boom bust cycle in which it adds spending initiatives in the good times and ramps up debt, increases taxes and reneges on those promises in bad times, such as New Jersey has seen over and over again with pensions and property tax credits.

National and Regional Comparison

While on certain tax questions New Jersey is in keeping with national trends, it is abundantly clear that New Jersey is an outlier on highest rate and rate structure. In other words, because it is poorly constructed, the CBT serves as a powerful negative incentive, causing corporations to focus on ways to avoid having income allocable to New Jersey.

At the national level, this means multistate firms find ways to avoid nexus in New Jersey. Of course geographical competition is more consequential at the regional level. Despite there being a number of high-tax states in the Northeast and Mid-Atlantic regions, New Jersey once again stands out as the worst tax regime, particularly after Pennsylvania's recently enacted tax reform (Table 2).

TABLE 3. REGIONAL TAX REGIME CHARACTERISTICS

State	Type of Tax	"Top Rate"	Top Bracket	Apportionment Method	Throw-back Rule	"Services Sourcing"	Mandatory Combined Reporting?	Job Tax Credits	R&D Tax Credits	Investment Tax Credits
Connecticut (a)	Income	7.50%	$-	Sales	No	Market Based	Yes	No	Yes	Yes
Delaware (b)	Income	8.70%	$-	Sales	No	Cost of Performance	No	Yes	Yes	Yes
Maryland	Income	8.25%	$-	Sales	No	Market Based	No	Yes	Yes	Yes
Massachusetts	Income	8.00%	$-	Sales/Double Wtd Sales	Yes	Market Based	Yes	Yes	Yes	Yes
New Jersey (c)	Income	11.50%	$1,000,000	Sales	No	Market Based	Yes	Yes	Yes	Yes
New York	Income	7.25%	$5,000,000	Sales	No	Market Based	Yes	Yes	Yes	Yes
Pennsylvania*	Income	9.99%	$-	Sales	No	Market Based	No	Yes	Yes	Yes
Rhode Island	Income	7.00%	$-	Sales	Yes	Market Based	Yes	Yes	Yes	Yes
Virginia	Income	6.00%	$-	Double wtd Sales/Sales	No	Cost of Performance	No	Yes	Yes	Yes
Washington, D.C.	Income	8.25%	$-	Sales	Yes	Market Based	Yes	Yes	No	No

Source: Laffer Associates, Tax Foundation, Center for Budget & Policy Priorities, KPMG, Federation of Tax Administrators

(a) Connecticut charges a 10% surtax on a business's tax liability if it has gross proceeds of $100 million or more, or if it files as part of a combined unitary group. This surtax was recently extended and is scheduled to expire on January 1, 2023.

(b) Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Delaware, Oregon, and Tennessee have gross receipts taxes in addition to corporate income taxes, as do several states like Pennsylvania, Virginia, and West Virginia, which permit gross receipts taxes at the local (but not state) level.

(c) In New Jersey, the rates indicated apply to a corporation's entire net income rather than just income over the threshold. A temporary and retroactive surcharge is in effect from 2020 to 2023, bringing the rate to 11.5% for businesses with income over $1 million.

Note: In addition to regular income taxes, many states impose other taxes on corporations such as gross receipts taxes and capital stock taxes. Some states also impose an alternative minimum tax and special rates on financial institutions.

*These rates are as of 1/1/22, but a number of states have since enacted reform. Pennsylvania enacted a phased-in corporate tax rate reduction, going to 8.99% for 2023, then reducing an additional 0.5% annualy until reaching 4.99% in 2031. Via revenue triggers in coming years, Iowa's rate could decline as low as 5.5%. Nebraska's top rate will decline to 7.25% on 1/1/23, phasing down to 5.84% on 1/1/27. New Hampshire's tax rate will decline to 7.5% on 1/1/24. Idaho dropping to 5.8% for TY2023.

Low Rates and Broad Base

As discussed previously, the essence of an optimal tax structure is a broad tax base with a low tax rate. Several states have enacted tax reforms seizing upon this north star, broadening the tax base and lowering the tax rate at the same time - enacting reform that is approximately revenue neutral in the short-run but economically more pro-growth. This ultimately, leads to stronger revenue growth over time. Indeed, in recent years Rhode Island enacted combined reporting and market-based sourcing and at the same time lowered the corporate income tax rate.

Unfortunately, New Jersey has done just the opposite on the rate side – adopting combined reporting and market-based sourcing, while also increasing the tax rate. While broadening the tax base is generally appropriate, doing so at the same time as increasing the tax rate solely serves to increase the burden on corporations and increase the incentive for them to avoid nexus in New Jersey.

Simultaneously, New Jersey in fact acknowledges the negative impacts of the CBT by enacting revenue reducing tax credits higher than the vast majority of other states. These existing tax credits, deductions and exclusions total more than $1.2Billion (as enumerated in Appendix 2.)

Yet the effect of these programs, often for firms who locate new investment in New Jersey, is to narrow the tax base and exacerbate the tax burden on the state's existing firms or those lacking the narrow specifications and political favor required. Moreover, as such programs also complicate the tax system and distort market incentives, most studies find they do not efficiently promote economic growth.[8] In addition, they serve to make revenue forecasting more difficult as the State itself acknowledges.[9]

8 See *supra* note 12.

9 Official Statement, Appendix I, https://emma.msrb.org/P21625013-P21251601-P21676489.pdf

Tax Reform Recommendations

New Jersey's corporate tax regime is problematic at both a national and regional level. Unless a corporation absolutely needs to be in New Jersey, there is currently no economic incentive to locate there as opposed to anywhere else in the region. There is ample incentive for multistate firms to do everything in their power to avoid nexus to the state as well. As other states follow through on their phased in tax reforms, New Jersey will become even more of a negative outlier. With Pennsylvania setting the gauntlet and New Jersey's surtax already set to expire, the time is now for New Jersey to act boldly.

Ultimately the best course for New Jersey is elimination of the CBT coupled with reduction of tax incentive programs and consideration of the cancellation of grants and credits not yet used. While certain companies will protest the elimination of existing incentives, everyone will benefit from the reduction of CBT, creating a level playing field for all companies and a more vibrant economy moving forward.

With this change, New Jersey would immediately become more attractive for large businesses to have nexus as well as for small businesses and start-up creation by boosting the incentives to invest in capital, property, and employees in the state. Moreover, the elimination of an incredibly complex tax would lead to dramatic savings in time and accounting expense. While ostensibly the largest dollar impact would go to the largest corporate taxpayers, their shareholders, consumers, and employees would share in that benefit. In addition, small C-corps and S-corps would benefit from elimination of the alternative minimum gross receipts tax, saving on both taxes and accounting expense.

Large drops in compliance costs could be feasible under comprehensive tax reform, namely the elimination of the CBT. The administrative costs, time costs, and compliance outlays would plummet drastically, while the inefficiencies caused by tax code complexity would be greatly reduced. As a result, overall economic efficiency would increase, capital and labor would flow to more highly valued uses, and the growth in income and wealth in New Jersey would increase substantially.

Economic Impact Analysis

A Conceptual Framework

This section focuses on how to evaluate the empirical relationship between the maximum tax rate on personal income, corporate income, capital gains, dividends or inheritance, and tax receipts realized from those categories. The relationship between tax rates and revenues is important but is not the only consideration with respect to the issue of whether to tax these categories and, if so, at what rates. Nonetheless, the following points reflect the conceptual structure of how one should evaluate the fiscal responses to tax rate changes:

- It is difficult to justify taxing capital gains beyond the rate that maximizes revenues. If lowering capital gains tax rates would amplify tax revenues, then the state should lower those rates until revenues stop rising. In this scenario, both the average taxpayer would pay less, and the beneficiaries of government assistance would receive more.
- Even if a capital gains tax rate cut did not yield more direct capital gains tax revenues, a capital gains tax rate cut will increase investments, employment, profits, sales, etc., in addition to yielding more realized capital gains. Both separately and together, this will increase tax receipts from other sources such as income taxes, payroll taxes, sales taxes, and more. Here again, it would be beneficial to cut the capital gains tax rate if total State tax receipts rose as a result.
- A capital gains tax rate cut will expand output, employment, and productivity, which in turn will reduce State expenditures—especially those expenditures predicated upon needs tests, means tests, and incomes tests. Simply put, a capital gains tax rate cut will reduce the number of people in need and therefore State expenditures.
- Moreover, if State tax receipts fall by more than State expenditures thus resulting in lower State fund balance, there is also a serious consideration to be paid to local fiscal conditions. If the decrease in the State fund balance were to be offset by an increase in total local fund balances, then it is still difficult to see why a cut in the State capital gains tax rate wouldn't be warranted for virtually all constituencies.
- When considering whether a cut in the capital gains tax rate increases or lowers total government fund balance, there needs to be an effective time frame. In general, the longer the time frame, the more likely it will be that revenue feedback effects and spending reduction effects will materialize. Conceptually, what would be ideal is to take the discounted present value of all the net fund balance effects resulting from a cut in the capital gains tax rate, and if that present value calculation reveals an increase in net fund balance, the answer would be to cut the State capital gains tax rate under all circumstances. This truly is what the prohibitive range of the Laffer Curve is all about.

