

4. For purposes of applying (b) above to this subsection, any basic research payments shall be treated as an amount paid in carrying on a trade or business of the taxpayer in the taxable year in which it is paid (without regard to the provisions of (g)1 above).

5. The term "corporation" shall not include:

- i. An S corporation;
- ii. A personal holding company (as defined in IRC section 542); or
- iii. A service organization (as defined in IRC section 414(m)(3)).

(m) For Special Rules, see IRC section 41(f).

(n) Notwithstanding any provision in this section to the contrary, other than calculations made pursuant to (u) below, a credit can be claimed for only those research activities that are performed in New Jersey.

(o) Notwithstanding any provision in this section to the contrary, a credit for increased research activities is allowed based on qualified expenditures made in taxable years beginning on and after January 1, 1994.

(p) The filing of a consolidated tax return by a controlled group of corporations shall not be permitted.

(q) Section references are to the Internal Revenue Code, unless otherwise noted.

(r) The research credit shall be generally allowed for qualified research. Qualified research is that which is limited to scientific experimentation or engineering activities designed to aid in the development of a new or improved product, process, technique, formula, invention, or computer software program held for sale, lease, or license, or used by the taxpayer in a trade or business. For in-house research expenses, this trade or business requirement will be met if the principal purpose for conducting the research is to use the results of the research in the active conduct of a future trade or business. The research credit shall generally not be allowed for the following types of activities:

1. Research conducted after the beginning of commercial production;
2. Research adapting an existing product or process to a particular customer's need;
3. Duplication of an existing product or process;
4. Survey or studies;
5. Research relating to certain internal-use computer software;
6. Research conducted outside the State of New Jersey;

7. Research in the social sciences, arts, or humanities; or

8. Research funded by another person (or government entity.)

(See IRC Section 41 and regulations thereunder for other definitions and special rules concerning the research credit.)

(s) The research and expenditure tax credit is determined as follows:

1. First, calculate fixed-base percentage. Fixed-base percentage is the percentage which the aggregate qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983 and before January 1, 1989 is of the aggregate gross receipts of the taxpayer for such taxable years.

Example:	<u>Year</u>	<u>Qualified Research Expenses</u>	<u>Gross Receipts</u>
	1984	\$ 2,000,000	\$ 10,000,000
	1985	4,000,000	15,000,000
	1986	6,000,000	20,000,000
	1987	8,000,000	30,000,000
	1988	10,000,000	25,000,000
	Total	\$30,000,000	\$100,000,000
		<u>\$ 30,000,000</u>	
		\$100,000,000	

= 3% fixed base percentage

2. Next, compute the base amount. The base amount is the average gross receipts of the taxpayer for the four taxable years preceding the taxable year for which the credit is being determined (credit year) multiplied by the fixed base percentage.

Example:	<u>Year</u>	<u>Gross Receipts</u>
	1990	\$ 25,000,000
	1991	20,000,000
	1992	35,000,000
	1993	30,000,000
	Total	\$120,000,000
		divided by 4 =
		<u>\$ 30,000,000</u>
	Average Gross Receipts	
	Fixed Base Percentage	× 3%
	Base Amount	\$ 900,000

3. Then, compute current qualified research expenses.

	<u>Total Costs Incurred</u>	<u>Research Tax Credit Qualified Research Expenses</u>
Wages	\$ 750,000	\$ 500,000
Supplies	250,000	250,000
Depreciation	100,000	-0-
Overhead	<u>250,000</u>	<u>250,000</u>
Total	\$1,350,000	\$1,000,000

Then compute the research tax credit.

Current year qualified research expenses	\$1,000,000
Less: Base Amount	( 900,000)
Total incremental research expenses	\$ 100,000
Research tax credit %	× 10%
New Jersey research tax credit	\$ 10,000

(t) Credit for increased research activities shall take priority as specified by N.J.S.A. 54:10A-5.246. If any amount of property or expenditures is included in the calculation of the research credit, or for which a credit is allowed, then no such amounts can be allowed for the recycling credit, manufacturing and employment investment credit, and the new jobs credit.

(u) If taxpayer has research within and outside New Jersey and cannot determine the amount of New Jersey qualified research expenses for the period beginning after December 31, 1983 and before January 1, 1989, calculate the amount to be used in the numerator of the ratio to arrive at the fixed base percentage as follows: take the figure for qualified research and development expenses everywhere for the period and multiply it by the average of the average of the payroll fraction and the property fraction used on the corporation business tax returns for the corresponding years in question. This amount becomes the numerator of a fraction whose denominator is taxpayer's aggregate gross receipts everywhere for the period.

(v) Any Federal deduction under IRC Section 174 will be the same for New Jersey purposes, since there is no New Jersey provision for a separate modified state tax credit amount under such circumstances.

(w) The credit allowable in any given tax year cannot exceed 50 percent of the tax liability otherwise due on the return.

(x) The amount of the credit cannot reduce the tax liability to any amount less than the statutory minimum provided in N.J.S.A. 54:10A-5(e).

(y) The amount of the tax year credit allowable which cannot be applied for the tax year due to certain limitations may be carried over, if necessary, to the seven accounting years following a credit's tax year.

(z) Credits allowable shall be applied in the order of the credits' tax years.

New Rule, R.1995 d. 462, effective August 21, 1995.  
See: 27 N.J.R. 842(a), 27 N.J.R. 3210(a).

## SUBCHAPTER 4. ENTIRE NET WORTH

### 18:7-4.1 (Reserved)

Amended by R.1983 d.62, effective March 7, 1983.  
See: 14 N.J.R. 1206(a), 15 N.J.R. 343(d).

Added last sentence to (a). Added last sentence to (b)5.  
Amended by R.1984 d.453, effective October 15, 1984.  
See: 16 N.J.R. 1327(a), 16 N.J.R. 2827(a).

(c) added.  
Repealed by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Entire net worth; definition; computation".

### 18:7-4.2 (Reserved)

Amended by R.1979 d.45, effective February 6, 1979.  
See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Repealed by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Effect on net worth of investment in subsidiaries".

### 18:7-4.3 (Reserved)

Repealed by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Investment in subsidiaries allows proportionate reduction for calculating net worth".

### 18:7-4.4 (Reserved)

Repealed by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Net worth; right of director to independently determine".

### 18:7-4.5 Indebtedness owing directly or indirectly

(a) "Indebtedness" is not limited in scope by the duration thereof and thus includes all debts due, whether money, goods or services, including, inter alia, accruals of salaries, bonuses and dividends, as well as interest accrued on all indebtedness.

(b) "Indebtedness owing directly or indirectly" includes but is not limited to all indebtedness owing to any stockholder or shareholder and to members of his immediate family where a stockholder and members of his immediate family together or in the aggregate own or beneficially own 10 percent or more of the aggregate outstanding shares of the taxpayer's capital stock of all classes.

(c) "Immediate family" includes the collective body of persons, consisting of parents, children and other relatives, living together in one household in a permanent and domestic character under one head or management.

(d) Direct indebtedness: In the case of a creditor, corporate or otherwise (other than an individual), including an estate, trust or other entity, indebtedness is includible by reason of direct holding of taxpayer's stock by the creditor whether or not the creditor is functioning as a mere conduit of funds from a third party source.

(e) Indirect indebtedness: Indebtedness must be owing directly or indirectly to a 10 percent shareholder. Indebtedness owing by a taxpayer to a commonly controlled creditor is presumed to be owing indirectly to the common parent. However, indebtedness between commonly controlled debtors and creditors may not be attributable as owing indirectly to the common shareholder if it can be shown that the common shareholder was in no way the source of the funds. The taxpayer must establish that the common shareholder was not the source of the funds since it has the burden of defeating the presumption. The taxpayer must conclusively establish that:

1. The creditor is merely a conduit of funds from an unrelated third party source; or
2. The indebtedness was from funds generated by the creditor from its own operations and clearly not in any way attributable to or funded by the common shareholder.

