

9. A New Jersey resident taxpayer in determining the resident credit allowed against the tax due under this Act for the amount of any income tax or wage tax imposed for the taxable year by another state or political subdivision of such state or by the District of Columbia, shall not combine in the numerator (line 64, N.J. 1040) the same income subject to tax by the jurisdiction and/or political subdivision. The amount of income or wage tax during the tax year shown on line 70, N.J. 1040 for the taxpayer paying both a tax to another state and political subdivision of such state would be the total amount of state income tax and income tax or wage tax paid to the other state and political subdivision of such state where the same amount of income is subject to tax in both the other state and political subdivision of such state. Where the income subject to tax in both the other state and political subdivision of such state are not equal, a separate calculation shall be made of the excess income to arrive at the limitation of the credit for the income tax or wage tax paid to the other state and political subdivision of such state.

For example:

STEP NO. 1	
Line 67	Income subject to tax in both the other state and its political subdivisions _____
Line 68	New Jersey Gross Income (Line 17c, NJ 1040) _____
Line 69	Line 67 _____ _____ × New Jersey Tax (Line 25, N.J. 1040)
	Line 68 _____ = Maximum allowable credit _____
Line 70	Tax paid on amount in Line 67 to each jurisdiction _____ State Political Subdivisions _____
Line 71	Lesser of Line 69 or 70 _____
STEP NO. 2	
Line 67	Amount subject to tax in one jurisdiction and not in the other(s) _____
Line 68	New Jersey Total Gross Income (Line 17c, NJ 1040) _____
Line 69	Line 67 _____ _____ × New Jersey Tax (Line 25, NJ 1040)
	Line 68 _____ = Maximum allowable credit _____
Line 70	Tax paid to the jurisdiction on amount appearing on Line 67 _____
Line 71	Lesser of Line 69 or 70 _____

STEP NO. 3  
Step No. 1 Line 71 plus Step No. 2 Line 71 \_\_\_\_\_  
The following examples illustrate the above outlined procedures:

Example 1

Taxpayer A

- (1) Total Gross Income (Line 17c, NJ 1040) \$100,000
- Income subject to tax in other jurisdictions:
- (2) New York State: \$40,000
- (3) New York City: \$50,000
- (4) Identical income subject to tax in both jurisdictions: \$40,000
- (5) New York State Tax: \$2,700

- (6) New York City Tax: \$225
- (7) New Jersey Tax (Line 25, NJ 1040) \$2,690

Calculation of Credit

STEP NO. 1	
Line 67	(4) above <span style="float: right;">\$ 40,000</span>
Line 68	(1) above <span style="float: right;">100,000</span>
Line 69	\$40,000 _____ _____ × \$2,690 <span style="float: right;">1,076</span>
	100,000 _____
Line 70	New York State (based on \$40,000 as indicated on line (4) above) <span style="float: right;">\$2,700</span>
	New York City 4/5 × \$225 (based on \$40,000 as indicated on line (4) above) <span style="float: right;">180</span>
Line 71	<span style="float: right;"><u>2,880</u></span> <span style="float: right;"><u>\$1,076</u></span>
STEP NO. 2	
Line 67	(3)-(2) <span style="float: right;">\$ 10,000</span>
Line 68	<span style="float: right;">100,000</span>
Line 69	\$10,000 _____ _____ \$2,690 <span style="float: right;">269</span>
	100,000 _____
Line 70	/15 × \$225 <span style="float: right;">45</span>
Line 71	<span style="float: right;"><u>\$ 45</u></span>

STEP NO. 3

Line 71	Step No. 1 <span style="float: right;">\$1,076</span>
	Step No. 2 <span style="float: right;">45</span>
Line 26	Total New Jersey Tax Credit Allowed <span style="float: right;"><u>\$1,121</u></span>

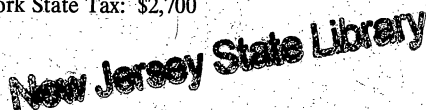
Example 2

Taxpayer B

- (1) Total Gross Income (Line 17c, NJ 1040) \$100,000
- Income subject to tax in other jurisdictions:
- (2) New York State: \$50,000
- (3) New York City: \$40,000
- (4) Identical income subject to tax in both jurisdictions: \$40,000  
Tax paid to other jurisdictions:
- (5) New York State Tax: \$4,200
- (6) New York City Tax: \$180
- (7) New Jersey Tax (Line 25, NJ 1040) \$2,690

Calculation of Credit

STEP NO. 1	
Line 67	(4) above <span style="float: right;">\$ 40,000</span>
Line 68	(1) above <span style="float: right;">100,000</span>
Line 69	\$40,000 _____ _____ × \$2,690 <span style="float: right;">1,076</span>
	100,000 _____
Line 70	New York State (based on \$40,000 as indicated on line (4) above) <span style="float: right;">\$2,700</span>
	New York City (based on \$40,000 as indicated on line (4) above) <span style="float: right;">180</span>
Line 71	<span style="float: right;"><u>2,880</u></span> <span style="float: right;"><u>\$1,076</u></span>
STEP NO. 2	
Line 67	(2)-(3) <span style="float: right;">\$ 10,000</span>
Line 68	<span style="float: right;">100,000</span>
Line 69	\$10,000 _____



	<u>100,000</u> × \$2,690		269
Line 70	(5) Above Less: Step No. 1, Line 70	\$4,200	
		<u>2,700</u>	1,500
Line 71			<u>\$ 269</u>
STEP NO. 3			
Line 71	Step No. 1	\$1,076	
	Step No. 2	<u>269</u>	
Line 26	Total New Jersey Tax Credit Allowed		<u>\$1,345</u>