But the Laffer Curve is <u>not</u> the whole consideration for deciding whether or not to tax capital gains and, if so, at what rate. Revenue, expenditure, and debt feedbacks are only three considerations, albeit big ones. The role of government is to improve the lot of all Americans. The special role of taxes is to provide government with the requisite revenues to achieve its objectives. All taxes—save sin taxes—are bad because they have the effect of reducing the taxed activity. Therefore, the role of the State should be to collect the requisite revenues while doing the least damage. Any tax rate at or above that tax's maximum revenue point hurts total economic activity with no revenue offset. Tax rates should be significantly below the maximum revenue tax. The purpose of government is to make people better off, <u>not</u> to maximize revenues.

Dynamic Impact

The Model

There are any number of ways in which one may go about predicting a tax cut's economic impact. Standard methodologies for assessing state topics often include some variant of a difference-in-difference analysis, where a state is compared to a control state, or group of states, that share common attributes. The divergence between the state in question and the control group is determined and conclusions are drawn. We take a more precise route in our "control group" by isolating New Jersey. Rather than comparing the state to its peers, we examine New Jersey's intra-state tax policy and growth trends over a timeframe spanning over 50 years.

To estimate the impact of eliminating the Corporation Business Tax, we review the impact of New Jersey's collection of tax policies on growth rates. Specifically, this analysis focuses on the relationship between tax burden and gross state product (GSP) growth. Tax burden is defined as total state and local tax receipts as a share of New Jersey's aggregate personal income. GSP growth is calculated as the annual rate of the metric's growth or decline. Both series provide us with a time series dataset with 56 observations, recorded annually from 1965 through 2020.

To test the relationship between these two series, we employ an ordinary least squares (OLS) model regressing annual GSP growth on tax burden. The model is expressed as follows:

$$\Delta Y_t = \beta_1 T_t + \beta_0 + \varepsilon_t$$

Where: Y is New Jersey GSP, ΔY_t is the annual rate of GSP growth in year t.

$$\Delta Y_t = [\, Y_t - Y_{t-1}] \div Y_{t-1}$$

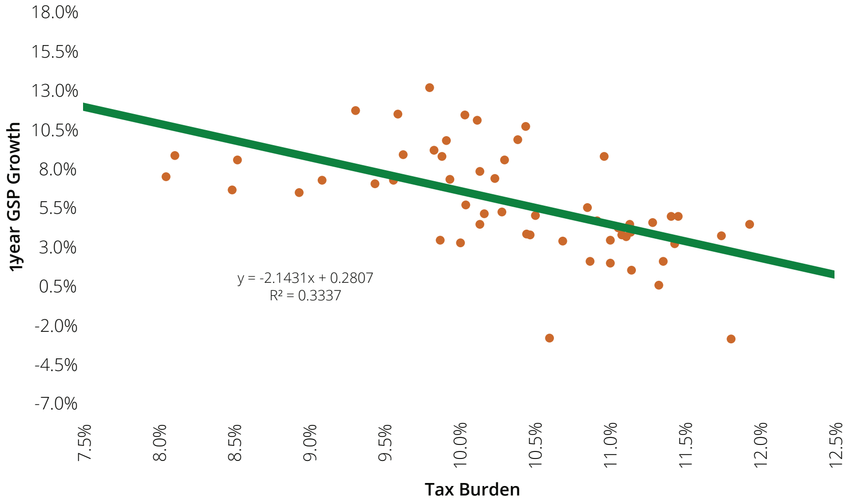
Where: T_t is tax burden in year t, calculated as the total state and local New Jersey tax receipts as a share of cumulative New Jersey personal income. Both series are recorded in year t.

$$T_t = (\text{Tax Receipts})_t \div (\text{Personal Income})_t$$

In the scatterplot below, we have plotted GSP growth and Tax Burden. Each of the 55 datapoints represent the annual measure of these values for New Jersey.

FIGURE 10. NEW JERSEY TAX BURDEN VS. 1-YEAR GSP GROWTH

(ANNUAL, 1965 THROUGH 2020)



Source: Census Bureau, Bureau of Economic Analysis

Results

The model output suggests a clear negative association between our two series and infers a 1 percentage point increase in tax burden predicts a 2.14 percentage point reduction in GSP growth. An R^2 value of 0.33 indicates that 33% of the variations in GSP are explained by tax burden. As such, tax burden possesses a healthy capability to explain variations in GSP growth. Considering the simplicity of the model's framework, being a single variable analysis, the independent variable's ability to explain roughly one third of the dependent series output is impressive.

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95.0%*
Intercept ($ß_0$)	0.2807	0.0428	6.5527	0.0000	0.1948	0.3666
Tax Burden ($ß_1$)	-2.1431	0.4121	-5.2006	0.0000	-2.9693	-1.3169

The regression output above further supports the relationship between our two series. With a regressor coefficient t statistic of -5.2 translating to a P-value of statistically zero, the association clears any reasonable significance threshold.

Application

To place these results into context regarding the Corporation Business Tax's impact on state economic expansion, we calculate two hypothetical results for 2019 New Jersey GSP growth with alternative input values. The first of which being the actual tax burden of the average New Jerseyan, which was 11.08% in 2019. State and local governments collected a total of $70.2 billion in tax revenue from the taxpayers' $633.5 billion aggregate personal income that year, producing a tax burden of 11.08%. Our model expects an annual GSP growth of 4.33%.

Removing Corporation Business Tax revenue from the calculation substantially alters tax burden, lowering total tax revenues from $70.2 billion to $66.2 billion. The drop in revenues causes tax burden to fall to 10.44%, or a 0.57 percentage point decrease. Under these conditions, the static impact of the lowered tax burden suggests a growth rate of 5.69%. That's a 31.4% increase in the rate of GSP growth after the Corporation Business Tax revenues are eliminated. Now, this estimation is static, meaning all other factors are assumed to hold constant. Soaring GSP expansion is strongly correlated with higher levels of personal income growth. Higher personal income raises taxable income (i.e., the tax base), and results in a sizeable offset- through tax revenue gained from other sources- to the foregone tax revenue.

Simply put, the Corporation Business Tax has effectively reduced New Jersey's GSP by $7.85 billion in 2019 alone. The CBT has failed to fulfill any intended revenue raising purpose.

Limitations

The model is intended to show association and direction, not to provide concrete answers proposing exact forecasts of GSP growth if New Jersey alters one specific element of its tax code. There are far too many omitted variables to say as much.

This is especially true in New Jersey, afflicted with endemic economic complications and underperformance across the board. The state is subjected to a draconian and obfuscated tax code unlike any other. New Jersey's pension programs have ranked either last or second to last in the U.S. since

2015.[10] Headline economic metrics for the state have been disappointing for over half a century. Commuters endure more hours of stand-still traffic than any other state while driving on highways ranking, once again, dead last in overall performance.[11] To assume ridding New Jersey of this one issue, albeit a critical one, is the cure-all for the states intergenerational economic decline is clearly a stretch. Eliminating the Corporation Business Tax structure is as good a place as any to lay the groundwork for the U-turn, onto the path of recovery.

10 David Draine and Susan Banta, "State Pension Contributions Hit Important Benchmark," Pew Charitable Trusts, October 2022, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2022/10/state-pension-contributions-hit-important-benchmark

11 Baruch Feigenbaum and Spence Purnell, "26th Annual Highway Report," Table 10: Total Disbursements per State-Controlled Mile, Reason Foundation, November 2021 https://reason.org/policy-study/26th-annual-highway-report/urbanized-area-congestion/

Tax Credits, Incentives and Other Tax Expenditures

As acknowledged, the elimination or reduction of CBT will not – as a singular act- serve as a panacea for all of New Jersey's economic ills. The state needs to stop being handcuffed by the burden of offering revenue-reducing tax credits, deductions and exclusions that currently total more than $1.2Billion as enumerated in Appendix 2, table 5. While it is not unusual for states to provide various tax credits, deductions, exclusions, to incentivize growth, it is important to consider the economic impact of the ensuing reduction in the tax base by all of the companies that meet certain criteria.[12] These programs generally exist with the intention of incentivizing certain corporate behavior, ultimately they can serve to reduce the effective income tax rate faced by corporations that engage in certain statutorily favored activity – typically certain industries or types of investment that policymakers seek to encourage.

Some of the most common types of tax incentive programs are:

- **Investment Tax Credits –** These tax credits serve to reduce a company's tax liability if it makes an in-state investment in certain specified new property, plant, equipment, or machinery. Effectively, such credits often distort the free market by making investment in new property more attractive than renovation of old property. In addition, they can be duplicative with existing provisions that already provide an incentive to make such a capital investment by allowing for accelerated depreciation or immediate expensing, causing even greater distortion by adding a second layer of tax code incentives for a given activity.
- **Job Tax Credits –** These tax credits serve to reduce a company's tax liability if the company creates a certain number of jobs over a specified period of time. Sometimes, as in New Jersey, companies are eligible for credits not only by creating new jobs but also if the tax credits prevent the company from moving the jobs to another state. In practice, job tax credits can be gamed, whether by only qualifying politically connected firms or by lying about the materiality of the tax credits in the location decision. Even under the best circumstances, they distort the free market by providing an artificial incentive for labor over other expenses that

12 There are certain important differences and considerations between the types of tax incentives, though they all serve to reduce the amount of tax owed. Tax deductions and exclusions reduce the amount of income that is subject to tax, thus reducing tax liability. Tax credits are even stronger, providing a dollar-for-dollar reduction in the tax bill. Tax credits can be refundable or non-refundable. Each serves to reduce tax liability dollar for dollar, but a non-refundable tax credit can only reduce tax liability to $0, while a refundable tax credit can continue reducing tax liability into negative territory (i.e., generate a tax refund). In circumstances where tax credits are non-refundable, states can also set up programs by which they can be sold to other taxpayers that do have positive tax liability to which to apply them.

could otherwise be more efficient and provide additional advantage to firms (and sometimes even entire industries) that are already expanding within the state.