Example 1: A corporation owns 100 percent of the stock of B Corporation and C Corporation, and these subsidiaries are engaged in their respective businesses. B Corporation has generated unneeded cash from its operation or has sold some of its securities to third persons (other than to the parent corporation) and the proceeds are available for loans. B Corporation then advances some of that money to C Corporation. C Corporation's indebtedness is not indirectly owed to A Corporation.

Example 2: D Corporation owns 100 percent of the stock of E Corporation and F Corporation and these subsidiaries are engaged in their respective businesses. D Corporation sold securities and advanced the proceeds to E Corporation, which in turn made loans to F Corporation. This indebtedness would be indirectly owed to D Corporation.

Example 3: G Corporation owns 100 percent of the stock of H Corporation and K Corporation and these subsidiaries are engaged in their respective businesses. G Corporation made advances to H Corporation that had also obtained funds by borrowings from non-related creditors. K Corporation borrows from H Corporation. It is presumed that K Corporation's indebtedness is indirectly owed to G Corporation. However, the presumption is not conclusive. To the extent that K Corporation can establish that its indebtedness to H Corporation is in no way funded by the advances from G Corporation to H Corporation, that indebtedness would not be owing indirectly to the parent G Corporation.

(f) For the purpose of determining the degree of stock ownership of a corporate creditor, the shares of the taxpayer's capital stock held by all corporations bearing the relationship of parent, subsidiary, or affiliate of the corporate creditor shall not be aggregated.

Example: L corporation owns 100 percent of M corporation which in turn owns 100 percent of N corporation. M corporation has a valid business purpose. L corporation made loans or otherwise provided funds directly to N corporation. The source of such funds is not from M corporation. The indebtedness from N corporation to L corporation is not indebtedness owing directly or indirectly to a 10 percent stockholder.

Amended by R.1985 d.561, effective November 4, 1985.  
See: 17 N.J.R. 1537(a), 17 N.J.R. 2677(a).

Substantially amended.

Amended by R.1987 d.118, effective March 2, 1987.  
See: 18 N.J.R. 2004(b), 19 N.J.R. 410(c).

Examples 1 and 2 added to (f).

Amended by R.1992 d.289, effective June 20, 1992.  
See: 24 N.J.R. 175(a), 24 N.J.R. 2628(b).

Revised (f).

Amended by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

#### Statutory References

N.J.S.A. 54:10A-4(d), (e).

#### Case Notes

Taxpayer was entitled to exclude from its net income calculation interest expense paid on notes. *Rollins Leasing Corp. v. Director, Div. of Taxation*, 14 N.J.Tax 289 (A.D.1994).

Indebtedness was direct, not indirect, and under Corporation Business Tax Act taxpayer had to include loan in its net worth and could not deduct interest on loan to extent prohibited by the Act. *Rollins Leasing Corp. v. Director, Div. of Taxation*, 13 N.J.Tax 359 (1993), reversed 14 N.J.Tax 289.

Corporation was not holder of taxpayer's stock, and, thus, debt owed to owner did not affect taxpayer's net worth. *Centex Homes of New Jersey, Inc. v. Director, Div. of Taxation*, 10 N.J.Tax 473 (1989), affirmed 241 N.J.Super. 16, 574 A.2d 448.

Rule governing corporate debt for net worth purposes was ultra vires. *Centex Homes of New Jersey, Inc. v. Director, Div. of Taxation*, 10 N.J.Tax 473 (1989), affirmed 241 N.J.Super. 16, 574 A.2d 448.

Division of taxation can not make inquiry to determine loan is loan or contribution to capital. *Centex Homes of New Jersey, Inc. v. Director, Div. of Taxation*, 10 N.J.Tax 473 (1989), affirmed 241 N.J.Super. 16, 574 A.2d 448.

Inquiry may be made into source of funds, for purposes of calculating net worth. *Centex Homes of New Jersey, Inc. v. Director, Div. of Taxation*, 10 N.J.Tax 473 (1989), affirmed 241 N.J.Super. 16, 574 A.2d 448.

Taxpayer corporation, which possessed 100 percent ownership of investment in French and Brazilian corporations directly and through its wholly-owned Dutch subsidiary, was entitled to 100 percent exclusions for the dividends received from the French and Brazilian corporations. *International Flavors & Fragrances, Inc. v. Taxation Div. Director*, 5 N.J.Tax 617 (Tax Ct.1983), affirmed per curiam 7 N.J.Tax 652 (App.Div.1984), affirmed 102 N.J. 210, 507 A.2d 700 (1986).

Liability owed by taxpayer to sister corporation was includable in the taxpayer's net worth for purposes of determining the amount of franchise tax, notwithstanding the fact that the indebtedness originated prior to affiliation; ninety percent of the interest on the indebtedness could not be excluded as a deduction in net worth base tax computation. *Skyline Industries, Inc. v. Taxation Div. Director*, 3 N.J.Tax 612 (Tax Ct.1981).

Liability owed by taxpayer to affiliate was not includable in the taxpayer's net worth tax base where the affiliate was a mere conduit through which indebtedness was owed and paid to unrelated real creditor third parties and where opportunities for balance sheet manipulations were minimal; ninety percent of interest paid was not disallowable for computing corporation business tax liability (also cited as N.J.A.C. 18:7-5(a)(7)). *Mobay Chemical Corp. v. Taxation Div. Director*, 3 N.J.Tax 597 (Tax Ct.1981), affirmed per curiam 6 N.J.Tax 445 (App.Div.1982).

Liability owed wholly-owned subsidiary by taxpayer which was a wholly-owned subsidiary of another corporation was includable in the taxpayer's net worth base for purposes of the franchise tax; 90 percent of the interest paid to the subsidiary by the taxpayer was not deductible (citing former rule). *Fedders Financial Corp. v. Taxation Div. Director*, 3 N.J.Tax 576 (Tax Ct.1981), affirmed per curiam 6 N.J.Tax 444 (App.Div.1982), reversed.

#### 18:7-4.6 Receivables offset against indebtedness owing directly or indirectly

(a) The taxpayer may offset against includible indebtedness owed to any creditor the amount of any receivable due from that creditor.

Example 1: P Corporation owns 100 percent of the capital stock of S Corporation. S Corporation has indebtedness owing directly or indirectly to P Corporation as well as a lesser receivable due from them. Indebtedness owing directly or indirectly to P Corporation is the amount of the indebtedness reduced by the receivable due from that creditor.

Example 2: P Corporation owns 100 percent of the capital stock of both S1 Corporation and S2 Corporation. S1 Corporation has indebtedness owing directly or indirectly to P Corporation. S1 Corporation also has a receivable due from S2 Corporation which, had it been a debt, would also have been indebtedness owing directly or indirectly to P Corporation. S1 Corporation may not offset the receivable due from S2 Corporation from its indebtedness owing directly or indirectly to P Corporation since it is not a receivable due from that creditor.

Example 3: P Corporation owns 100 percent of the capital stock of S1 Corporation. S1 Corporation owns 100 percent of the capital stock of S2 Corporation. S1 Corporation has indebtedness owing directly or indirectly to P Corporation and has a receivable due from S2 Corporation which, had it been a debt, would also have been indebtedness owing directly or indirectly to P Corporation. S1 Corporation may not offset the receivable due from S2 Corporation from its indebtedness owing directly or indirectly to P Corporation since it is not a receivable due from that creditor.

Amended by R.1987 d.118, effective March 2, 1987.  
See: 18 N.J.R. 2004(b), 19 N.J.R. 410(c).

Examples 1 through 3 added.

#### 18:7-4.7 Governmental obligations and securities

In the determination of net income, interest and other income from governmental obligations and securities are includible.