Example 3

Taxpayer C			
Income the same in both state and city			
Line 67		\$ 40,000	
Line 68		100,000	
Line 69	\$40,000		1,076
	<u>100,000</u> × \$2,690		
Line 70	New York State	\$2,700	
	New York City	<u>180</u>	2,880
Line 71	(Line 26, NJ 1040) Tax Credit		<u>\$ 1,076</u>

i. When claiming a credit for the taxes paid to another jurisdiction and/or political subdivision, the taxpayer shall file with the New Jersey tax return, a signed copy of the tax return filed with the other jurisdiction and/or political subdivision showing the amount of the tax paid. A W-2 form or its equivalent which indicates the withholding of income tax in another jurisdiction and/or political subdivision is considered prima facie evidence of such amount of tax paid where the taxing jurisdiction and/or political subdivision imposing an income tax or wage tax does not require the filing of a return by the taxpayer claiming a credit.

ii. Where a taxpayer claims credit for taxes paid to more than one state on income earned in that state, a separate computation for the maximum allowable credit shall be made for each such state.

iii. Example 1: Taxpayer Income is as follows:

Husband and Wife File Jointly—2 Exemptions

NEW YORK	
Wages	\$20,000
Standard Deduction	<u>2,400</u>
	\$17,600
Exemption	
2 × 66.6% (\$700)	<u>933</u>
	<u>\$16,667</u>
New York State Tax	\$ 1,027
New York City Tax	<u>81</u>
Total Tax	\$ 1,108
NEW JERSEY	
Wages	\$20,000
Interest	1,000
Dividends	2,000
Other Income	<u>7,000</u>
	\$30,000
Exemptions	<u>2,000</u>

	\$28,000
New Jersey Tax	\$ 600
Tax Credit	
Line 67 Income Subject to Tax by Other Jurisdiction	\$20,000
Line 68 Income Subject to Tax by New Jersey	\$30,000
Line 69 Maximum Allowable Credit	
\$20,000 ÷ \$30,000 × \$600 (N.J.Tax) =	\$400
Line 70 Income or Wage Tax Paid to Other Jurisdictions	\$1,108
Line 71 New Jersey Tax Credit Allowed	\$400

iv. Example 2: Taxpayer Income is as follows: Husband and Wife File Jointly—2 Exemptions

OTHER STATE	
Wages	\$20,000
Assume	
State Tax	250
Local Wage Tax	<u>75</u>
Total Tax	\$ 325
Wages	\$20,000
Interest	1,000
Dividends	2,000
Other Income	<u>7,000</u>
	\$30,000
Exemptions	<u>2,000</u>
	\$28,000
New Jersey Tax	\$ 600
Tax Credit	
Line 67 Income Subject to Tax by Other Jurisdiction	\$20,000
Line 68 Income Subject to Tax by New Jersey	\$30,000
Line 69 Maximum Allowable Credit	
\$20,000 ÷ \$30,000 × \$600 (N.J.Tax) =	\$400
Line 70 Income or Wage Tax Paid to Other Jurisdictions	\$325
Line 71 New Jersey Tax Credit Allowed	\$325

v. Example 3: Taxpayer Income is as follows:

Husband and Wife File Jointly—2 Exemptions

OTHER JURISDICTION	
Wages	\$20,000
Local Wage Tax	\$ 800
NEW JERSEY	
Wages	\$20,000
Interest	2,000
Dividends	<u>2,000</u>
	\$24,000
Exemptions	<u>2,000</u>
	\$22,000
Tax	\$ 450
Tax Credit	
Line 67 Income Subject to Tax by Other Jurisdiction	\$20,000
Line 68 Income Subject to Tax by New Jersey	\$24,000
Line 69 Maximum Allowable Credit	
\$20,000 ÷ \$24,000 × \$450 (N.J.Tax) =	\$375
Line 70 Wage Tax Paid to Other Jurisdiction	\$800
Line 71 New Jersey Credit Allowed	\$375

vi. Example 4: Taxpayer Income is as follows:

Husband and Wife File Jointly—2 Exemptions

OTHER JURISDICTIONS	
State A—Wages	\$10,000
State B—Wages	\$15,000
Assume	
State A—Tax	\$ 150
State B—Tax	\$ 600

NEW JERSEY	
Wages	\$25,000
Interest	1,000
Dividends	<u>2,000</u>
	\$28,000
Exemptions	<u>2,000</u>
	\$26,000
New Jersey Tax	\$ 550
Tax Credit	
State A	
Line 67—Income Subject to Tax by Other Jurisdiction	\$10,000
Line 68—Income Subject to Tax by New Jersey	\$28,000
Line 69—Maximum Allowable Credit	
$\$10,000 \div \$28,000 \times \$550$ (N.J.Tax) =	\$196.42
Line 70—Income or Wage Tax Paid to Other Jurisdiction	
	\$150.00
Line 71—New Jersey Tax Credit Allowed	\$150.00
State B	
Line 67—Income Subject to Tax by Other Jurisdiction	\$15,000
Line 68—Income Subject to Tax by New Jersey	\$28,000
Line 69—Maximum Allowable Credit	
$\$15,000 \div \$28,000 \times \$500$ (N.J.Tax) =	\$294.65
Line 70—Income or Wage Tax Paid to Other Jurisdiction	
	\$600.00
Line 71—New Jersey Tax Credit Allowed	\$294.65
Total New Jersey Tax Credit Allowed	
State A—\$150.00	
State B—\$294.65	
	\$444.65

R.1979 d.433, effective October 26, 1979.

See: 11 N.J.R. 525(b); 11 N.J.R. 650(b).

As amended, R.1983 d.618, effective January 17, 1984.

See: 15 N.J.R. 1566(a), 16 N.J.R. 149(a).

Section substantially amended.