- **Research and Development Tax Credits –** These tax credits reduce a company's tax liability if it engages in certain favored research and development activities. Regrettably, government officials lack the expertise to determine the most economically desirable R&D activities. Thus, the credits are inevitably economically inefficient – in the event of providing credits to desirable R&D, the credits serve to advantage investment that would already be profitable; in the event of credits to undesirable R&D, the credits serve to promote business activity that would not naturally occur. Furthermore, even in the event of an all-knowing public sector that only provides tax credits to desirable R&D activity that is somehow not viable without the credits, the process further complicates the tax code and diminishes the tax base.
- **Film Tax Credits –** These are a specific type of job tax credit by which film companies are encouraged to engage in production and filming activities in a state. In practice, these often tend not to be tax credits but simply payment to production companies, refunding a portion of the costs associated with utilizing temporary labor for a film shoot. Beyond distorting the free market by picking favorites and increasing the effective tax rate on all other industries by reducing the tax base, research broadly shows film tax credits have a high cost with little economic benefit.[13]

While these tax incentive provisions seem to make sense by encouraging economic growth via certain desired activity - who would not want more jobs and capital investment in the state? Unfortunately, the programs can have unintended consequences. First, such programs create an uneven playing field for corporations in the state, as those engaging in favored activity face significantly different effective tax rates than those who are not in favored areas or do not know how to navigate the bureaucratic process to receive the tax incentives. Second, research suggests that these programs fail to achieve their intended initiative of increasing economic growth and are incredibly expensive

13 See, for instance: Burton, Patrick, "Do Tax Incentives Affect Business Location and Economic Development? Evidence from State Film Incentives", Regional Science and Urban Economic, 2019
https://www.nber.org/papers/w25963
Bradbury, John Charles, "Do Movie Production Incentives Generate Economic Development?", 2019
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3155407
Luther, William, "Movie Production Incentives: Blockbuster Support for Lackluster Policy", Tax Foundation, 2010.
https://files.taxfoundation.org/legacy/docs/sr173.pdf
Tannenwald, Robert, "State Film Subsidies: Not Much Bang For Too Many Bucks", Center for Budget and Policy Priorities, 2010
https://www.cbpp.org/research/state-film-subsidies-not-much-bang-for-too-many-bucks
Thom, Michael, "Do State Corporate Tax Incentives Create Jobs? Quasi-experimental Evidence from the Entertainment Industry", State and Local Government Review, 2019.
https://journals.sagepub.com/doi/epub/10.1177/0160323X19877232
Weiner, Jennifer, "Cost-benefit analysis of Connecticut's film tax credit", Federal Reserve Bank of Boston, 2009.
https://www.bostonfed.org/-/media/Documents/neppc/weiner011609.pdf
Zin, David, "Film Incentives in Michigan", Michigan Senate Fiscal Agency, 2010.
https://www.senate.michigan.gov/sfa/Publications/Issues/FilmIncentives/FilmIncentives.pdf
California Legislative Analyst's Office, "Letter to Legislator - Evaluation of UCLA Film Credit Study", 2012.
https://lao.ca.gov/reports/2012/stadm/letters/evaluate-film-tax-credit-061312.pdf

per job created;[14] and often the jobs created are filled by commuters rather than local residents. Third, even if a state desires the creation of new jobs and is willing to pay companies for each job created, the economically proper approach is to achieve that goal through the annual appropriation process rather than enshrining it into the tax code. Annual appropriation prioritizes expenditures on an annual basis, with the legislature choosing each year where the priorities must lie. Moreover, if the legislature deems new jobs a priority, payments should be dispersed to all companies creating jobs, not just those skilled at navigating the application process that introduces tremendous cost and complication to the system. Finally, by engaging in such programs, the states are inherently admitting that their standard tax regime is not competitive enough. This is reinforced by our neighbor New York- following suit by offering new film credit initiatives- and ultimately increasing competition – and reducing New Jersey's share of this market. All in all, states would clearly be better served with a more equitable and attractive tax system for all companies engaged in business activities in the state.

A key characteristic of an efficient, fair, and neutral tax regime is that like activity receives like treatment. Yet with the current New Jersey tax code, there is vastly disparate taxation for different types of corporations, depending upon the type of investment they wish to make and whether or not they are already in the State.[15] While some companies may temporarily protest the elimination of existing incentives, ultimately all businesses will benefit from the creation of a level playing field and more vibrant economy moving forward.

14 See, for instance: Bartik, Timothy J, "Who Benefits from Economic Development Incentives? How Incentive Effects on Local Incomes and the Income Distribution Vary with Different Assumptions about Incentive Policy and the Local Economy", Upjohn Institute, 2018.
https://research.upjohn.org/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1037&context=up_technicalreports
Bartik, Timothy J., and Kevin Hollenbeck, "An Analysis of the Employment Effects of the Washington High Technology Business and Occupation (B&O) Tax Credit: Technical Report." Upjohn Institute, 2012. https://doi.org/10.17848/wp12-187
Coyne, Christopher and Lotta Moberg, "The Political Economy of State-Provided Targeted Benefits", Mercatus Working Paper, 2014. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3191326
Holmes, Thomas, "Analyzing a Proposal to Ban State Tax Breaks to Businesses," Federal Reserve Bank of Minneapolis, 1995. https://www.minneapolisfed.org/research/quarterly-review/analyzing-a-proposal-to-ban-state-tax-breaks-to-businesses
"New Jersey Economic Development Authority: A Performance Audit of Selected State Tax Incentive Programs", State of New Jersey, 2019.
https://www.state.nj.us/comptroller/news/docs/eda_final_report.pdf
https://www.pewtrusts.org/en/research-and-analysis/reports/2017/05/how-states-are-improving-tax-incentives-for-jobs-and-growth

15 "Locations Matters 2021: The State Costs of Doing Business", Tax Foundation and KPMG, 2021.
https://files.taxfoundation.org/20210504162527/Location-Matters-2021-The-State-Tax-Costs-of-Doing-Business.pdf

Does Corporate Tax Reform Work?

The North Carolina Example

Analyzing the New Jersey of the past to project the Garden State's future, however useful for comparison purposes, carries limitations. What we lack with this model configuration is reliable external validity, or the regression's generalizable application to other scenarios or states. The 50-state union offers an ideal organization for this type of analysis. Woodrow Wilson Supreme Court nominee, Louis Brandeis, explained this concept in his 1932 dissenting opinion:

> It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.[16]

Unfortunately, major upheavals of corporate tax structures are rare. At present, there are only two states that collect neither a corporate income nor a gross receipts tax (South Dakota and Wyoming). There are, however, examples of states dramatically lowering their top rates. Pennsylvania and Iowa have recently taken action to reduce their top marginal rates from 9.99% to 4.99%[17] and 9.8% to a flat 3.9% respectively[18]. Both states have adopted these plans with revenue trigger stipulations that gradually reduce the top rate each fiscal year until the goal is met. Unfortunately, both pieces of legislation were enacted in the summer of 2022. There is simply not enough time or data to examine the outcomes.

North Carolina is a more applicable scenario. Cuts to North Carolina's top corporate income tax rate began in 2013, falling one percentage point each year until the top rate reached 3.0% by 2017. North Carolina's economy grew rapidly over that short period of time, and lawmakers scrambled to maintain the momentum by further reducing the top rate to 2.5% via 2017 tax reforms effective January 1, 2019.[19] Governor Roy Cooper signed the bill that dealt the final blow to the corporate income tax in 2021. The top rate is set to gradually fall each year until the tax is eliminated by 2030.[20] North Carolina is reaping the benefits of a ten-year head start in a race that New Jersey has yet to enter.