Amended by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

##### Statutory References

See N.J.S.A. 54:10A-4(k)(2)(B) as to interest and income from securities includible in determination of net income.

#### 18:7-4.8 (Reserved)

Repealed by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Treasury stock; when includible in net worth".

#### 18:7-4.9 (Reserved)

Repealed by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Treasury stock; certified rider required".

#### 18:7-4.10 (Reserved)

Amended by R.1983 d.62, effective March 7, 1983.  
See: 14 N.J.R. 1206(a), 15 N.J.R. 343(d).

Changed "total" to "the average value of" real and tangible personal property. Added real estate investment trust. Added 3, to (b). Repealed by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Total property base; alternate method of computing net worth tax".

#### 18:7-4.11 Subsidiary corporations; definition

(a) A subsidiary is defined as any corporation in which the taxpayer is the owner of:

1. At least 80 percent of the total combined voting power of all classes of stock of the subsidiary entitled to vote; and
2. At least 80 percent of the total number of shares of all other classes of stock except nonvoting stock which is limited and preferred as to dividends.
3. The investment shall be determined only with reference to investment in capital stock and shall exclude any loans or advances to any such subsidiaries.

(b) An entity organized under the laws of a foreign country shall be considered a subsidiary if the foregoing requisite degree of ownership is met and if the entity is considered a corporation for any purpose under the United States Federal income tax laws, such as (but not by way of sole examples) for the purpose of supplying deemed-paid foreign tax credits or purpose of status as a controlled foreign corporation.

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Amended by R.1985 d.561, effective November 4, 1985.

See: 17 N.J.R. 1537(b), 17 N.J.R. 2677(b).

Substantially amended.

Amended by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

##### Statutory References

See N.J.S.A. 54:10A-9 as to definition of a "subsidiary."

#### 18:7-4.12 (Reserved)

Amended by R.1970 d.121, effective October 5, 1970.

See: 2 N.J.R. 78(a), 2 N.J.R. 95(a).

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Repealed by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Subsidiary deductions from net worth".

#### 18:7-4.13 (Reserved)

Repealed by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Effect of short tax table on subsidiary deductions".

#### 18:7-4.14 (Reserved)

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Repealed by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Parent must report book value of subsidiary corporation".

**18:7-4.15 (Reserved)**

Repealed by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Consolidated returns for subsidiary corporations".

**Case Notes**

Taxpayer corporation, which possessed 100 percent ownership of investment in French and Brazilian corporations directly and through its wholly-owned Dutch subsidiary, was entitled to 100 percent exclusions for the dividends received from the French and Brazilian corporations. *International Flavors & Fragrances, Inc. v. Taxation Div. Director*, 5 N.J.Tax 617 (Tax Ct.1983), affirmed per curiam 7 N.J.Tax 652 (App.Div.1984), affirmed 102 N.J. 210, 507 A.2d (1986).

**18:7-4.16 (Reserved)**

Repealed by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Valuation of securities".

**18:7-4.17 (Reserved)**

New Rule, R.1984 d.496, effective November 5, 1984.

See: 16 N.J.R. 1325(a), 16 N.J.R. 3057(a).

Repealed by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

Section was "Urban enterprise zones".

**18:7-4.18 (Reserved)**

## SUBCHAPTER 5. ENTIRE NET INCOME; DEFINITION, COMPONENTS AND RULES FOR COMPUTING

**18:7-5.1 Entire net income; definition**

(a) "Entire net income" means total net income from all sources, whether within or without the United States, and includes:

1. The gain derived from the employment of capital or labor, or from both combined, as well as
2. Profit gained through a sale or conversion of capital assets.

(b) For the purpose of the New Jersey tax, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its Federal income tax, subject to the adjustments set forth in this Subchapter.

(c) Consistent with N.J.A.C. 18:7-11.15, entire net income shall be determined on a separate entity basis as if the contemporaneous Federal return had not been a consolidated return.

Example 1: Corporation A is part of a consolidated group filing for Federal purposes which as a group in-

curred a net operating loss for the year. Corporation A, however, on a separate entity basis had net income of \$100,000 before its charitable contribution expense of \$15,000 is taken into account. Based on a separate, non-consolidated calculation under the Internal Revenue Code, and the contribution limitations applicable to all corporations for the period under review (that is, 10 percent), Corporation A's reportable net income for New Jersey purposes is \$90,000 (\$100,000 - (\$100,000 × .10)).

Example 2: Corporation B is part of a consolidated group filing for Federal purposes which sold goods in the ordinary course of business to Corporation C, also a member of the same consolidated group filing. The selling price between Corporation B and C was at arm's length and included a profit element in it. The Federal corporate consolidated filing would recognize but defer the gain on the sale of the goods between Corporation B and C since Corporation C had not disposed of the property outside the group at year end. For New Jersey purposes, however, Corporation B must report the gain on the sale of the property for net income purposes, and Corporation C must include the full sales price of the property in its inventory value.

(d) Entire net income shall be determined as if no election had been made under 26 U.S.C. 1371 (Subchapter S of the Federal Internal Revenue Code).

Amended by R.1985 d.562, effective November 4, 1985.

See: 17 N.J.R. 1538(a), 17 N.J.R. 2678(a).

(c) added.

Amended by R.1992 d.231, effective June 1, 1992.

See: 24 N.J.R. 1522(a), 24 N.J.R. 2074(c).

Added examples to (c); deleted (e).

**Statutory References**

See N.J.S.A. 54:10A-4(k) as to definition and scope of "entire net income."

**Case Notes**

Regulations were valid. *General Bldg. Products Corp. v. State, Div. of Taxation*, 14 N.J.Tax 232 (1994).

State's prohibition against filing of consolidated income tax returns by related corporations does not immunize subsidiary corporation from state taxation of any gain realized as result of deemed sale of its assets. *General Bldg. Products Corp. v. State, Div. of Taxation*, 14 N.J.Tax 232 (1994).

New York S corporation's distribution to New Jersey taxpayer would be treated as being from corporation's accumulated earnings. *Laurite v. Director, Div. of Taxation*, 12 N.J.Tax 483 (1992), affirmed 14 N.J.Tax 166, certification denied 135 N.J. 301, 639 A.2d 301.

Absent showing that S corporation's income was from current earnings it would be assumed that distribution was from accumulated earnings. *Laurite v. Director, Div. of Taxation*, 12 N.J.Tax 483 (1992), affirmed 14 N.J.Tax 166, certification denied 135 N.J. 301, 639 A.2d 301.

**18:7-5.2 Entire net income; how computed**

(a) "Taxable income before net operating loss deduction and special deductions," hereinafter referred to as Federal taxable income, is the starting point in the computation of the entire net income. After determining Federal taxable income, it must be adjusted as follows:

1. Add to Federal taxable income:

i. The amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporations, where such specific exemption or credit has been deducted in computing Federal taxable income;

ii. All interest income from sources within the United States which has not been included in computing Federal taxable income, including interest on State and Municipal bonds and certain obligations of the United States and its instrumentalities, less interest expense incurred to carry such investments, to the extent such interest expense has not been deducted in computing Federal taxable income;

iii. All dividend income from sources within the United States which has not been included in computing Federal taxable income;

iv. All Federal taxes on or measured by income or profits which were deducted in computing Federal taxable income;

v. All New Jersey franchise taxes paid or accrued under the Corporation Business Tax Act, whether measured by net worth, net income or otherwise, to the extent such taxes were deducted in computing Federal taxable income; and, with respect to accounting years beginning after July 7, 1993, taxes paid or accrued to a possession or territory of the United States, a state, a political subdivision thereof, or the District of Columbia on or measured by profits or income, or business presence or business activity including, without limitation, the Michigan Single Business Tax and taxes measured in whole or in part by "net taxable capital" to the extent such taxes were deducted in computing Federal taxable income;

vi. Net operating losses sustained during any year or period other than that covered by the return, which were deducted in computing Federal taxable income, but a net operating loss deduction shall be allowed to the extent provided by N.J.A.C. 18:7-5.12 through 5.16.