#### Case Notes

Rule upheld against equal protection challenge; credit for New York state personal income tax found to have exhausted New Jersey tax on taxpayer's New York income, notwithstanding that the taxpayer was also subject to New York City earnings tax. *Jenkins v. Taxation Div. Director*, 4 N.J.Tax 127, 184 N.J.Super 402, 446 A.2d 217 (Tax Ct.1982).

Rule interpreting "resident credit" as requiring exclusion for income which is excluded or deducted from taxable gross income by another jurisdiction held valid; application of 1979 rule to 1976 tax return held proper. *Sorensen v. Director, Div. of Taxation*, 2 N.J.Tax 470, 184 N.J.Super 393, 446 A.2d 213 (Tax Ct.1981).

Net gain from partnership activities taxed by foreign jurisdictions but completely offset by allowable partnership loss deductions in state; not included in numerator of tax credit fraction. *Kanarek v. Director, Div. of Taxation*, 14 N.J.Tax 589 (1995).

In calculating credit fraction numerator, gross income subject to tax in other jurisdiction would be reduced by taxpayers' capital loss, which was deductible in New Jersey but not in other state but not by additional lesser amount of taxpayers' rental loss, which was deductible in other state but not in New Jersey. *Allen v. Director Div. of Taxation*, 14 N.J.Tax 385 (1994).

Instructions on computing resident credit for income tax purposes were not erroneous. *Widder v. Director, Div. of Taxation*, 14 N.J.Tax 349 (1994).

Income not actually taxed by another state, but which was used by that state in calculating applicable tax rate for income from that state, would not be included in numerator of resident credit fraction. *Chin v. Director, Div. of Taxation*, 14 N.J.Tax 304 (1994).

Credit for foreign income tax; loss disallowed by New Jersey tax statute. *Berlin v. New Jersey Div. of Taxation*, 13 N.J.Tax 405 (1993).

Resident credit was properly calculated separately for each New York City and state tax. *Willett v. Director, Div. of Taxation*, 10 N.J.Tax 402 (1989).

Only income subject to tax by another state also taxed by New Jersey could be used to determine maximum gross income tax credit. *Stiber v. Director, Div. of Taxation*, 9 N.J.Tax 623 (1988).

Foreign city income tax that did not exceed minimum credit available could be credited against New Jersey income tax. *Stiber v. Director, Div. of Taxation*, 9 N.J.Tax 623 (1988).

Since alimony paid by taxpayers residing in New Jersey but working in New York was a deduction in New York, Director held to have properly excluded alimony payments from the numerator of the fraction used to calculate the credit for tax paid to New York. *Nielson v. Taxation Div. Director*, 4 N.J.Tax 438 (Tax Ct.1982).

#### 18:35-1.13 One-time election to exclude up to \$100,000 of gain on sale of principal residence; rollovers

(a) The rules concerning one-time election to exclude up to \$125,000 of gain on sale of principal residences and rollovers are as follows.

1. General rule: Capital gains one-time exclusion; where taxpayers 55 years or older sell a principal residence on or after January 1, 1979 which they have owned and used as principal residence for at least three years during the five year period ending on the date of the sale, they may make a one-time election to exclude up to \$125,000 of gain realized on the sale.

2. Prior election: The fact that a taxpayer age 65 or older made the prior election to exclude gain on a pre-January 1, 1979 sale of residence will not prevent him or her from electing the new \$125,000 exclusion.

3. Joint return: In the case of jointly owned property where a joint return is filed, if one spouse meets the age, holding, and use requirements for the exclusion, both spouses are treated as meeting such requirements.

4. Deceased spouse: Taxpayer over 55 years of age whose spouse is deceased will be treated as satisfying the holding and use requirements if the taxpayer was at least 55 years of age prior to the date of the sale and has not remarried, and the deceased spouse must have satisfied the holding and use requirements and must not have made a prior election to take the exclusion on another residence.

5. Coupling one-time exemption with residence rollover exclusion: This one-time election may be coupled with the residence rollover exclusion described below, for deferring all or part of the gain not excluded under the \$125,000 exclusion rule.

6. Residence rollover exclusion: Gains derived from the sale or exchange of principal residence where a new residence is purchased within two years after the sale of the prior residence are not includible in gross income if the purchase price of the new principal residence is equal to or greater than the adjusted sales price of the principal residence sold.

7. Multiple rollover provision—Applicable only to residence rollover-exclusion: If a taxpayer had excluded gain from the sale of a residence within 24 months prior to the sale of a subsequent principal residence, the tax free rollover of the second sale will be permitted only where the sale of the residence is in connection with relocation and employment at a new principal place of work, and the taxpayer satisfies both the geographic and length of employment requirements for the deductibility of moving expense for Federal purposes.

i. Example: On January 1, 1979, a taxpayer sold his personal residence in Englewood at a gain and purchased a more expensive residence in the same city on February 15, 1979. The gain derived from the sale of the first residence qualified for deferral under the law and the taxpayer was not required to report the gain for tax purposes. In August, 1979, the taxpayer's employer permanently transferred him to a new principal place of work in Cherry Hill which transfer qualified the taxpayer to deduct his moving expenses for Federal income tax purposes. On September 1, 1979, the taxpayer sold his Englewood residence at a gain and purchased a more expensive residence at the new job location in Cherry Hill. Ordinarily, a taxpayer cannot defer the gain derived from two personal residences if he has already elected to defer a gain during a two-year period. However, in this situation, the taxpayer qualified again to defer the gain derived from the sale of the second home which he purchased in Englewood by reason of the fact that his purchase of a new personal residence in Cherry Hill was necessitated in connection with relocation in employment at a new principal place of work and because geographic and Federal moving expense requirements were met.

ii. Where the multiple rollover provision applies, the basis of each new residence must be reduced by the amount of gain deferred on the preceding sale.