16 New State Ice Co. v. Liebman, 285 U.S. 262 (1932) (Brandeis, J., dissenting)

17 Pa. Act 53 (H.B. 1342), Laws 2022

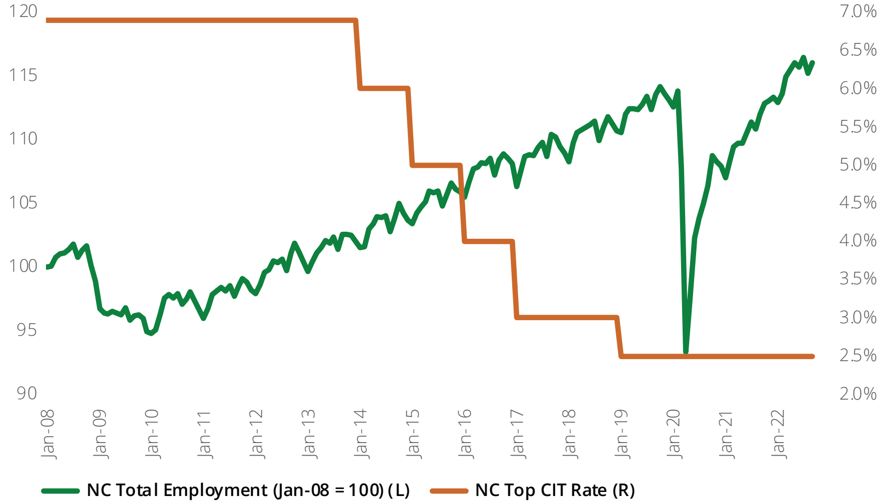
18 Jared Walczak, "Iowa Enacts Sweeping Tax Reform," Tax Foundation, March 14, 2022. https://taxfoundation.org/iowa-tax-reform/

19 Nicole Kaeding and Jaremy Horpedahl, "Help from Our Friends: What States Can Learn from Tax Reform Experiences across the Country," Tax Foundation, May 15, 2018. https://taxfoundation.org/state-tax-reform-lessons-2018/

20 "North Carolina enacts corporate income tax phase-out," PricewaterhouseCoopers LLP (PwC), November, 2021. https://www.pwc.com/us/en/services/tax/library/north-carolina-enacts-corporate-income-tax-phaseout.html

FIGURE 11. NORTH CAROLINA: TOTAL EMPLOYMENT VS. TOP MARGINAL CORPORATE INCOME TAX RATE

(MONTHLY, JAN-2008 THROUGH SEP-2022, SEASONALLY ADJUSTED NONFARM PAYROLL EMPLOYEES, INDEXED TO 100 IN JAN-08)



Source: Bureau of Labor Statisticcs, Laffer-ALEC Rich States Poor States

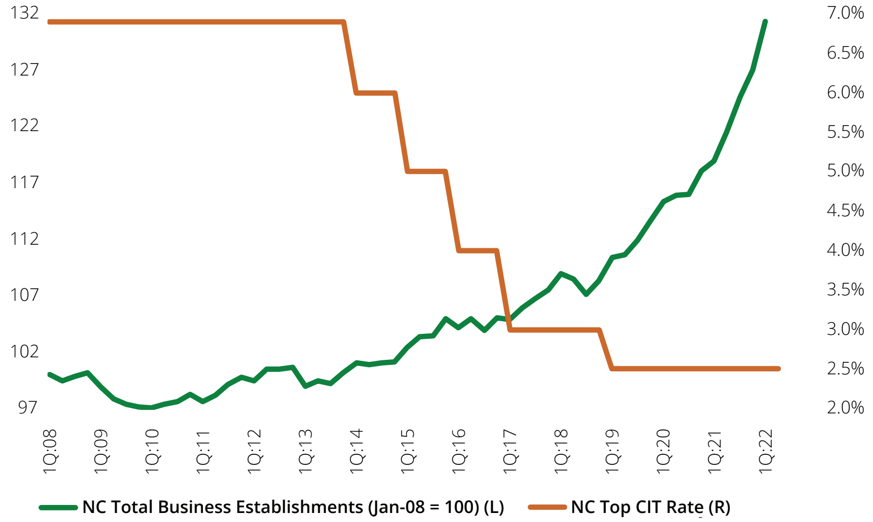
Figure X plots the monthly employment level for North Carolina since 2008 and we can see several fascinating outcomes that followed the tax reforms. Since the year before the initial tax cuts became effective in January of 2013, employment has grown 16.5%, or 1.85% annually, in under a decade. Of course, the 2020 recession limited job growth for North Carolina, but what's remarkable is North Carolina's strong jobs recovery coming out of the 2020 downturn—it appears that North Carolina is set to not only fully recover from the COVID recession, but to fully return to former growth trends.

If New Jersey were to follow suit with similar reforms, North Carolina's results could plausibly be seen in the Garden State. Scaling North Carolina's excellent results following its tax reforms to the workforce size of New Jersey, New Jersey would see an additional 750,000 jobs within the next ten years.

It's clear that lower income tax rates for businesses incentivize job growth and job creation, but this is a downstream benefit. More directly, lower corporate income tax rates are an incentive for businesses to expand and boost earning potential for entrepreneurs. The enhanced profit motive for aspiring business owners tips the scales within the cost benefit calculation, inevitably leading to a greater number of businesses opening their doors.

FIGURE 12. NORTH CAROLINA: NUMBER OF BUSINESS ESTABLISHMENTS VS. TOP MARGINAL CORPORATE INCOME TAX RATE

(QUARTERLY, 1Q:2008 THROUGH 1Q:2022, TOTAL PRIVATE ESTABLISHMENTS, INDEXED 100 IN 1Q:08)



Source: Bureau of Labor Statisticcs, Laffer-ALEC Rich States Poor States

In Figure 12 above, it's clear that North Carolina was not immune to the entrepreneurial incentive of income tax rate reductions over the years. Again, measuring from one year prior to the initial tax rate reductions, total private business establishments expanded 32.7%, or 3.2% annually. Applying this growth to the New Jersey level of business establishments, nearly 415,000 new business would enter the state's economy in under a decade. 415,000 business bring new employment opportunities to New Jerseyans, offering higher levels of taxable income, in addition to new goods and services offered to consumers, also driving tax revenues upward via consumption tax collections.

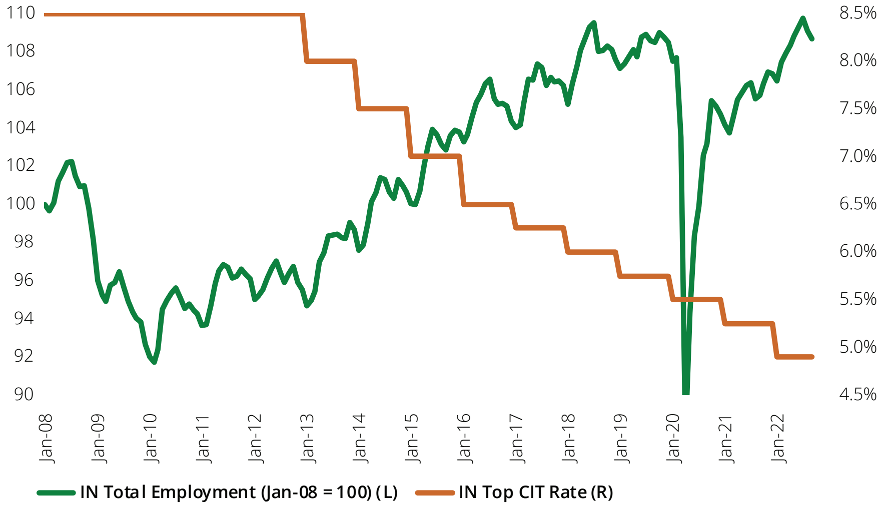
With the above example of North Carolina, it's important to keep in mind that North Carolina implemented a range of other positive economic policies over the same period in which corporate tax rates were cut, which certainly contributed to North Carolina's excellent economic performance. With that said, North Carolina didn't fully eliminate the corporate tax, the rate was only lowered. The difference between lowering a tax rate to, for instance, 1% versus fully eliminating the tax is significant, as full elimination of a tax also means no future tax filing or compliance costs for either the taxpayer or the tax collector.

Interstate Comparisons: Indiana

Another notable example of reducing corporate tax rates and realizing substantial economic growth is Indiana. In 2012, Indiana held the 15th highest corporate income tax rate in the nation at 8.5%. Today, the state has reduced its corporate income tax rate to 4.9%, or 11th lowest in the nation. The results, much like those of North Carolina, provide ample evidence of success.

FIGURE 13. INDIANA: TOTAL EMPLOYMENT VS. TOP MARGINAL CORPORATE INCOME TAX RATE

(MONTHLY, JAN-2008 THROUGH SEP-2022, SEASONALLY ADJUSTED NONFARM PAYROLL EMPLOYEES, INDEXED TO 100 IN JAN-08



Source: Bureau of Labor Statisticcs, Laffer-ALEC Rich States Poor States

Again, a state's adoption of pro-growth policies has successfully led to economic benefits. From January of 2013 to just before the pandemic decline in December of 2019, Indiana employment grew 14.8%, significantly outpacing the nation, and far surpassing New Jersey's growth of 11.0%. If New Jersey were to follow the same trajectory, the Garden State would create approximately 674,000 new jobs over the next 8 years.