vii. The amount deducted, in computing Federal taxable income, for interest on indebtedness whether or not evidenced by a written instrument. To be added back, such interest must be owed directly or indirectly either to an individual stockholder or members of his or her immediate family who, in the aggregate, own beneficially 10 percent or more of the taxpayer's outstanding shares of capital stock or to a corporate stockholder which owns 10 percent or more of the taxpayer's outstanding shares of capital stock. The amount deducted shall be reduced by 10 percent of the amount so deducted or \$1,000, whichever is larger. Thus, if the amount of such interest is \$1,000 or less, then none of said amount need be added back. (For definition of and guidance in determining "directly" and "indirectly" see N.J.A.C. 18:7-4.5(d), (e) and (f).) However, there shall be allowed as a deduction:

(1) Any part of a deduction for interest on written evidence of indebtedness issued, with stock, pursuant to a bona fide plan of reorganization to persons who is prior to such reorganization were bona fide creditors of the taxpayer or any predecessor corporation, but were not stockholders thereof; and

(2) Any part of a deduction for interest that relates to financing of motor vehicle inventory held for sale to customers, provided that the underlying indebtedness is owing to a taxpayer customarily and routinely providing this type of financing. The portion of such interest which may be deducted is limited to interest on indebtedness relating to floor-planning of motor vehicles evidenced by a trust receipt or similar document and is also limited to interest on unsold inventory items. The interest must be paid or accrued directly to a creditor which is a taxpayer under the act and not indirectly to any related entity. That taxpayer, or a corporation which is a parent or subsidiary of that taxpayer must be the manufacturer or the motor vehicles financed; and

(3) Any deduction for interest that relates to debt of a "financial business corporation" owed to an affiliate corporation but only where the interest rate does not exceed two percentage points over a prime rate to be determined by the Commissioner of Banking. Interest paid or accrued to such an affiliate is an unrestricted deduction only when a corporation is a financial business corporation as determined at N.J.A.C. 18:7-1.16. A debt is owed to an "affiliate" corporation when it is owing directly or indirectly to holders of ten percent or more of the aggregate outstanding shares of the taxpayer's capital stock of all classes as defined in N.J.A.C. 18:7-4.5. The deduction may not be claimed on the Corporation Business Tax Return, Form CBT-100. Any corporation which is a financial business corporation must file the Corporation Business Tax Return for Banking and Financial Corporations, Form BFC-1, and complete Schedule L apportioning the financial business conducted in New Jersey consistent with N.J.S.A. 54:10A-38; and

(4) Any part of a deduction for interest that related to debt of a banking corporation owing directly to a bank holding company as defined in 12 U.S.C. 1841 of which the banking corporation is a subsidiary. The allowable deduction for interest is limited to interest paid or accrued directly by the subsidiary to its bank holding company parent notwithstanding that related indebtedness may be excluded from net worth where it is indirectly owing to such bank holding company.

viii. Recoveries with respect to war losses, regardless of whether such war losses were deducted in any return previously made for the purpose of computing the New Jersey Corporation Business Tax;

Example: Corporation D entered into an employment agreement with its sole shareholder's spouse for the performance of services as an accounting clerk. The agreement called for the shareholder's spouse to monitor 10 accounts. For the service performed, the spouse is to receive an annual salary of \$100,000 along with a substantial benefit package. The Director, upon audit, learns that the spouse works only five hours per week in completely performing the duties. The Director, based upon the going wage for such services, determines that the total compensation package would not exceed \$10,000 a year and adjusts the taxpayer's expense to determine properly the net income and the taxpayer's wage fraction of the allocation factor and to provide dividend treatment for the disallowed wage compensation.

(d) Where any taxpayer, 20 percent or more of whose capital stock is owned either directly or indirectly by or through the same interests as those of the taxpayer, conducts any activity, transaction, or business with such interests which either directly or indirectly creates an artificial loss, net income, or allocation factor, the Director may adjust and redetermine such items on any taxpayer report or return as may be necessary properly to reflect the taxpayer's adjusted entire net income apportionable to New Jersey.

Example 1: Corporation E, the great grandparent of the taxpayer, borrows \$1 million from the taxpayer. The agreement calls for the principal and interest at the rate of two percent per annum to be paid at the end of one year. Upon audit, the Director determines that a market interest rate given the economic conditions at the time of the loan and the circumstances of the borrower is 13 percent per annum. Therefore, he adds the additional income to the taxpayer's net income as reported, and adjusts the expense on the great grandparent's return, if it files in New Jersey.

Example 2: Corporation F is the parent company of over 10 subsidiaries and provides all administrative services for the 10 subsidiaries. Corporation F receives dividend income from its subsidiaries, interest income from other investments, and service fee income from the subsidiaries for the administrative services it performs on their behalf which are an integral part of the business activity of the parent. All costs incurred by the parent are charged to the subsidiaries based solely upon the total assets of each subsidiary. Upon audit, the Director determines that the service fee includes no profit element and that the allocation of the costs of the administrative services bears no relationship to the services provided to each subsidiary. Accordingly, the Director imputes an element of profit, and assigns the charges to each subsidiary by a method reflecting the actual costs incurred in providing the services to each subsidiary.

(e) The following examples are merely illustrative and are in no way intended to limit the scope of the Director's discretion to inquire into transfer pricing or the determination of a fair and reasonable tax:

Example 1: K Corporation, the manufacturer of a proprietary product, sells goods to its distributors and wholesale customers at a 50 percent profit. It also sells goods to related foreign corporations at a 5 percent gross profit for marketing by them overseas.

On a separate entity basis, in an arm's length transaction these sales would yield a 50 percent gross profit and the price which might have been paid or received for the goods includes an amount sufficient to reflect that 50 percent gross profit.

The Director may include additional profits in entire net income sufficient to reflect the arm's length price which might have been paid or received.

Example 2: L Corporation is the parent corporation in a vertically integrated oil company. Its marketing subsidiary is a taxpayer. The marketing corporation reports a significantly lower gross profit than other taxpayers selling the same generic products in volume.

L Corporation has set its transfer prices to its marketing subsidiary at a price \$0.02 per gallon higher than published New York tanker port prices for its product because it deems, in good faith, that its brand name value and economies of scale are more properly attributable to the parent corporation. It also uses this transfer price to sell its product to all its independent retailers.

The fair price which might have been paid for the product sold by the marketing subsidiary would not be based upon "New York tanker prices" plus the lesser of representative contract carrier costs or the actual costs incurred for delivery. The Director would recognize the \$0.02 per gallon higher price since that is the same price used for comparable sales to all uncontrolled entities for the audit period.

(f) Whenever the Director deems it necessary, in order properly to reflect entire net income of the taxpayer, he or she may determine the year or period in which an item of income, deduction, asset or liability shall be included, without regard to the method of accounting used by the taxpayer.

(g) The Director may require any person or corporation to submit whatever information under oath or affirmation, or to permit whatever examination of its books, papers and documents, as may be necessary to enable him or her to determine the existence, nature or extent of an agreement, understanding or arrangement to which this section relates, whether or not the person or corporation is subject to the tax imposed by the Act.

Amended by R.1992 d.231, effective June 1, 1992.  
See: 24 N.J.R. 1522(a), 24 N.J.R. 2074(c).  
Revised section.

**Statutory References**

See N.J.S.A. 54:10A-4(k)(3) as to right of Director to determine the year in which an item of income or a deduction shall be included without regard to taxpayer's method of accounting, and 54:10A-10 as to Director's right to redetermine tax due when taxpayer's business records appear distorted.