R.1979 d.475, effective December 5, 1979.

See: 11 N.J.R. 594(a), 12 N.J.R. 56(c).

Amended by R.1987 d.476, effective November 16, 1987.

See: 19 N.J.R. 1182(a), 19 N.J.R. 2201(c).

18-month changed to two-year.

#### 18:35-1.14 Partnerships and partners

(a) The following words and terms, when used in this section, shall have the following meanings:

1. "Partnership" means and shall include a syndicate, group, pool, joint venture and any other unincorporated organization through or by means of which any business, financial operation or venture is carried on and which is not a corporation, trust or estate within the meaning of the New Jersey Gross Income Tax Act. "Partnership" shall not include:

- i. A publicly traded partnership;
- ii. A limited partnership association;
- iii. An unincorporated organization whose members properly elect to exclude such organization from the application of Subchapter K of Subtitle A of the Internal Revenue Code; or
- iv. Any other entity which is not taxed as a partnership for Federal income tax purposes.

2. "Partner" means and shall include any person or entity subject to the Gross Income Tax who shall be a member of a partnership, whether as a general partner or a limited partner.

(b) Partners, not partnerships shall be subject to tax and resident and non-resident partners treated as follows:

1. A partnership as such is not subject to the Gross Income Tax. However, each partner of a partnership shall be subject to Gross Income Tax on his or her distributive shares of the categories of New Jersey gross income, whether or not distributed, realized by the partnership for its taxable year ending within or with such partner's taxable year. Each partner shall account for and report his or her distributive shares of the partnership's categories of New Jersey gross income in the manner provided in (c) below.

2. A partner who is a resident taxpayer of New Jersey shall report and be subject to Gross Income Tax upon such partner's full distributive shares of the categories of New Jersey gross income of each partnership in which such partner is a member, regardless of the sources from which such income was derived by each such partnership.

3. A partner who is a nonresident taxpayer of New Jersey shall report and be subject to tax upon the distributive shares of the categories of New Jersey gross income of each partnership in which such partner is a member, but only to the extent such income was derived by the partnerships from sources within New Jersey.

i. Where a partnership's business is carried on solely within New Jersey, all items of the income, gain, expenses or losses of the partnership are deemed to have been derived from sources within New Jersey.

ii. Where a partnership's business is carried on both within and outside of New Jersey, the portion of the partnership's income, gains, expenses or losses attributable to sources within New Jersey shall, except as provided in (b)3iii below, be determined by use of the New Jersey Business Allocation Schedule (Form NJ-1040-NR-A), as prepared by the partnership.

iii. Where a partnership's business is carried on both within and outside of New Jersey, and the partnership believes that the determination of the portion of the partnership's income, gains, expenses or losses attributable to sources within New Jersey by use of the New Jersey Business Allocation Schedule does not provide an equitable allocation of such items to sources within and outside of New Jersey, and the books and records of the partnership will disclose to the Director's satisfaction a more appropriate method of allocation of such items, the partnership may request from the Director an exception from the use of the New Jersey Business Allocation Schedule. Any such request shall be made in writing and shall set forth the basis of the request and the substitute method of allocation requested to be used in lieu of use of the New Jersey Business Allocation Schedule. The substitute method of allocation may not be utilized prior to the submission of the partnership's exception request and the approval of such request by the Director. The partnership's exception request, once approved, shall be made every three years, unless the Director or the partnership requests a change sooner.

(c) The determination of a partner's distributive shares of the partnership's items of gross income shall be as follows:

1. Each partnership which has one or more New Jersey resident partners, or which derives any item of gross income from sources within New Jersey, shall compute its New Jersey gross income in the same manner as would an individual taxpayer. Such gross income shall be allocated according to its character among the categories of gross income specified in N.J.S.A. 54A:5-1. Each partner's respective distributive shares of the partnership's various categories of gross income shall be determined by the partnership agreement of the partnership in the same manner the partner's distributive share of partnership income is determined for Federal income tax purposes.

2. Each partner shall report as such partner's "distributive share of partnership income" described in N.J.S.A. 54A:5-1k the net aggregate amount of:

i. The partner's distributive shares of the net profits (or loss) from each partnership of which such partner is a member derived from the conduct by such partnership of a business, profession or other income-producing activity, provided such business, profession or income-producing activity constitutes the conduct of a trade or business, plus

ii. The amount of the partner's guaranteed payments, as determined for Federal income tax purposes, from each partnership of which such partner is a member.

3. A partnership shall determine its net profits (or loss) from the conduct of a business, profession or other income-producing activity for purposes of this subsection in the same manner an individual taxpayer determines his or her "net profits from business" pursuant to N.J.A.C. 18:35-1.25, provided, however, in the case of tiered partnerships, a partnership shall take into account its distributive share of partnership income from any partnership of which it is a member.

4. Each partner shall report such partner's distributive shares of each category of New Jersey gross income of the partnership, other than the partnership's net profits (or loss) from the conduct of a business, profession or other income-producing activity described in (c)2 and 3 above, as an item of income attributable to such category of gross income in the same manner as if the partner had derived such item of gross income directly from sources other than a partnership. Each such item of gross income attributable to any category of gross income shall be reported on a consolidated basis with the partner's other items of gross income which are attributable to such category and which are derived from sources other than a partnership.

5. In the case of any category of gross income which pursuant to the Gross Income Tax Act is to be determined on a net income basis, a partner's distributive share of partnership income, gain, loss or expense attributable

to such category shall be reported on a net consolidated basis with the partner's items of income, gain, loss or expenses derived from sources other than a partnership which also are attributable to the same category of gross income.