Evidence from Federal Tax Policy

Another way to estimate the effect of the elimination of the CBT is based upon the Council of Economic Advisors (CEA) analysis of the impact of corporate tax reform in the Tax Cuts and Jobs Act.[21] As Kevin Hassett and his colleagues argued, "[The] sizable empirical literature measures the relationship between wages and corporate taxes, controlling for other variables that may affect wage growth across countries and over time. The literature suggests the relationship between taxes and wages is more than observational and is econometrically robust."[22] The process that they detail, all backed up by both economic theory and academic studies of real-world data, is as follows: (1) lower corporate tax rates incentivize additional capital investment; (2) additional capital investment leads to both higher demand for workers and more productive labor; (3) such improved dynamics for labor leads to wage growth. (Remember too that a large portion of the corporate tax burden is borne by labor, so it makes sense that as the corporate tax burden declines, workers would see a benefit of increased wages.) Based on this process, the CEA predicted that the corporate tax rate reduction in the Tax Cuts and Jobs Act would lead to average annual real wage growth of $4,000 per household. The actual results mapped this projection almost perfectly.[23]

21 "Corporate Tax Cuts and Wages: Theory and Evidence", The Council of Economic Advisors, October 2017. https://trumpwhitehouse.archives.gov/sites/whitehouse.gov/files/documents/Tax%20Reform%20and%20Wages.pdf

22 Ibid, pg. 2.

23 Tyler Goodspeed and Kevin Hassett, "The 2017 Tax Reform Delivered as Promised", The Wall Street Journal, May 8, 2022. https://www.wsj.com/articles/the-2017-tax-reform-delivered-as-promised-predictions-jobs-act-economic-data-boost-11652036657

This same process would materialize in New Jersey in the wake of elimination of the Corporation Business Tax and likewise lead to more capital investment and higher average personal income. Of course, that would in turn lead directly to higher corporate property tax revenues for local government and higher Gross Income Tax revenue for the State, as well as indirectly to higher sales tax revenue and realty transfer fees for the State, lower social safety net spending at the State level, and higher residential property tax values, thus greater property tax revenues for local government. While the full accounting of all these impacts is difficult to measure, we can conservatively state that state and local fund balance would increase on a present value basis, as described above.

Just to measure the first-order effect on Gross Income Tax receipts, we can follow the same mathematical process as The Council of Economic Advisors report. The elasticity of wages with respect to state corporate income tax rates is estimated by Felix (2009), such that each 1 percentage point reduction in the Corporation Business Tax Rate would be projected to increase average wages by 0.14 to 0.36%.[24] That would imply an increase in personal income of 1.61 to 4.14% from elimination of the Corporation Business Tax. Taking a midpoint approach would imply an increase in New Jersey personal income of 2.875%. We would expect Gross Income Tax receipts to immediately rise by the same amount, meaning an increase of $575 million.

We view these numbers as conservative for several reasons. First, as Felix's research also showed: (1) the negative impact of higher corporate tax rates on wages has increased over time, and (2) the negative impact is greater in populations with higher education levels, meaning wages would increase more for higher income earners (who are subject to higher Gross Income Tax rates).[25] Second, New Jersey's policy makeup is so anti-growth that the elimination of the CBT would represent a sea change in outlook, in addition to making it vastly more competitive than any of the states in the region. As a result, we would anticipate even stronger capital investment, job growth, and wage growth than the midpoint of the Felix historical estimates and that instead the wage impact would be on the order of the -0.52% per 1 percentage point increase in corporate income tax rate observed from 1992 to 2005. This would imply a personal income increase of 5.98% and a Gross Income Tax revenue increase of $1.195 billion. We would anticipate an indirect impact on the sales tax along the same percentage terms, implying an additional revenue increase of $748 million. Third, there is a large difference between a tax cut, which the academic research models, and complete elimination of a tax, which features all of the benefits to businesses and to government of no longer needing to devote resources towards the accounting, avoidance, auditing, and collection of a tax.

Conclusion

The central purpose of this study is to provide background and analysis on the economic impact of the Corporation Business Tax in New Jersey and to suggest opportunities for reform that would enhance New Jersey's economic growth and competitive position. As the State enters the 2024 budget process, this detrimental tax is a principal concern—the existing 2.5% surtax is set to expire at the end of 2023, and whether it will be renewed or allowed to expire is sure to spark debate in the legislature. In 2023, New Jersey will have the nation's highest corporate income tax by a full 1.7 percent-

24 R. Alison Felix, "Do State Corporate Income Taxes Reduce Wages", *Federal Reserve Bank of Kansas City Economic Review*, Second Quarter 2009. https://www.kansascityfed.org/documents/1393/2009-Do%20State%20Corporate%20Income%20Taxes%20Reduce%20Wages%3F.pdf

25 Ibid.

age points. Among its regional neighbors, New Jersey's 2023 corporate tax rate will be the highest by a full 2.5 percentage points, putting New Jersey at a distinct disadvantage in attractiveness for business establishment and retention. New Jersey's shift to single sales factor apportionment, elimination of the throwout rule, and the adoption of market-based sourcing and combined reporting are moves in the right direction, but these positive changes are of minor benefit within the larger context of this economic growth-stifling tax.

Based on this study's findings, reduction of the CBT over time is the best option for New Jersey's economic growth prospects. Comparison of the economic performance of the eight states with the highest and lowest corporate income tax rates provides crucial insight into the consequences of excessive taxation on corporations. Across all five economic performance metrics examined in Figure 6 of this study, states with lower corporate income tax rates drastically outperform those with the highest rates. Moreover, the contrast in population and output growth shows that New Jersey is falling behind the rest of the nation. The Ordinary Least Squares (OLS) regression model presented in this study solidifies our position for the elimination of the CBT in New Jersey. Based on the results of this model, there is a clear negative correlation between tax burden and GSP growth. Specifically, approximately 33% of the variation in GSP is explained by the tax burden.

Conceptually, there are several reasons for full and immediate elimination of the CBT in New Jersey. First, it is costly for taxpayers, businesses, and government by increasing compliance costs associated with state tax collection. Moreover, corporations are forward-looking and devote significant resources to tax planning. As a result, they often find ways to make some of their income non-taxable. In addition to finding ways to avoid taxes, corporations take advantage of tax incentives that the government doles out at great cost to other taxpayers. These programs narrow the tax base and increase tax burden. In New Jersey, these tax incentives amount to $1.2 billion in annual revenue impact.

The bottom line is clear: New Jersey's tax code needs extensive reform, namely by creating a more equitable system that attracts and retains businesses and prioritizes economic growth. Each year New Jersey lawmakers wait; the economic hole gets deeper.

Appendices

Appendix 1

In the large corporate income tax literature, a predominant view is that a high or raised corporate tax has two important negative effects on the economy. The first is that the higher the tax, the lower total employment. The second, more subtle but nearly as important, is that the higher the tax, the more enterprises move out of the corporate form of organization into alternatives, including personal companies subject to individual income tax rates.

The dean of the tax literature, Joel Slemrod of the University of Michigan, proposed such a problem in research from the 1990s, writing of his findings from four decades that "an increase in corporate tax rates relative to personal rates resulted in an increase in reported personal income and a drop in corporate income…The possibility of such income shifting has many implications."[26]

Austan Goolsbee (President Obama's chair of the Council of Economic Advisers) explored these implications in the 2000s, discovering that enterprises organized themselves differently given different levels of corporate tax rates. As he wrote in 2002, "If an increase in reported personal income following a tax cut simply represents a shift of taxable income from the corporate to the personal tax base, then corporate tax revenue and perhaps even total tax revenue will have fallen as a result of this behavioral response." He cautioned that evidence of high corporate tax rates "suggests a larger DWL" (deadweight loss) that might otherwise be supposed, because of the economic inefficiency of firms opting for a form of organization preponderantly for tax reasons.[27]

This argument has become standard across the literature. As scholars writing recently in the *American Economic Journal: Macroeconomics* put it: "A reduction in the corporate income tax rate leads to moderate job growth….The corporate income tax distorts firm-entry decisions and generates dispersion in marginal returns across existing firms…." The particular research noted that areas with high corporate tax rates, forcing an increase in sole proprietorships, will restrict capital allocations to the firms that made the switch. C-corp firms have greater and deeper access to capital than individuals. "The corporate income tax can cause inefficiency by leaving some marginal-return-to-capital firms without sufficient access to capital."[28]

26 Gordon, Roger H., and Joel Slemrod, "Are 'Real' Responses to Taxes Simply Income Shifting Between Corporate and Personal Tax Bases?" NBER working paper 6576 (May 1998), 2, 4.

27 Austan Goolsbee, "The Impact and Inefficiency of the Corporate Income Tax: Evidence From State Organizational Form Data, NBER working paper 9191 (Sept. 2002), 17.

28 Chen, Daphne, et al., "Corporate Income Tax, Legal Form of Organization, and Employment," *American Economic Journal: Macroeconomics* 10, no. 4 (2018), 271, 302.

Appendix 2

A Thorough Examination of the New Jersey Corporate Tax System

New Jersey's Rate Structure

New Jersey is amongst the minority of states that taxes corporate income via a graduated rate structure, using multiple tax brackets that face higher tax rates as corporate income increases (Table 4). Economically, this is an indefensible choice. A single rate structure is more neutral, as each firm faces the same tax rate with no distortions around bracket breakpoints. Additionally, unlike in personal income taxes where there are arguments about redistribution and/or ability to pay, such concepts do not exist at the corporate level – the income level of a corporation is disconnected from the income levels of its owners, meaning there are no theoretical policy arguments in favor of a graduated rate structure.