**Case Notes**

Rule that a corporation's "net income" can be reduced by only 10 percent of the interest on indebtedness to a person or entity which owns 10 percent or more of the corporation's capital stock held applicable to corporate indebtedness owed to a corporation's parent; Division Director held without authority to recompute corporation's taxes to exclude such indebtedness from income; 10 percent rule held not violative of due process or equal protection; statutory amendments eliminating the 10 percent rule could not be applied retroactively. *GATX Terminals Corp. v. Taxation Div. Director*, 5 N.J.Tax 90 (Tax Ct.1982), affirmed in part, remanded in part per curiam 7 N.J.Tax 659 (App.Div.1985), certification denied 102 N.J. 337, 508 A.2d 213.

**18:7-5.11 (Reserved)**

New Rule, R.1978 d.30, effective January 27, 1978.  
See: 10 N.J.R. 40(b), 10 N.J.R. 128(b).  
Repealed by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).  
Section was "New jobs credit; salaries deduction".

**18:7-5.12 Net operating loss deduction**

A taxpayer may deduct a New Jersey net operating loss carryover as defined in N.J.A.C. 18:7-5.13 in computing its entire net income before exclusions and before the net operating loss deduction.

New Rule, R.1986 d.26, effective February 3, 1986.  
See: 17 N.J.R. 2096(a), 18 N.J.R. 309(a).  
Amended by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

**18:7-5.13 New Jersey net operating loss carryover**

(a) A New Jersey net operating loss as defined in N.J.A.C. 18:7-5.15 for any taxable year ending after June 30,

1984 becomes a net operating loss carryover. The net operating loss carryover is carried to each of the succeeding taxable years and is reduced in each such succeeding year by the amount of entire net income before net operating loss deduction and before exclusions, and is further reduced to zero seven years following the year of the loss, taking into account the normal or extended due date for filing the return for the seventh year succeeding the year of the loss. The net operating loss carryover may not be carried back to any year preceding the year of the loss. For this purpose, taxable year shall mean the accounting period covered by the taxpayer's return. In no event may a net operating loss carryover be used for a net operating loss deduction on the eighth return succeeding the loss year.

(b) The net operating loss may only be carried over by the actual corporation that sustained the loss. The net operating loss may, however, be carried over by the corporation that sustained the loss and which is the surviving corporation of a statutory merger. The net operating loss may not be carried over by a taxpayer that changes its state of incorporation or is a part of a statutory consolidation. Section 4(k) of the Act defines entire net income in terms of a specific corporate franchise.

(c) Corporations acquired under Internal Revenue Code Section 338 do not lose their net operating loss carryover because the corporate franchise remains unchanged to the extent it does not fall within the provisions of N.J.A.C. 18:7-5.14.

Example 1: A domestic corporation dissolves pursuant to laws of the State of New Jersey and incorporates in another state. This newly formed corporation of another state is a new legal entity for corporation business tax purposes and the net operating loss carryover of the domestic corporation is not available to the new entity.

Example 2: The example below illustrates the net operating loss carryover for the full term of seven years and demonstrates the application of net operating loss deductions in the proper sequence.

Amounts From Returns	1984	1985	1986	1987	1988	1989	1990	1991	1992
Return Year	31-Dec-84	31-Dec-85	31-Dec-86	31-Dec-87	31-Dec-88	31-Dec-89	31-Dec-90	31-Dec-91	31-Dec-92
Fiscal Year Ended	(\$100,000)	(6,000)	(8,000)	(10,000)	50,000	8,000	(5,000)	2,000	10,000
Line 28									
NJ Adjustments	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000
ENI before NOL ded. or exclusions	(95,000)	(1,000)	(3,000)	(5,000)	55,000	13,000	0	7,000	15,000
NOL Deduction	NA	0	0	0	55,000	13,000	0	7,000	9,000
ENI before exclusions	0	0	0	0	0	0	0	0	6,000
Dividend exclusion & IBF exclusion	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Entire Net Income	0	0	0	0	0	0	0	0	4,000
NOL Carryovers Applied									
1985	0								
1986	0	0							
1987	0	0	0						
1988	55,000	0	0	0					
1989	13,000	0	0	0	0				
1990	0	0	0	0	0	0			
1991	7,000	0	0	0	0	0	0		
1992		1,000	3,000	5,000	0	0	0	0	0
1993			0	0	0	0	0	0	0
1994				0	0	0	0	0	0
1995					0	0	0	0	0

Amounts From Returns Return Year	1984	1985	1986	1987	1988	1989	1990	1991	1992
Fiscal Year Ended	31-Dec-84	31-Dec-85	31-Dec-86	31-Dec-87	31-Dec-88	31-Dec-89	31-Dec-90	31-Dec-91	31-Dec-92
1996						0	0	0	0
1997							0	0	0
1998								0	0
1999									0
Unused	20,000	0	0	0	0	0	0	0	0
Total	95,000	1,000	3,000	5,000	0	0	0	0	0

(d) The following explain and/or define the above table: Line 28 is the amount of the taxpayer's taxable income, before net operating loss deduction and special deductions which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its Federal income tax. NJ Adjustments are the statutory additions and deductions to line 28 that are peculiar to the New Jersey corporation business tax.

1. "ENI" means entire net income as defined in the Act and in these rules.

2. "NOL" means net operating loss.

i. Exclusions are the exclusions from entire net income for dividends received and the eligible net income of an international banking facility.

3. "IBF" means the eligible net income of an international banking facility.

New Rule, R.1986 d.26, effective February 3, 1986.

See: 17 N.J.R. 2096(a), 18 N.J.R. 309(a).

Administrative Correction to (c), removing Examples 1:B and 2:C from Code.

See: 23 N.J.R. 1024(a).

Amended by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

#### Law Review and Journal Commentaries

Tax Law. Robert J. Alter, Jay A. Soled, 138 N.J.L.J. No. 1, S64 (1994).

Taxes. Steven P. Bann, 136 N.J.L.J. No. 8, 53 (1994).

#### Case Notes

Successor corporation; net operating losses of merged corporation. *Richard's Auto City, Inc. v. Director, Div. of Taxation*, 270 N.J.Super. 92, 636 A.2d 572 (A.D.1994), also published at 14 N.J.Tax 436, certification granted 137 N.J. 167, 644 A.2d 614, reversed 140 N.J. 523, 659 A.2d 1360.

Regulation governing net operating loss carryovers was not authorized. *Richard's Auto City, Inc. v. Director, Div. of Taxation*, 270 N.J.Super. 92, 636 A.2d 572 (A.D.1994), also published at 14 N.J.Tax 436, certification granted 137 N.J. 167, 644 A.2d 614, reversed 140 N.J. 523, 659 A.2d 1360.

Surviving corporation could not carryover loss of a merged corporation. *Richard's Auto City, Inc. v. Director, Div. of Taxation*, 12 N.J.Tax 619 (1992), reversed, certification granted 137 N.J. 167, 644 A.2d 614.

Change in 50% or more of ownership of corporation may remove corporation's right to carryover net operating losses. *Richard's Auto City, Inc. v. Director, Div. of Taxation*, 12 N.J.Tax 619 (1992), reversed, certification granted 137 N.J. 167, 644 A.2d 614.

#### 18:7-5.14 Limitations to the right of a net operating loss carryover

(a) The net operating loss carryover automatically becomes zero when the cumulative effect of all its capital stock

redemptions and sales after June 30, 1984 is a 50 percentage point change in the ownership of its voting stock and the corporation changes from the business giving rise to the loss. For this purpose the exchange of stock is a sale. Further, solely for this purpose and no other purpose in the Act, a business is defined in terms of the economic factors of production. The sequence in change of ownership and change in the business and the taxability of an exchange for Federal income tax purposes are irrelevant. The economic substance of the transaction is, however, paramount and may indicate forfeiture of a net operating loss carryover.