6. A partner may not report a distributive share of partnership income or loss on a consolidated basis with the partner's net income or loss from business derived from sources other than a partnership.

7. In determining a partner's distributive share of partnership income or loss, no deduction is allowed for expenses which are not incurred by the partnership.

8. The provisions of this section are illustrated by the following examples:

**Example 1:** A partnership shows the following income on its Federal Partnership Return of Income (Form 1065):

Partnership ordinary income (derived from the conduct of a trade or business):	\$25,000
Included in the partnership's ordinary income is interest income of \$500 derived from U.S. Treasury bills and excluded from the partnership's ordinary income is interest income of \$300 derived from State of New York bonds	
Dividend income (non-business source):	1,200
Long term capital gain on sale of partnership capital assets:	<u>1,000</u>
Total	<u>\$27,200</u>

Partner A has a 50 percent interest in the partnership and is entitled to a 50 percent share of partnership profits or losses. How does partner A report his share of the partnership income or gain on his New Jersey Form NJ-1040?

Partner A reports this income for New Jersey Gross Income Tax purposes as follows:

Distributive share of federal partnership ordinary income	\$12,500
Adjustments for New Jersey Gross Income Tax purposes:	
Add: Interest on New York State bonds	<u>150</u>
	<u>\$12,650</u>
Deduct: Interest on U.S. Treasury bills	(250)
Partner A's distributive share of partnership income:	\$12,400
Dividends:	600
Net gains from disposition of property:	<u>500</u>
Total New Jersey Gross Income:	<u>\$13,500</u>

**Example 2:** A taxpayer has the following income:

Distributive share of partnership income, including \$5,000 of guaranteed payments:	\$12,000
Distributive share of partnership capital gain (non-business):	2,000
Salary and wages from employment:	15,000
Capital loss on sale of individually owned stock:	(4,000)

How is this reportable for New Jersey gross income tax purposes on taxpayer's Form NJ-1040?

The taxpayer will report this income for New Jersey Gross Income Tax purposes as follows:

Salary and wages from employment:	\$15,000
Distributive share of partnership income:	12,000
Capital loss on sale of individually owned stock:	(\$4,000)
Plus: Distributive share of partnership gain:	<u>2,000</u>
Net gain from disposition of property:	<u>0 †</u>
Total New Jersey gross income	<u>\$27,000</u>

† Note: The taxpayer may offset the capital loss on the sale of individually owned stock against his distributive share of the partnership's capital gain, but may not apply the resulting net loss from the disposition of property against income attributable to other categories of New Jersey gross income.

**Example 3:** A taxpayer has the following income:

Salary and wages from employment:	\$10,000
Distributive share of partnership loss:	(3,000)
Distributive share of partnership capital loss (non-business):	(2,000)
Capital gain on sale of individually owned stock:	<u>5,000</u>

How is this income reportable for New Jersey Gross Income Tax purposes on Form NJ-1040?

Salary and wages from employment:	\$10,000
Gain on sale of stock:	\$5,000
Less: Share of partnership capital loss	(2,000)
Net gains or income from disposition of property:	<u>3,000</u>
Distributive share of partnership income:	<u>0 †</u>
Total New Jersey gross income	<u>\$13,000</u>

† Note: The taxpayer cannot apply his distributive share of partnership loss against his income attributable to other categories of New Jersey gross income. The taxpayer may only net a distributive share of a partnership loss against a distributive share of partnership income derived from another partnership.

**Example 4:** The Federal form Schedule K-1 (Form 1065) issued to a partner of a partnership actively engaged in the practice of medicine contained the following information:

Partnership net ordinary income (all of which is derived from business activities):	\$25,000
Interest income realized on money market accounts holding required working capital	300
Interest income realized on security deposits held by lessors pertaining to medical equipment leased by the partnership and used in its trade or business	100
Portfolio (i.e., non-business) income:	
Interest (Includes \$500 from U.S. Treasury bills and does not include \$300 from New York State bonds held by the partnership):	1,800
Dividends:	1,200
Royalties:	500
Net long term capital gain:	600
Gain on the sale of property described in I.R.C. § 1231	<u>400</u>

The taxpayer will report this information on his NJ-1040 as follows:

Distributive share of partnership income:

Business ordinary income	\$25,000
Interest on working capital	300 †
Interest on security deposits	<u>100</u>
Net distributive share of partnership income reportable on NJ-1040:	25,400
Interest:	1,800
Adjustments:	
Less interest income from U.S. Treasury bills	(500)
Plus interest income from New York State bonds	<u>300</u>
Interest income reportable on NJ-1040:	1,600
Dividends:	1,200
Net income from rents, royalties, etc.:	500
Gains from disposition of property:	
Long term capital gain	600
§ 1231 gain	<u>400</u>
Net gains from disposition of property:	1,000

† Note: Interest income realized by the partnership with respect to its working capital and security deposits may be taken into account in determining the partnership's net income or loss from trade or business only if the partnership annexes to its tax return the statement described in N.J.A.C. 18:35-1.14(f)4. Absent such statement, the interest income must be separately reported as "interest" by the partnership and will be taxable to the partners as "interest."