TABLE 4. NEW JERSEY CORPORATION BUSINESS TAX BRACKETS AND RATES

Entire Net Income	Tax Rate
$0 to $50,000	6.50%
$50,000 to $100,000	7.50%
$100,000 to $1 million	9.00%
$1 million[29] and above	11.50%

Beyond the graduated rate structure, there are two additional aspects of the rate structure in New Jersey. First, the tax brackets are set based on Entire Net Income, rather than Allocated Net Income. Thus, companies are immediately penalized for all of the business they do outside of New Jersey, rather than the tax focusing on business activity taking place within the State. Second, the tax brackets are not indexed to inflation. Accordingly, some companies face unlegislated tax increases on their real income when their nominal income increases above the next tax bracket threshold on account of inflation. Moreover, New Jersey is the one of the only states that engages in rate recapture – rather than only marginal income being taxed at the higher tax rate as a corporation reaches the next tax bracket, all income back to dollar one is taxed at the higher rate. Such a structure creates economic distortion, as there are incredibly high marginal tax rates around the bracket breakpoints. This structure can be confusing for taxpayers both in general and even more so given this policy is so rare.

As such, New Jersey's rate structure compounds the negative effects of the high rates and discourages corporate growth- especially on the margins..

Apportionment Approach

Unlike the personal income tax, where it is relatively simple to determine in which state(s) the vast majority of taxpayers need to file a tax return, many corporations have a presence in multiple states. Different states have different technical approaches for determining whether a company indeed has "nexus" in the state and is required to file a tax return.[30] For all states, these considerations are based upon the corporation having sufficient connection to that state. Once a company has nexus in

29 While the statutory tax brackets are permanent and apply to Entire Net Income, the surtax of 2.5% only applies to those corporations with allocated taxable net income over $1 million.

30 For New Jersey's guidance, see: "Nexus for Corporation Business Tax", New Jersey Division of Taxation, Technical Bulletin 79(R), August 13, 2015. https://www.state.nj.us/treasury/taxation/pdf/pubs/tb/tb79r.pdf

multiple states, the question becomes how to allocate taxable income, and thus tax liability, amongst those states to prevent the same income from being taxed by multiple states.

Historically, most states followed a 3-factor apportionment model, weighting equally the percentage of a corporation's property, employees, and sales in that state in determining the fraction of the corporation's total income to tax. For example, a company with ¼ of its property, ½ of its employees, and no sales in a state would allocate its income as follows under this model: (1/4 + 1/2 +0) / 3 = 25%.

Over time, many states have shifted to putting more weight on the sales factor, removing a disincentive for companies to increase their investment in property or employees in the state. As many companies make sales both nationally and internationally, tax reform placing greater weight on the location of sales often serves to lower the tax liability of those companies most heavily invested in plant, property, and employees within the state.

New Jersey is amongst the majority of states that now apportions taxable income based solely on the percentage of sales within the state. We believe this is the right policy choice, as it does not penalize a company for investing in capital and employees in New Jersey.

Throwout and Throwback Rules

Regardless of the apportionment formula used by a state, if a company makes sales into a state in which there is no corporate income tax or the company has no nexus, that income (often called "nowhere income") would be untaxed by any state absent a rule to the contrary. Toward that end, some states have adopted rules allowing the taxation of profits earned by companies making sales in jurisdictions where they face no corporate tax.

There are two main forms of such rules that states have employed. Under a throwback rule, nowhere income sales are allocated to the state from which they originated- In this case, a New Jersey firm selling into a state where the company is not subject to corporate business tax would include such profits in allocable income facing New Jersey CBT, thus increasing the numerator in the apportionment fraction. Under a throwout rule, profits derived from nowhere income are not included in the denominator used to calculate the firm's share of total profits allocated to the state. In this scenario, the percentage of income allocable to New Jersey would be increased due to the smaller denominator. In either type of rule, the amount of income allocated to New Jersey would increase.

States are approximately evenly split between having or not having a throwout or throwback rule. New Jersey previously maintained a throwout rule, but has since eliminated it, which we believe is the correct policy, as such rules add complexity to the tax code. Additionally, they can lead to incredibly high marginal tax rates on the establishment of nexus within a state. Indeed, some research has found throwout rules to be amongst the most powerful negative incentives on the location of capital investment.[31]

Market-Based Sourcing

For the apportionment of income from the provision of services (as opposed to the sale of goods), there are also several approaches. Historically, most states apportioned the income to the state where the majority of income producing activity occurred. While many states still follow such a practice,

31 See, for instance: Gupta, Sanjya and Mary Ann Hofmann. "The Effect of State Income Tax Apportionment and Tax Incentives on New Capital Expenditures," Journal of the American Taxation Association 25, Supplement 2003 (May 2003): 1–25.

others have shifted to a benefit-based approach, apportioning the income to the state where the benefit of the service is received. New Jersey now follows the latter approach, known as market-based sourcing, which is particularly prevalent amongst states that use single sales factor apportionment as New Jersey does. Indeed, market-based sourcing mirrors the single sales factor approach, apportioning service-based income to the location of the purchaser rather than the location of the people supplying the service, just as single sales factor apportions income based solely upon the location of the sale.

The cost-of-performance method of apportioning service revenue can place local businesses at a disadvantage relative to their out-of-state competitors by requiring sales of services to customers outside of New Jersey to be sourced all or in part to New Jersey for tax purposes if the services were performed in New Jersey. In particular, the cost-of-performance method can lead to double taxation on New Jersey businesses in the event that work is performed in New Jersey but for the benefit of an entity in a state that uses market-based sourcing. Accordingly, New Jersey's recent change to market-based sourcing is a positive change, as it significantly alleviated this potential for double-taxation.

From an apportionment standpoint, New Jersey's CBT is in good standing following the shift to single sales factor, elimination of the throwout rule, and adoption of market-based sourcing.

Tax Base

In addition to apportionment rules defining what portion of a company's income is sourced to New Jersey, there are other portions of the corporate tax code which serve to define the Corporation Business Tax base - that is, the income that is subject to taxation. Here, we focus on several of the most material provisions. In each case, we focus on the provision in isolation, though in the general context of fairness and economic efficiency:

1. Conformity with the federal tax code
2. The extent of tax credits and other tax expenditures that reduce the tax base
3. Combined reporting for business groups of related entities
4. The treatment of net operating losses
5. The presence of a state-level alternative minimum tax
6. The deductibility of taxes paid to foreign jurisdictions
7. Provisions around expensing/depreciation of capital investment
8. State-level GILTI (global intangible low-taxed income) provisions

1. Conformity with the federal tax code

Within the array of tax provisions, there are a variety of areas in the calculation of the tax base and taxable income in which states can choose to conform to the federal definitions or apply their own provisions. Conformity to the federal provisions reduces complexity in tax filing for corporations in the state. Like most states, New Jersey uses federal taxable income as the starting point for calculating entire net income, which is a positive.[32] However, New Jersey follows a process known as "selective conformity", meaning the State must proactively incorporate federal provisions on an individual basis via the legislative (or, when possible, regulatory) process. We would prefer to see "rolling conformity", by which the State would automatically conform with the federal tax code other than in instances in which the State would affirmatively decouple via legislation or regulation.

2. Reduction of tax base due to tax credits and other expenditures

New Jersey unfortunately engages in all manner of tax credits, incentives, exemptions, and exclusions at great cost to total CBT collections and questionable economic benefit. The Division of Taxation provides several separate lists of available CBT tax credits, incentives and expenditures - a web listing of tax credits and incentives, with a summary of the relevant statute(s)[33], the annual Tax Expenditure Report[34], and the instructions for the CBT tax return.[35] A combined listing of available tax credits, incentives, exclusions, and other expenditures is as follows:

TABLE 5. NEW JERSEY DIVISION OF TAXATION DISCLOSED CORPORATION BUSINESS TAX EXPENDITURES

Expenditure	2023 Estimate	Special Considerations
AMA Tax Credit	$3,215,000	Non-refundable, unlimited carryforwards
Angel Investor Tax Credit		Refundable or 15-yr Carryforward
Apprenticeship Program Tax Credit		Non-refundable, no carryforwards
Brownfield Site Tax Credit		
Business Employment Incentive Program Grant/Credit	$105,943,000	Refundable[1]
Business Retention and Relocation Assistance Act	$6,849,000	Non-refundable, 1-yr carryforward
CBT and Insurance Premiums Tax Credits Transfer Program[2]		
CBT Tax Benefit Certificate Transfer Program[3]		
Economic Recovery Tax Credit	$0	Refundable under certain criteria
Economic Redevelopment and Growth Program (ERG)	$66,414,000	No new applications
Effluent Equipment Tax Credit	$0	Non-refundable, carryforward
Environmental Opportunity Zones		Property tax exemption
Film and Digital Media Tax Credit		Non-refundable, carryforward
Film Production Tax Credit	$100,000,000	Non-refundable, 7-yr carryforward
Grow New Jersey Assistance Tax Credit	$413,399,000	No new applications; Non-refundable, 20-yr carryforward
Health Enterprise Zones Tax Deduction		
HMO Assistance Fund Tax Credit	$0	Non-refundable
Manufacturing Equipment and Employment Investment Tax Credit	$10,714,000	Non-refundable, 7-yr carryforward
Neighborhood Revitalization State Tax Credit	$4,468,000	Non-refundable, no carryforwards
Net Operating Loss Carryforward		20-yr carryforward
New Jobs Investment Tax Credit	$6,413,000	Refundable under certain criteria, no carryforward

32 N.J. Admin. Code § 18:7-5.2, https://regulations.justia.com/states/new-jersey/title-18/chapter-7/subchapter-5/.

33 New Jersey Division of Taxation, "Corporation Business Tax Credits and Incentives." https://www.state.nj.us/treasury/taxation/cbt-creditlist.shtml.