(b) The Director may disallow the carryover in those instances where the facts support the premise that a corporation was acquired for the primary purpose of the use of its net operating loss carryovers. In this context, to prevent the trafficking in loss corporations, the Director will consider the following facts:

1. Whether the physical location or other fixed assets of the loss corporation were used in a new business;
2. The extent of the termination of the existing work force of the loss corporation;
3. A price paid for the loss corporation in excess of the market value of the assets; and
4. Any other material deemed appropriate to the determination.

(c) No single factor shall be deemed on its own to be dispositive of the issue.

Example 1: B Corporation was wholly owned by a single stockholder. It operated a notably unsuccessful restaurant and built up significant net operating loss carryovers. The stockholder transferred 49 percent of his stock to an investor who has access to a recognized and uniformly profitable fast food franchise. B Corporation releases substantially all of its existing employees, disposes of its equipment and undertakes the fast food franchise business at a new location. Notwithstanding that B Corporation's sole stockholder sold less than 50 percent of his stock and the corporation still sells food in a heated state, the net operating loss carryovers to B Corporation become zero. The disposition of land, labor and capital until nothing remains except an empty corporate shell whose principal attributes are the apparent existence of an unused net operating loss carryover and some liquid capital in quest of an entirely new business is deemed to support the premise that the corporation was acquired for the primary purpose of the use of its net operating loss carryover. The economic substance of the transaction would have been to transfer the loss carryovers to a new business which is precluded by the rule.

Example 2: C Corporation was a manufacturer of buggy whips and button hooks. Due to a declining demand for its products it has built up significant net operating loss carryovers. C Corporation has only one stockholder who sells 50 percent of his capital stock to a woman who has invented a cheap and well-styled perpetual motion machine for which there is a clamorous demand. C Corporation changes its name to D Corporation, retools and hires additional employees. It expands its plants, closes out its old product lines and realizes huge profits in its rejuvenation. D Corporation's net operating loss carryovers from its buggy whip days are unaffected by any of the above circumstances and may be claimed as a net operating loss deduction. The economic substance of the transaction is a mere restructuring of its manufacturing product line. It did not change its business where it only reallocated its economic factors of production.

Administrative Correction to (c), added Examples to section.  
See: 23 N.J.R. 1024(a).

#### Case Notes

Surviving corporation could not carryover loss of a merged corporation. *Richard's Auto City, Inc. v. Director, Div. of Taxation*, 12 N.J.Tax 619 (1992), reversed, certification granted 137 N.J. 167, 644 A.2d 614.

Change in 50% or more of ownership of corporation may remove corporation's right to carryover net operating losses. *Richard's Auto City, Inc. v. Director, Div. of Taxation*, 12 N.J.Tax 619 (1992), reversed, certification granted 137 N.J. 167, 644 A.2d 614.

#### 18:7-5.15 Net operating loss

(a) A net operating loss is the excess of allowable deductions over gross income used in computing entire net income.

(b) Neither a net operating loss deduction nor any exclusions from entire net income are allowable deductions in computing a net operating loss.

(c) There is no net operating loss for any year that a Corporation Business Tax Return (CBT-100) is not filed or if filed does not report entire net income as a negative amount.

New Rule, R.1986 d.26, effective February 3, 1986.  
See: 17 N.J.R. 2096(a), 18 N.J.R. 309(a).

#### 18:7-5.16 Effect of audit adjustments

An audit adjustment to entire net income shall serve to revise the amount of any net operating loss for the year of the change and the net operating loss carryover to which it relates.

New Rule, R.1986 d.26, effective February 3, 1986.  
See: 17 N.J.R. 2096(a), 18 N.J.R. 309(a).

#### SUBCHAPTER 6. (RESERVED)

#### SUBCHAPTER 7. ALLOCATION

##### 18:7-7.1 General instructions regarding allocation of net income

(a) No corporation, foreign or domestic (other than a corporation entitled and electing to report as an investment company, regulated investment company or real estate investment trust) is entitled to allocate any part of its entire net income outside New Jersey unless during the period covered by the return it maintained a regular place of business outside the State.

(b) In the absence of a regular place of business, 100 percent of its entire net income must be allocated to New Jersey.

(c) The mere ownership of assets outside New Jersey does not constitute a basis for allocating less than 100 percent of the taxpayer's net income to New Jersey.

(d) Where the taxpayer does not maintain a regular place of business outside New Jersey and its allocation factor is 100 percent and the taxpayer in fact pays a tax based on or measured by income to another state, see N.J.A.C. 18:7-8.3 which provides for the eligibility and method in computing a reduction in the tax for such taxpayer.

Amended by R.1985 d.54, effective February 19, 1985.  
See: 16 N.J.R. 2999(b), 17 N.J.R. 476(b).

"Corporation" substituted for "taxpayer" and added "or real estate investment trust."

Amended by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

#### Statutory References

See N.J.S.A. 54:10A-6 as to how to determine allocation factor for taxpayer maintaining regular place of business outside New Jersey.

#### Case Notes

Failure to permit allocation to New Jersey corporation which owned rental property in Connecticut but had no regular employees working outside New Jersey held neither contrary to the scheme of the Business Tax Act, a burden on interstate commerce nor double taxation. *S.M.Z. Corp. v. Director, Div. of Taxation*, 5 N.J.Tax 232 (Tax Ct.1982), reversed and remanded 193 N.J.Super. 305, 473 A.2d 982 (App.Div. 1984).

##### 18:7-7.2 Regular place of business; definition

(a) A regular place of business is any bona fide office (other than a statutory office), factory, warehouse, or other space of the taxpayer which is regularly maintained, occupied and used by the taxpayer in carrying on its business and in which one or more regular employees are in attendance. The following will assist in the determination of what is a regular place of business.

**18:7-11.12 Extension of time to file return; interest and penalty**

(a) No extension will be granted unless request is made on Tentative Return Form CBT-200T and is actually received by the Division or postmarked on or before the due date of the return. The Tentative Return must:

1. Show the information required, including the exact name, address, New Jersey serial number, the Federal employer identification number, if any, and the amount of the estimated tax liability;

2. Be accompanied by a remittance to cover the unpaid balance of the estimated tax due for the accounting year for which an extension of time to file the return is requested; and

3. Be accompanied by the payment on account of its tentative tax which is due on or before the original due date for filing of the return for which an extension is requested.

(b) Taxpayers using the New Jersey Corporation Business Tax Return Form CBT-100 may request an extension for a period not exceeding six months and will receive automatic approval, provided that the taxpayer has complied with the instructions set forth on the Tentative Return Form CBT-200T, and has paid any unpaid balance of its estimated tax.

1. In general, extension requests shall not be granted for any period exceeding six months from the original due date.

2. Initial extensions will be confirmed in writing by the Division.

3. If the final return is not submitted within the extended period, penalties for delinquent filing will be applied as if no extension has been granted.

(c) Banking and financial corporations may request an extension of time to file return subject to the following conditions.

1. No extension will be granted unless request is actually received by the Division or postmarked on or before the due date of the return;

2. The extension shall be made on a copy of page 1 of Form BFC-1, including the exact name, address, New Jersey Serial number, if applicable, the Federal employer identification number, if any, and the amount of tentative tax liability.

3. Be accompanied by a remittance to cover the unpaid balance of the tentative tax due for the accounting year for which an extension of time to file the return is requested; and

4. Be accompanied by a completed copy of Schedule L from Form BFC-1, and a copy of the taxpayer's Federal extension request.

5. In general, extension requests shall not be granted for any period exceeding five months from the original due date.

6. Where the taxpayer has requested a Federal extension, the Division shall grant the taxpayer an extension for a period not exceeding five months. In cases where the taxpayer has failed to obtain a Federal extension, the taxpayer, upon request, may be granted a two month extension for filing the return if sufficient cause is submitted. Sufficient cause should be interpreted so that it is impossible or wholly impracticable to file a return within two months from the original due date of the return.