**Example 5:** The Federal form Schedule K-1 (Form 1065) issued to a partner of a partnership actively engaged in a trade or business of dealing in and trading securities contained the following information:

Partnership net ordinary income (all of which is derived from business activities):	\$25,000
Other classes of partnership income:	
Interest (Includes \$500 from U.S. Treasury bills and does not include \$300 from New York State bonds) (realized in the ordinary course of business):	1,800
Dividends (realized in the ordinary course of business):	1,200
Trading gains treated as capital gain (realized in the ordinary course of business):	600
Net gain under I.R.C. § 1231:	400
Royalties (non-business):	<u>500</u>

The taxpayer will report this income on his NJ-1040 as follows:

Partnership items of income derived from the conduct of a trade or business:	
Partnership net ordinary income:	\$25,000
Interest:	1,800
Dividends:	1,200
Net trading gains treated as capital gain:	<u>600</u>
	\$28,600
Adjustments:	
Interest income from U.S. Treasury bills	(500)
Interest income from New York State bonds	<u>300</u>
	(200)
Distributive share of partnership income:	\$28,400
Net Gains from the disposition of property:	
§ 1231 Gain	400
Net income from rents, royalties, etc.:	<u>500</u>

**Example 6:** Taxpayer is a partner in two partnerships. Partnership A is a medical partnership and Partnership B is a securities partnership. Each partnership's activities constitute an active trade or business. The Federal Schedules K-1 (Form 1065) issued to the taxpayer by the partnerships contained the following information:

	Partnership A	Partnership B
Partnership net ordinary income	\$100,000†	(\$240,000) †
Other income:		
Interest:	5,000 ††	1,000 †
Dividends:	—	25,000 †
Capital gain:	12,000 ††	20,000 †
Net gain or loss under I.R.C. § 1231		(5,000) ††
The taxpayer also incurred with respect to his partnerships the following unreimbursed business expenses:	15,000	8,000

† Business income.  
†† Non-business income.

The Taxpayer will report this income on his NJ-1040 as follows:

Partnership A	
Partnership Ordinary Income	\$100,000
Partnership B	
Partnership net ordinary income	(\$240,000)
Interest	1,000
Dividends	25,000
Capital gain	20,000
	(194,000)
	(94,000)
Distributive share of partnership income:	0 †
Interest income (Partnership A):	5,000
Gains from disposition of property:	
Capital gain (Partnership A)	12,000
§ 1231 loss (Partnership B)	(5,000)
Net gain from disposition of property:	7,000

† Note: Taxpayer would report "0" on the line of his NJ-1040 calling for the taxpayer's distributive share of partnership income. However, if the taxpayer had been a partner of a third partnership, up to \$94,000 of the taxpayer's distributive share of income realized by the third partnership from the conduct of a trade or business could be offset by the net \$94,000 loss from Partnerships A and B.

**Example 7:** The Federal form Schedule K-1 (Form 1065) issued to a New Jersey resident partner of a partnership actively engaged in the practice of law in New York contained the following information:

Partnership net ordinary income:	\$10,000
Guaranteed payments:	5,000
Interest (Includes \$2,000 from U.S. Treasury bills and does not include \$2,000 from New York State bonds) (non-business):	5,000
Net gain under I.R.C. § 1231:	4,000
I.R.C. § 179 deduction:	1,000
Taxes based on income (UBT):	2,000
Expense incurred to carry New York State bonds:	1,000
Keogh deduction:	2,000
Charitable contributions (non-business):	3,000

The taxpayer also incurred unreimbursed business expenses with respect to his partnership in the amount of \$3,000.

The taxpayer will report this information on his NJ-1040 as follows:

Partnership net ordinary income	\$10,000	
Guaranteed payments	5,000	\$15,000
Adjustments		
Taxes Based on Income	2,000	
§ 179 Deduction	(1,000)	1,000
Distributive share of partnership income:		16,000 †
Interest income		
Adjustments:	5,000	
Interest income from U.S. Treasury bills	(2,000)	
Interest income from New York State bonds	2,000	
Net Adjustments:	-0-	5,000 ††
Interest:		
Net Gains from the disposition of property:		
§ 1231 Gain		4,000

† Note: Keogh Plan contributions for partners, charitable contributions not deducted under I.R.C. § 162 and unreimbursed business expenses are not deductible for Gross Income Tax purposes.

†† Note: The cost to carry the New York State bonds cannot be deducted because the expense was not incurred in the ordinary course of a trade or business conducted by the partnership.

**Example 8:** The taxpayer is a New Jersey resident who is a partner in two partnerships. Partnership A is a New York based securities partnership and Partnership B is a New Jersey based accounting partnership. Each partnership's activities constitute an active trade or business. The Federal forms Schedule K-1 (Form 1065) issued to the taxpayer by the partnerships contained the following information:

	Partnership A	Partnership B
Partnership Ordinary Income:	(\$10,000) †	(\$15,000) †
Guaranteed payments:	2,000	
Interest:	8,000 †	3,000 ††
Interest from U.S. Treasury Bills included in the interest above	7,000 †	
Interest from Pennsylvania State bonds not included in interest above	5,000 †	
Dividends:	5,000 †	
Net short term capital gains or losses:	(2,000) †	
Net long term capital gains or losses:	18,000 †	(1,000) ††
Net Gain under § 1231:	1,500 ††	
Taxes based on income (UBT):	2,500 †	
Cost to carry Pennsylvania bonds:	1,000 †	
Keogh deductions:	2,000	
Charitable contribution incurred as a business expense:		3,000

† Business income.  
†† Non-business income.

The taxpayer is also a shareholder in a New York S corporation. The Schedule K-1 issued by the S corporation showed an ordinary loss of (\$5,000)†.