34 New Jersey Division of Taxation, "Tax Expenditure Report: Fiscal Year 2023." https://www.state.nj.us/treasury/taxation/pdf/taxexpenditurereport2022.pdf.

35 New Jersey Division of Taxation, "Instructions for Corporation Business Tax Return." https://www.nj.gov/treasury/taxation/pdf/current/cbt/cbt100ins.pdf.

Expenditure	2023 Estimate	Special Considerations
Offshore Wind Energy Facility Tax Credit		Non-refundable, carryforward
Pass-Through Business Alternative Income Tax Credit[4]		Non-refundable, 20-yr carryforward
Personal Protective Equipment Manufacturing Tax Credit		Refundable
Public Infrastructure Tax Credit		Non-refundable, no carryforwards
Redevelopment Authority Project Tax Credit	$0	Non-refundable
Recycling Equipment Tax Credit		
Remediation Credit	$0	No new applications; Non-refundable - 5-yr carryforward
Research and Development Tax Credit	$367,768,000	Non-refundable; 7-yr or 15-yr carryforward
Residential Economic Redevelopment and Growth Program (ERG)		No new applications; Non-refundable, 20-yr carryforward
Small New Jersey Based High Technology Business Investment Tax Credit[5]		Non-refundable, 15-yr carryforward
Sheltered Workshop Tax Credit	$0	Non-refundable, 7-yr carryforward
Tax Credit for Employers of Employees with Impairments		Non-refundable, no carryforwards
Tax Credit for Employer of Organ/Bone Marrow Donor		Non-refundable, no carryforwards
Tiered Subsidiary Dividend Pyramid Tax Credit		Non-refundable, no carryforwards
Urban Enterprise Zone Employee Tax Credit	$0	
Urban Enterprise Zone Investment Tax Credit	$0	Non-refundable, certain carryforwards
UEZ-Impacted Business District		Sales tax exemption
Urban Transit Hub Tax Credit	$95,988,000	Phased-out; Non-refundable, 20-year carry forward
	$1,181,171,000	

Source: New Jersey Department of the Treasury: Division of Taxation

1 - previously a grant program but corporations given non-revocable opportunity to change grant to a refundable tax credit

2 - allows emerging tech or biotech companies to transfer unused R&D tax credits or NOL carryforwards for at least 80% of the amount of the surrendered tax benefit

3 - allows the transfer of unused CBT or insurance premiums tax credits for at least 75% of the amount of the surrendered tax benefit

4 - related to SALT cap workaround for pass-through entities

5 - replaced and expanded by Angel Investor Tax Credit

As detailed above, tax credits amount to almost $1.2 billion in revenue impact. CBT revenues are reduced by 20% to pass favor to certain companies rather than making a stronger and fairer tax structure. That revenue loss is more money than the State receives from Realty Transfer Fees and the Transfer Inheritance Tax combined[36]. It is more than the State spends on the Department of Health.

It should be noted that some of the tax credits listed on the Division of Taxation webpage are no longer active or do not apply to CBT. Others remain in existence but have no revenue estimate associated with them. While it is admirable to let certain programs lapse, the sheer number of programs listed here – not to mention the fact that even the Division of Taxation, which administers and oversees tax compliance with the CBT, cannot keep track of them all on its public-facing website – reinforces that tax incentives have been taken to the extreme in New Jersey as a way of compensating for a poorly structured general corporate tax regime. Even more striking is that there are still newer programs enacted in 2021 as part of the Economic Recovery Act of 2020 (ERA) that do not show up on either Division of Taxation report, but are disclosed in the State's Official Statement: [37]

36 New Jersey Transportation Trust Fund Authority, "Updated Official Statement", April 20, 2022, Appendix I. https://emma.msrb.org/P21566734-P11160434-P21631217.pdf

37 ibid.

TABLE 6. SUMMARY OF NJ ERA TAX CREDIT PROGRAMS[38]

($ MILLIONS)

Program	Annual Cap	Total Cap	Fiscal Year 2023
Historic Property Reinvestment Act	$50	$300	$0
Brownfield Redevelopment Incentive Program Act	50	300	0
New Jersey Innovation Evergreen Act	60	360	60
Food Desert Relief Act	40	240	40
Community Anchored Development Act	200	1,200	0
New Jersey Aspire (Non-Transformative) + Emerge	1,100	6,600	0
New Jersey Aspire (Transformative) + Emerge	0	2,500	0
Total New NJ ERA Programs	$1,500	$11,500	$100
Source: State of New Jersey			

The ERA was designed to provide new incentive programs, while the ongoing costs in Table 5represent the current budget impact of incentives already granted under legacy programs. The amount of additional complexity created by these overlapping programs with varying qualifying factors, testing dynamics, and statutory effects on CBT (i.e., differing rules across refundability, number of years over which realized, carryforwards, etc.) creates inefficiency and complexity both for corporations and the State. The New Jersey Economic Development Authority, which oversees all these programs, has an annual operating budget of over $70 million.[39] And that number almost certainly pales in comparison to the amount that corporations spend on internal and external legal and accounting resources to ensure their compliance with the program statutes, regulations, and eligibility requirements.

As the ERA allocates the total cap of tax credits over six years, between past programs and new programs, New Jersey is allocating approximately $2.8 billion annually to CBT tax expenditures (whether in the form of a current appropriation, current revenue loss, or assumed tax credit debt) at least as long as the State works its way through its legacy programs. This is an enormous amount by any standard, particularly as compared to the $5.0 billion in CBT tax revenues anticipated in the FY2023 budget. And of course, because of the various transfers statutes that allow companies without tax liability to transfer their tax credits for 75% to 80% of the surrendered tax benefit, the programs are far more inefficient at delivering their espoused goals than even the pedestrian results economic research suggests for the average program. The transfer programs actually act as backdoor subsidies to the largest corporate business taxpayers – yet another implicit admission that the CBT needs dramatic reform. New Jersey's tax incentive programs need to be reined in as part of any serious Corporation Business Tax reform effort.

3. Combined reporting

New Jersey is one of several states that in recent years has moved to require members of unitary business groups to file combined reports of corporate income tax. Separate reporting can fail to accurately measure the income of a unitary business (i.e., the totality of an integrated business viewed

38 While for the most part these tax credits are subject to the annual maximum amount of tax credits that can be awarded, the tax credits will be earned following completion of the project and then the credit will be issued to the recipient over a period of years. Accordingly, the annual revenue impact will not match the annual awards and will have a longer tail.

39 "New Jersey Economic Development Authority, Financial Statements and Required Supplementary Information, Year Ended December 31, 2020", https://www.njeda.com/wp-content/uploads/2022/01/FINAL-NJEDA-Audited-Financials-123120.pdf

as one holistic unit rather than a group of independent components) that is properly apportionable to individual states for tax purposes. This dynamic is because, in the case of interstate or international businesses, opportunities exist to shift taxable income to lower tax jurisdictions via a wide array of complex corporate structures, thus reducing New Jersey tax liability. While such shifting of income is understandable and efficient for the corporation, from an individual state's standpoint, mandatory combined reporting allocates the income more appropriately based on economic activity. By shifting to combined reporting, as over half the states with corporate income taxes have done, New Jersey served to broaden the tax base, eliminating many of the more challenging (and time consuming) taxation issues (such as non-arm's length transactions between affiliated companies), as well as many tax minimization strategies utilized by large corporations. Meanwhile, intrastate businesses see minimal change to tax liability. In isolation, we believe mandatory combined reporting is the proper path in terms of broadening the tax base and most accurately and appropriately allocating tax liability. However, broadening the tax base should go in concert with lowering the tax rate, which is the opposite of what has occurred in New Jersey.

4.The Treatment of net operating losses

Corporate profits are inherently volatile, varying both on a macro basis over the course of a business cycle and on a micro basis over the life cycle of a firm. A standalone tax on corporate profits, however, could serve to levy large taxes on a firm during its best years and no taxes during loss years, leading the firm to face an effective tax rate much higher than the statutory rate over an extended period of time.

In order to prevent firms from facing uneven tax rates over time – and to prevent firms in cyclical industries from facing higher average effective tax rates than those in more stable industries – the federal government and many states have established a tax deduction for net operating losses (NOLs). There can be both net operating loss carryforwards, which allow a company to maintain an NOL schedule that can be used to reduce taxable income in future years, and carrybacks, which allow a company with a net operating loss in the current year to amend prior year tax returns and utilize the NOL to reduce taxable income in those prior years.