(d) Extensions may be confirmed in writing by the Division, if necessary.

(e) If the original return is not submitted within the extended period, penalty for delinquent filing will be applied as if no extension has been granted.

(f) Interest and penalty are chargeable as follows:

1. The total amount of the tax due must be paid on or before the original due date for filing the return.

2. Any unpaid portion of the tax on the final return which is in excess of the amounts paid shall bear interest at the rate of one and one-half percent per month, or fraction thereof from the original due date of the return to the date of actual payment or December 8, 1987. On and after December 9, 1987 the unpaid portion of the tax shall bear interest at the annual rate of five percentage points above the prime rate, compounded daily from the date the tax was originally due or December 9, 1987, whichever is later, to the date of actual payment. On and after July 1, 1993, the unpaid portion of the tax shall bear interest at the rate of three percentage points above the prime rate assessed for each month or fraction thereof, compounded annually at the end of each year from the date such tax was originally due to the date of actual payment.

3. In addition, if the amounts paid up to and including the time for filing of the tentative return total less than the lesser of 90 percent of the amount of tax due, or for a taxpayer that had a preceding fiscal or calendar accounting year of 12 months and filed a return for that year showing a tax liability equal to the tax computed at the rates applicable to the current accounting year applied to the facts shown on the return for and the law applicable to the preceding accounting year, the taxpayer shall be liable for a penalty of five percent per month, or fraction thereof, on the amount of underpayment. In this context, "filing of the return" means filing its tentative return incident to its request for extension, "the time for filing" means the original due date for filing the return, and "amount of underpayment" means the difference between 100 percent of the tax shown on the final return and the total of all installments of estimated tax paid on or before the original due date for filing the return, as well as any amount paid with the tentative return.

(g) Where taxpayer makes an election on Federal form 8023, it will be granted an extension of time to file a corporation business tax return until the Federal election is filed, provided that a CBT-200T has been properly filed in accordance with these rules.

(h) Warning:

1. No request for extension will be considered unless taxpayer has complied with all the filing requirements for extensions set forth in the rule.

Amended by R.1970 d.121, effective October 5, 1970.

See: 2 N.J.R. 78(a), 2 N.J.R. 95(a).

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Amended on an emergency basis, R.1981 d.163, effective May 11, 1981.

Expired July 10, 1981, without reoption.

See: 13 N.J.R. 377(a).

Rule substantially amended to provide for the imposition of interest and penalties on Corporation Business Tax payments made during additional extended period for which an additional extension was granted.

As amended, R.1982 d.6, effective January 18, 1982.

See: 13 N.J.R. 688(a), 14 N.J.R. 105(d).

Section substantially amended.

Amended by R.1983 d.497, effective November 7, 1983.

See: 15 N.J.R. 1366(a), 15 N.J.R. 1872(c).

Text substantially amended.

Amended by R.1988 d.407, effective September 6, 1988.

See: 19 N.J.R. 2255(b), 20 N.J.R. 2310(c).

Added text to (f) "or December 8, 1987. On ...".

Amended by R.1991 d.35, effective January 22, 1991.

See: 22 N.J.R. 2125(a), 23 N.J.R. 221(a).

Added (g), recodified old (g).

Amended by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

#### Statutory References

See N.J.S.A. 54:10A-15 as to the requirement to file an annual return; 10A-17 as to penalties for late filing of returns; 10A-15 as to necessity of certification of taxpayer's return by an authorized corporate officer; 10A-19 as to extension of the due date and interest to be assessed during such extension period; and 49-6 as to right of Director to issue deficiency assessments or reassessments after final return is filed.

#### 18:7-11.13 Place for filing returns and payment of tax

(a) The return together with remittance payable to "State of New Jersey" must be forwarded to the New Jersey Division of Taxation, CN666, Trenton, New Jersey 08646.

(b) A separate remittance is required to be made with each return.

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

#### Statutory References

See N.J.S.A. 54:10A-15, 18 as to manner and form of tax payment.

#### 18:7-11.14 Secrecy of returns

The returns are deemed secret and confidential and New Jersey law prohibits the unauthorized disclosure of information obtained from the returns or the records pertaining thereto.

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

#### Statutory References

See N.J.S.A. 54:50-8 as to prohibition against Director or any employee of the Division of Taxation divulging, disclosing, or permitting another to inspect any records or files pertaining to the administration of the tax under the Act.

#### 18:7-11.15 Consolidated returns

(a) Corporations are not permitted to file consolidated returns. Provided, however, any business conducted by an individual, partnership, or corporation or any other entity, or any combination thereof holding a license pursuant to the Casino Control Act shall file a consolidated corporation business tax return as described at N.J.A.C. 18:7-1.17.

(b) Except as provided in (a) above, where a taxpayer has filed a consolidated return with the Internal Revenue Service for Federal income tax purposes, it must complete its return under the act and must reflect its entire net income and entire net worth as if it had filed its Federal return on its own separate basis.

(c) A taxpayer under (b) above shall also file a copy of the Affiliations Schedule Form 851, which is filed with Form 1120 for Federal income tax purposes.

(d) For New Jersey purposes, a selling parent in a consolidated group may not exclude gain on the sale of target stock pursuant to a Federal election under IRC 338(h)(10). Each corporation is required to report income on a separate entity basis under N.J.A.C. 18:7-5.1(c).

(e) Where a target corporation recognizes gain as the result of an IRC 338(h)(10) election, the target reports and pays tax on such gain pursuant to N.J.A.C. 18:7-5.1(a).

Amended by R.1985 d.453, effective September 3, 1985.

See: 17 N.J.R. 901(a), 17 N.J.R. 2145(a).

Added text to (a): "Provided, however, any ... at N.J.A.C. 18:7-1.17."

Amended by R.1991 d.35, effective January 22, 1991.

See: 22 N.J.R. 2125(a), 23 N.J.R. 221(a).

Added (d) and (e).

#### Statutory References

See N.J.S.A. 54:10A-2 as to requirement for annual payment of tax and 10A-14 as to right of Director to require copies of pertinent extracts of its Federal income tax return or other records if taxpayer has filed a consolidated Federal income tax return.

## Case Notes

Gain recognized by wholly owned subsidiary as result of parent corporation's federal tax law election to treat sale of subsidiary's stock as sale of subsidiary's assets, and to file consolidated tax return, was subject to tax under Corporation Business Tax Act. *General Bldg. Products Corp. v. Director, Div. of Taxation*, 15 N.J.Tax 213 (A.D. 1995).

Regulations were valid. *General Bldg. Products Corp. v. State, Div. of Taxation*, 14 N.J.Tax 232 (1994).

State's prohibition against filing of consolidated income tax returns by related corporations does not immunize subsidiary corporation from state taxation of any gain realized as result of deemed sale of its assets. *General Bldg. Products Corp. v. State, Div. of Taxation*, 14 N.J.Tax 232 (1994).

Taxpayer that separated from consolidated group was not required to file two short-term returns. *Drake Bakeries, Inc. v. Taxation Div. Director*, 12 N.J.Tax 172 (1991).

The term "books of the corporation" includes financial statements prepared in accordance with applicable regulations in the sense encompassed by the term "financial reporting"; definition of the term by rule not necessary due to adequate legislative standard; Director's equity method of accounting in valuation of corporation's investments and subsidiaries not demonstrated to be unfair. *Cities Service Co. v. Director, Div. of Taxation*, 5 N.J.Tax 257 (Tax Ct.1983).

**18:7-11.16 Return to be filed by an S Corporation**

(a) Except as may be provided otherwise by this Section, an S corporation, that is, one which has made an election under Section 1361 et seq. of the Internal Revenue Code of 1954 as amended and supplemented, must complete its New Jersey Corporation Business Tax Return on its own separate basis as though no election had been made under the Federal Statute.