The taxpayer will report this information on his NJ-1040 as follows:

<b>Partnership A</b>		
Partnership ordinary income	(10,000)	
Guaranteed payments	2,000	
Interest	8,000	
Dividends	5,000	
Net short term capital loss	(2,000)	
Net long term capital gain	<u>18,000</u>	
		\$21,000
Adjustments:		
Interest income from U.S. Treasury Bills	(7,000)	
Interest income from Pennsylvania State Bonds	5,000	
Taxes based on income	2,500	
Cost to carry Pennsylvania bonds	<u>(1,000)</u>	
		(500)
Distributive share of partnership income from Partnership A:		20,500
<b>Partnership B</b>		
Partnership ordinary income	(15,000)	
Charitable contribution incurred as a business expense:	(3,000)	
Adjustments:	<u>-0-</u>	
Distributive share of partnership loss from Partnership B		(18,000)
Distributive share of partnership income:		2,500
Interest (Partnership B):		3,000
Gains from disposition of property:		
Net gain under § 1231 (Partnership A)	1,500	
Net long term capital loss (Partnership B)	<u>(1,000)</u>	
Net gains from the disposition of property:		500

† Note: S Corporation status is not recognized for New Jersey Gross Income Tax purposes. An S Corporation shareholder's share of the corporation's loss is not deductible for New Jersey Gross Income Tax purposes.

(d) If a partner's taxable year differs from that of the partnership, the partner is to report the partner's distributive share of income, gain or loss for the taxable year of the partnership which ends with or within his or her taxable year.

Example 1: A partner's taxable year ends on December 31, 1979, while the partnership's fiscal year ends on June 30, 1979. The partner is to report the partner's entire distributive share of the income, gain or loss from the partnership's taxable year ended June 30, 1979 on the partner's 1979 NJ-1040.

(e) The following apply to partners who are part-year residents:

1. A partner who is a resident taxpayer for part of any taxable year and a nonresident taxpayer for part of such taxable year is required to report his or her distributive share of partnership income as follows:

i. The part-year resident return shall include:

(1) The portion of the partner's distributive share of partnership income determined by multiplying the partner's entire distributive share of partnership income (including guaranteed payments) by the percentage which the number of days of the partnership's fiscal year that the partner was a New Jersey resident bears to 365; plus

(2) The partner's distributive share of each other category of New Jersey gross income (or loss) realized by the partnership during the period covered by the return.

ii. The part-year nonresident return shall include:

(1) The portion of the partner's distributive share of partnership income as follows:

(A) If the distributive share of partnership income was derived entirely from New Jersey sources, the portion of that distributive share of partnership income (including guaranteed payments) determined by multiplying the partner's entire distributive share of partnership income by the percentage which the number of days of the partnership's fiscal year that the partner was not a New Jersey resident bears to 365; or

(B) If the distributive share of partnership income was derived partly within New Jersey and partly outside New Jersey, the portion of such distributive share determined by multiplying the partner's entire distributive share of partnership income derived by the partnership from sources within New Jersey (determined as provided in (b)3ii or (b)3iii above), by the percentage which the number of days of the partnership's fiscal year that the partner was not a New Jersey resident bears to 365; and

(2) The partner's distributive share of each other category of New Jersey gross income (or loss) realized by the partnership and derived from New Jersey sources during that period covered by the return.

2. If the partner can demonstrate to the Director's satisfaction that the above reporting method does not properly reflect the partner's reportable income, gains and losses incurred during the partner's periods of residency and nonresidency, then the partner may allocate to the part year resident and part year nonresident returns the portions of the partner's distributive share of partnership income realized by the partnership during each such period.

3. In all cases, a partner who is a resident taxpayer for part of the tax year and a nonresident taxpayer for the remainder of the tax year must attach a schedule to the partner's part year NJ-1040 and the part year NJ-1040-NR showing the calculations used to determine the amounts reported on each return with respect to income, gains, or losses of a partnership.

(f) Partnership filing requirements are as follows:

1. Partnerships having a New Jersey resident partner or having any income derived from New Jersey sources shall file with the Division a complete copy of the Federal Form 1065, U.S. Partnership Return of Income, required to be filed with the Internal Revenue Service, along with the requisite schedules and attachments. Such information filing must be made on or before the date of expiration of the permitted filing period for the partnership's Federal Form 1065, including any extensions of such period allowed for Federal income tax purposes.

2. Except as may be authorized by the Director pursuant to (b)3iii above, every partnership which derives income both from sources within and outside of New Jersey and which has one or more nonresident partners shall complete a New Jersey Business Allocation Schedule (NJ-1040-NR-A). The partnership shall attach a copy of the Schedule to the Federal Form 1065 which it files with the Division, and must also provide a copy of the Allocation Schedule to each nonresident partner.

3. Each partnership shall distribute to each of its partners their respective Schedule K-1 of the partnership's Federal Form 1065. Each partnership also shall distribute to any partner requesting same any materials required to be filed by the partner with the partner's return pursuant to (g) below.

4. Any partnership which for Federal income tax purposes includes interest or dividends in the ordinary income or loss of the partnership, shall annex to its tax return which it files with the Division a statement such as that described in N.J.A.C. 18:35-1.25(b)2 which justifies the inclusion of such income items in the partnership's ordinary income or loss for New Jersey Gross Income Tax purposes. Any partnership which fails to annex such a statement to its return shall separately state on its return the full amounts of its dividend and interest income.

(g) Partner filing requirements are as follows:

1. Each nonresident taxpayer who is a partner in a partnership having income, gains or losses derived from New Jersey sources shall, for each such partnership, include a copy of each of the following with the partner's New Jersey non-resident tax return:

i. The partner's Federal Schedule K-1;

ii. Reconciliation of his or her share of partnership income as determined for Federal income tax purposes, in accordance with (c) above; and

iii. The partnership's New Jersey Business Allocation Schedule (NJ-1040-NR-A), as provided by the partnership.

2. Each resident taxpayer shall include with the New Jersey resident tax return a copy of each of the items specified in (g)1i through ii above, for each partnership in which the taxpayer is a partner, regardless of the source from which the partnership's income, gains, or losses are derived.

(h) The following apply to Keogh Plans:

1. Partnership contributions to a Keogh Plan made on behalf of employees of the partnership and which are deductible as ordinary and necessary business expenses for Federal income tax purposes also shall be deductible for New Jersey Gross Income tax purposes in determining the net income of the partnership. The employees on whose behalf such contributions were made are not subject to gross income tax on the amounts contributed in the taxable year in which they are contributed to the Keogh Plan, unless withdrawn in such taxable year by the employees from the Plan. The employees are not considered to have actually or constructively received the contributions at the time they were made to the Keogh Plan. When an employee makes a withdrawal from the Keogh Plan, both the untaxed employer contribution and accumulated interest earned thereon are taxable to the employee.

2. Partnership contributions to a Keogh Plan made on behalf of a partner are not deductible business expenses. Such contributions are to be taken into account in determining the distributive shares of partnership income of the individual partners for New Jersey gross income tax purposes in the taxable years in which they are contributed to the Keogh Plan. Previously taxed employer contributions to a Keogh Plan are not subject to tax when subsequently withdrawn by the partners.

3. The interest income accumulated on the Keogh Plan contributions made by the partnership on behalf of the partners is not subject to tax during the period of a partner's participation. Such interest shall become taxable when the partner withdraws it from the Keogh Plan. When a partner makes periodic withdrawals, the accumulated interest in the Keogh Plan is subject to tax in the ratio that the interest bears to the total amount in the partner's account.

4. The provisions of this subsection are illustrated by the following examples:

<b>Example 1: A partner's accumulated Keogh contributions held in his account:</b>	<b>\$7,500</b>
<b>Accumulated interest in partner's Keogh account:</b>	<b>500</b>
<b>Total amount in partner's Keogh account:</b>	<b>\$8,000</b>

Assume periodic payments to the partner from the account during the taxable year of \$1,600.

The amount of interest withdrawn would be calculated as follows:

$$\frac{\$ 500}{\$8,000} \times \$1,600 = \$100$$

**Note:** Under the above facts, if a periodic withdrawal of \$1,600 were made by an employee (rather than by a partner) during the taxable year, the full amount of \$1,600 is subject to tax since the employer contribution component of the amount withdrawn was not includable in the employee's income at the time the partnership made the contribution on his behalf.

**Example 2:** A partnership makes a contribution to a Keogh Plan on behalf of the partners for \$3,000 and on behalf of the employees for \$4,500. The partnership may deduct the \$4,500 contribution on behalf of the employees as a business expense for the taxable year and the employees will not include the \$4,500 as income until withdrawal is made from the Keogh Plan. The partnership cannot deduct the \$3,000 contribution made on behalf of the partners as a business expense for the taxable year. Each partner must include the portion of the \$3,000 contribution made on his behalf in his computation of his distributive share of partnership income in the taxable year the contribution was made. The amount of the contribution thus taxed to the partner will not again be taxable to the partner when such moneys are withdrawn by the partner from the Keogh Plan.

Amended by R.1981 d.6, effective January 8, 1981.

See: 12 N.J.R. 676(a), 13 N.J.R. 111(d).

Repeal and New Rule, R.1994 d.110, effective March 7, 1994.

See: 25 N.J.R. 677(a), 26 N.J.R. 1241(b).

Section was "Partnerships".

#### Case Notes

Regulation could not exclude from partnership net income dividends and capital gains. *Smith v. Director, Div. of Taxation*, 108 N.J. 19, 527 A.2d 843 (1987).

Partnership business expenses could be deducted from partnership income when determining taxpayers' distributive share. *Smith v. Director, Div. of Taxation*, 108 N.J. 19, 527 A.2d 843 (1987).

Regulation relating to deductibility of reimbursed expenses of individual partner for purposes of computing partner's distributive share of partnership income; void. *Sabino v. Director, Div. of Taxation*, 14 N.J.Tax 501 (1995).

Paragraph (c)4 held inconsistent with statute: in determining liability for partner's distributive share of partnership income, partnership expenses incurred in connection with tax exempt income were deductible; expense incurred by securities partnership in the conduct of its business may be deductible against all other forms of partnership income, including dividends and capital gains, in determining partner's distributive shares of partnership income. *Smith v. Director, Div. of Taxation*, 7 N.J.Tax 187 (Tax Ct.1984), affirmed per curiam 8 N.J.Tax 319, affirmed 108 N.J. 19, 527 A.2d 843 (App.Div.1986).

Depletion expenses of partnership engaged in oil and gas production are properly deductible by a partner subject to New Jersey gross income tax; since percentage depletion, to the extent it exceeds cost depletion, is not attributable to production of income for the purpose of New Jersey gross income tax, it is not deductible in computing New Jersey taxable income. *Lee v. Director, Div. of Taxation*, 6 N.J.Tax 385 (Tax Ct.1984).

#### 18:35-1.15 Employee accident or health insurance exclusion from taxable gross income

(a) Amounts received by an employee through an accident or health insurance plan for personal injuries or sickness are not subject to tax under the New Jersey Gross Income Tax Act.

(b) Amounts received by an employee on account of personal injury or sickness qualify for exclusion from taxable gross income when received under the provisions of an employee accident or health insurance plan which satisfies the following requirements:

1. The payments must be compensation for wage loss which results from absence due to injury or sickness of the employee; and
2. The payments must have a requisite certainty under an enforceable contractual obligation under the plan (see N.J.A.C. 18:35-1.15(e)); and
3. The payments must not relate to sick leave wage continuation, the taking of which is largely discretionary and the payments are made regardless of the reason for absence from work.

(c) The exclusion from taxable gross income applies to payments to employees under a health or accident insurance plan regardless of whether insurance coverage is with a commercial insurance company to which premiums are paid by both employees and employer or solely by the employer; or whether insurance coverage is provided by an employer's self-insured plan for which no insurance premiums are paid by the employees.