For privilege periods beginning after June 30, 2009, New Jersey allows for NOLs to be carried forward on an unlimited basis for 20 years. While the Tax Cuts and Jobs Act of 2017 allows for NOLs to be carried forward indefinitely – and ideally we would like to see conformity between the New Jersey tax code and federal tax code in order to limit complexity for corporations – on a net present value basis, the difference between infinite carryforwards and 20 years of carryforwards is not overly material.

Currently, there is no provision for federal carryback of NOLs for most taxpayers for tax years after 2020.[40] New Jersey also does not have a provision for NOL carrybacks. At a minimum, we would prefer to see statutory conformity with the federal provisions such that if the federal tax code is updated in future years to allow NOL carrybacks, corporations will have that same ability on their New Jersey CBT return.

5. The presence of a state-level alternative minimum tax

Both the federal government and many states have developed an alternative minimum tax (AMT), a second system by which corporations must calculate their tax liability in addition to the statutory

40 Internal Revenue Service, "Net operating losses." https://www.irs.gov/newsroom/net-operating-losses.

rate and bracket schedule. The impetus of imposition of an AMT is to ensure that all companies pay some minimum level of tax if they have sufficient business activity but do not show statutory tax liability. In practice, the added complexity of such a system tends to overwhelm any other desired outcomes around efficiency or fairness.[41]

The federal alternative minimum tax was eliminated as part of the Tax Cuts and Jobs Act. Many states previously had a state-level alternative minimum tax that piggybacked upon the federal AMT provisions but repealed those statutes following the elimination of federal AMT. Several states, however, maintain their own alternative minimum tax structure akin to the former federal AMT.[42] As alternative tax structures go, this is the most damaging, with corporations needing to comply with a separate tax system that removes many of the provisions within the tax code designed to improve neutrality. Another set of states levies a franchise or capital stock tax either in addition to or as an alternative calculation measure to an income tax.[43] Such taxes serve to discourage continued capital investment in a state and instead incentivize capital be moved out of state or returned to shareholders. Yet another group of states runs an alternative tax calculation based upon gross receipts, requiring the corporation to pay whichever calculated tax liability is higher.

In New Jersey, there is an alternative minimum tax assessed based upon gross receipts (Table 7). While the presence of an alternative minimum tax is already a negative, New Jersey also applies the alternative minimum tax to S-corporations, where the income is intended to pass-through to the individual income tax return, creating an additional complication in the tax code.

TABLE 7. NEW JERSEY CORPORATION BUSINESS TAX – GROSS RECEIPTS MINIMUM TAX SCHEDULE

Gross Receipts*	C-Corp Tax Liability	S-Corp Tax Liability
$100,000 or less	$500	$375
$100,000 to $250,000	$750	$562.50
$250,000 to $500,000	$1,000	$750
$500,000 to $1,000,000	$1,500	$1,125
$1,000,000 or more	$2,000	$1,500
*Provided that for a taxpayer that is a member of an affiliated or controlled group which has a total payroll of $5 million or more for the return period, minimum tax shall be $2,000.		
Source: New Jersey Department of the Treasury: Division of Taxation		

Around 80% of tax filers pay according to the Gross receipts minimum tax rather than the Schedule tax, however the largest taxpayers pay the Schedule tax, causing almost the entirety of CBT revenues to be via the Schedule tax rather than the Gross receipts minimum tax (Table 8).[44]

41 Chorvat, Terrence R. and Michael S. Knoll. "The Economic and Policy Implications of Repealing the Corporate Alternative Tax," Tax Foundation (Feb. 1, 2002).

42 Janelle Fritts, "Does Your State Have a Corporate Alternative Minimum Tax (AMT)?", Tax Foundation, August 11, 2021. https://taxfoundation.org/state-corporate-alternative-minimum-tax/

43 Janelle Fritts, "Does Your State Levy a Capital Stock Tax?", Tax Foundation, March 24, 2021. https://taxfoundation.org/state-capital-stock-tax-2021/

44 The table also has a line for "Alternative minimum assessment" (AMA), an additional minimum tax structure designed primarily for P.L. 86-272 entities, businesses that only sell tangible products indirectly within the state. The New Jersey State Tax Court found that the AMA violates federal law, so the AMA has since been repealed. Repeal is a positive in that it reduces tax code complexity in New Jersey. For more on the Tax Court findings, see Robert Willens, "New Jersey Court Strikes Down Tax on Out-of-State Business", Bloomberg Tax, August 9, 2019. https://news.bloombergtax.com/daily-tax-report-state/insight-new-jersey-court-strikes-down-tax-on-out-of-state-businesses

TABLE 8. NEW JERSEY CORPORATION BUSINESS TAX – BREAKDOWN BY TYPE OF TAX PAID

	Counts	Sums ($k)		Shares		
Type of Tax Calculation	Number of Returns	Allocated Net Income	Total Taxes and Fees	Share of Returns	Share of Allocated Net Income	Share of Total Taxes and Fees
2016						
Schedule Tax	24,147	20,126,260	1,728,212	18.8%	94.5%	93.4%
Gross Receipts Minimum Tax	103,982	1,163,034	111,703	81.0%	5.5%	6.0%
Alternative Minimum Tax Assessment	273	12,597	10,082	0.2%	0.1%	0.5%
Total	128,402	21,301,891	1,849,997	100.0%	100.0%	100.0%
2017						
Schedule Tax	23,687	19,950,453	1,686,106	18.6%	94.9%	93.6%
Gross Receipts Minimum Tax	103,262	1,068,571	110,922	81.2%	5.1%	6.2%
Alternative Minimum Tax Assessment	262	2,578	4,988	0.2%	0.0%	0.3%
Total	127,211	21,021,601	1,802,016	100.0%	100.0%	100.0%
2018						
Schedule Tax	24,721	28,092,840	2,823,703	19.8%	99.4%	96.3%
Gross Receipts Minimum Tax	100,053	173,516	105,428	80.1%	0.6%	3.6%
Alternative Minimum Tax Assessment	208	1,254	3,495	0.2%	0.0%	0.1%
Total	**124,982**	**28,267,610**	**2,932,626**	**100.0%**	**100.0%**	100.0%

Source: New Jersey Department of the Treasury: Division of Taxation

Ideally, this parallel structure would be eliminated. While assessing an alternative tax based upon gross receipts does not add significant compliance hurdles, parallel systems remain inefficient, nonetheless. In addition, gross receipts taxes place dramatically different tax burdens across industries based upon factors like the number of steps in their production process, the amount of cost of goods sold, and the level of employee compensation.

6. The deductibility of taxes paid to foreign jurisdictions

One of the primary considerations in properly calibrating income tax provisions is the avoidance of double taxation. The area in which many states fail this test is in relation to income already taxed in jurisdictions outside of the United States. However, states can avoid double taxation of such income by providing a deduction for taxes paid to foreign jurisdictions.

New Jersey does not provide such deductibility and should do so to be competitive with other states regarding attracting and retaining companies with multinational presences.

7. Around expensing/depreciation of capital investment

There is a vast array of federal tax rules around the accounting treatment of business investment in certain forms of assets. Generally speaking, the treatment is somewhere on a continuum between immediate expensing (recognizing the full cost of the investment as an expense in the current tax, reducing taxable income dollar for dollar) and straight-line depreciation (recognizing that the value of the capital investment will decline over time and thus recognizing depreciation expense on an equal basis each year over the anticipated useful life of the asset). As there are different tax treatments and assumed useful lives across all manner of assets at the federal level, having different systems at the state level would be incredibly cumbersome for corporate tax planning and accounting.

New Jersey conforms to the federal schedules for depletion (essentially depreciation but for natural resources) and Accelerated Cost Recovery System (ACRS) and Modified Accelerated Cost Recovery System (MACRS) depreciation, easing the burden of tax code complexity.

The Tax Cuts and Jobs Act introduced certain provisions around immediate expensing or bonus depreciation of certain business investment in business property. Such provisions are seen as desirable both because they encourage capital investment and help better measure the true profitability of the business. Unfortunately, New Jersey does not conform to IRC section 168(k) expensing provisions.

8. State-level GILTI provisions

The Tax Cuts and Jobs Act included provisions related to Global Intangible Low Taxed Income ("GILTI"), designed to discourage multinational corporations from shifting certain assets (particularly intangible property) and the associated profits to foreign jurisdictions with tax rates below the 21% federal corporate income tax rate. Even at the federal level, the provisions around GILTI are incredibly complex, and historically states have strayed from taxing foreign income.

New Jersey, however, has decided to include GILTI in the calculation of taxable income. The State initially proposed rules that were widely seen in the tax community as both as overly complex and allocating too much income to New Jersey.[45] Since then, the Division of Taxation has revised its rules on the matter. Essentially, GILTI income will be included in the calculation of entire net income, but for allocation purposes the income can almost never be allocated to New Jersey given the use of market-based sourcing and single sales factor. Accordingly, the revised rule has been received more favorably, though either eliminating GILTI or fully conforming to federal provisions would reduce complexity for corporations.

45 Eversheds Sutherland, "Down a rabbit hole: New Jersey regulations provide guidance on GILTI and FDII apportionment," 4/22/20. https://us.eversheds-sutherland.com/NewsCommentary/Legal-Alerts/231628/Down-a-rabbit-hole-New-Jersey-regulations-provide-guidance-on-GILTI-and-FDII-apportionment.

Further Reading

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