(b) Except as may be provided otherwise by this section, in preparing its Corporation Business Tax Return the taxpayer cannot assume that ordinary income or loss (Federal taxable income) is equal to Federal taxable income before net operating loss deduction and special deductions for New Jersey Corporation Business Tax purposes, when the taxpayer has elected Federal S corporation treatment. Certain amounts not necessarily limited to I.R.C. Section 179 expenses, and 1120-S dividends that qualify for the dividend exclusion are not included as part of the S corporation's ordinary income (loss) computation, but rather are passed directly through to the shareholder on the Federal Form K-1 Schedule. For Corporation Business Tax purposes these amounts are included in the computation of entire net income, as if the corporation were a C corporation and no Federal S corporation election were made.

Example 1: S Corporation has 1985 taxable income for Federal tax purposes of \$100,000. However, not included in computation of such amount is a \$5,000 Federal I.R.C. Section 179 expense and \$10,000 of S Corporation dividends received from a different corporation which qualify for the Federal dividend exclusion. Barring any other difference between Federal taxable income and New Jersey taxable income per Schedule A, Form CBT-100, New Jersey taxable income before net operating loss deduction (NOL) and special deductions is computed as such:

\$100,000	Federal Taxable Income
(5,000)	I.R.C. Section 179 Expense
10,000	Qualifying S Corporation Dividends
\$105,000	New Jersey Taxable Income Before NOL and Special Deductions

Example 2: S Corporation is liquidating under I.R.C. Section 337. When disposing of its real property during the 12 month distribution period, the corporation recaptures for Federal tax purposes \$5,000 of I.R.C. Section 291 expenses which an S Corporation does not include as part of Federal taxable income if it were an S Corporation for the three preceding years before the Federal I.R.C. Section 337 election and the I.R.C. Section 1363(b) election. Since the S Corporation is treated as a C Corporation for State tax purposes, the I.R.C. Section 291 recapture is part of taxable income before net operating loss and special deductions on Schedule A, Form CBT-100.

(c) With respect to tax years beginning after July 7, 1993, S corporation status may be elected for New Jersey purposes by the shareholders of a Federal S corporation. The filing of an election form CBT-2553 with the Division to be recognized as a New Jersey S corporation is required. A New Jersey S corporation is entitled to pay its tax at a preferential rate as provided in N.J.S.A. 54:10A-5(c)(2) and (3) and to report and pay its tax liability on Form CBT-100S.

Amended by R.1979 d.45, effective February 6, 1979.

See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).

Amended by R.1986 d.464, effective November 17, 1986.

See: 18 N.J.R. 1686(b), 18 N.J.R. 2332(a).

(b) added.

Amended by R.1994 d.186, effective April 18, 1994.

See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

**Statutory References**

See N.J.S.A. 54:10A-2 as to requirement for annual filing of return under this Act despite other arrangements for filing a Federal return.

**Case Notes**

Foreign S corporation's distribution to New Jersey taxpayer would be treated as if received from accumulated earnings. *Laurite v. Director, Div. of Taxation*, 12 N.J.Tax 483 (1992), affirmed 14 N.J.Tax 166.

Absent other evidence, distribution from foreign S corporation to New Jersey taxpayer would be treated as from accumulated earnings. *Laurite v. Director, Div. of Taxation*, 12 N.J.Tax 483 (1992), affirmed 14 N.J.Tax 166.

Pass-through losses and gains are to be excluded when calculating net gains and losses. *Walsh v. State, Dept. of the Treasury, Div. of Taxation*, 10 N.J. Tax 447 (1989), affirmed and remanded 240 N.J.Super. 42, 572 A.2d 222.

**18:7-11.17 Copies of tax returns or other information required**

(a) The Director may by general rule or by special notice require any taxpayer to submit copies or pertinent extracts of its Federal income tax returns, or of any other tax return made to any agency of the Federal Government, or of this or any other state, or of any statement or registration made pursuant to any state or Federal law pertaining to securities or securities exchange regulation.

(b) The Director may require all taxpayers to keep whatever records he may prescribe, and he may require the production of books, papers, documents and other data, to provide or secure information pertinent to the determination of the tax and its enforcement and collection.

(c) The Director may, also by general rule or special notice, require any taxpayer to make and file information returns, under oath, of facts pertinent to the determination of the tax or liability for tax pursuant to such regulations, at whatever times and in whatever form or manner and to whatever extent he may prescribe under law.

#### Statutory References

See N.J.S.A. 54:10A-14 as to right of the Director to require taxpayer to submit pertinent extracts for its Federal income tax return, other returns to government agencies, or other records.

#### 18:7-11.18 Reproduction of forms

(a) Subject to conditions and requirements of this section, the Director will accept for filing purposes reproductions of the New Jersey Corporation Business Tax Return Forms CBT-100, CBT-100-X, and CBT-200T in lieu of the official forms printed and furnished by the Director. Anyone contemplating the use of reproduced forms is cautioned to observe that the conditions herein stated may vary from the Federal regulations relating to reproduction of Federal tax forms.

(b) In order to be acceptable for filing purposes, reproduction of Forms CBT-100, CBT-100-X, and CBT-200T must meet the following conditions and requirements:

1. Reproductions must be facsimiles of the complete official form, produced by photo-offset, photo-engraving, photo-copying or other similar reproduction processes;
2. Reproductions must be on paper of substantially the same color, weight and texture and of a quality at least as good as that used in the official form;
3. Reproductions must be of the same size as that of the official form, both as to overall dimensions of the paper and the imagery produced;
4. Format of pages shall adhere to following:
  - i. It is preferable that both sides of the paper be used in making reproductions. However, reproduction on one side will be acceptable.
  - ii. All reproductions must result in the same page arrangement as that of the official form and the spacing of the printed matter on each individual page and the fold must be the same as on the official form.
  - iii. Separate pages must be fastened together in numerical order.
  - iv. Each separate page must be clearly identified, by listing at the top of the page the corporate name and New Jersey serial number.

5. The color and quality of the reproduction of the printed matter must be substantially the same as that of the official form, and the filled-in information must be entirely legible;

6. The taxpayer's full and correct name and address and identifying serial number as it appears on the pre-stenciled form furnished by the Director must be typed or printed on the reproduction;

7. All filled-in information on Page 1 of the Return must be typed or printed;

8. Reproductions of forms may be made after insertion of the tax computations and the other required information;

9. All signatures on forms to be filed must be original signatures, affixed subsequent to the reproduction process;

10. The Director does not undertake to approve or disapprove the specific equipment or process in reproducing official forms, but requires only that the reproduced forms satisfy the stated conditions. It should be noted, however, that photostats do not meet all the above conditions;

11. The Director does not undertake to approve or disapprove the specific writing medium or style of writing to be used, but requires that the filled-in information on the reproduced form be of good quality black-on-white with hand writing of satisfactory legibility.

Amended by R.1979 d.45, effective February 6, 1979.  
See: 11 N.J.R. 40(d), 11 N.J.R. 150(b).  
Amended by R.1994 d.186, effective April 18, 1994.  
See: 26 N.J.R. 761(a), 26 N.J.R. 1696(b).

#### Statutory References

See N.J.S.A. 54:10A-18 as to authority of Director to design tax return forms and determine the information to be required thereon.

#### 18:7-11.19 through 18:7-11.21 (Reserved)

### SUBCHAPTER 12. SHORT PERIOD RETURN

#### 18:7-12.1 Short period returns; when required

(a) In general, every corporation must file a return for each fiscal or calendar accounting period or part thereof during which it has or had a taxable status in New Jersey. In certain cases, the taxpayer will be required to file a return covering an accounting period of less than 12 months. This may necessitate an adjustment of entire net income.

(b) Some of the circumstances which require the filing of short period returns are: