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New Sales and Corporate Business Hikes

New Jersey's recent tax legislation was more than just a 1 percent hike in sales tax

In July of 2006, the New Jersey Legislature passed 14 new legislative bills as part of the New Jersey 2007 Fiscal Year Appropriations Act. The media focused on New Jersey's budget deadlock and the showdown between the Assembly Democrats and Governor Jon Corzine over what was slated as a proposed hike in the sales tax from 6 percent to 7 percent. Nearly a week after the government shutdown of nonessential services, New Jersey lawmakers settled on a budget compromise. The resulting tax legislation encompassed more than a 1 percent sales tax increase on previously taxable transactions. The Appropriations Act widened the sales tax base, applied the sales tax to previously exempt services and contained a number of corporate tax provisions. Although this article identifies many of the significant changes, it does not cover all provisions of the Appropriations Act.

Effective July 15, 2006, the New Jersey sales and use tax increased from 6 percent to 7 percent. Less widely publicized was the widening of the sales

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and use tax base to a number of services. Business owners of these service companies are now required to register with the state, collect and pay a sales and use tax. As of Oct. 1, 2006, the following services were subject to a 7 percent sales tax: storage space, tanning services, massage services, tattooing, investigation and security services, information services, limousine services, membership fees and parking. The sales tax applies to a new category of "digital property." The state is now taxing electronically delivered items (e.g., sales via the Internet or mobile telephones) the same way as it taxes the sale of compact discs and DVDs. The statute defines "digital property" as electronically delivered music, ringtones, movies, books, audio and video works and similar products, where the customer is granted a right or license to use, retain or make a copy of such item.

The sales tax on digital property delivered over the Internet or via mobile telephones creates a number of accounting, logistical and tax-related legal issues for companies doing business in New Jersey. This will include the difficulty of determining the source of a particular transaction (e.g., those involving cellular telephones used by customers in transit) and effectuating enforcement mechanisms to collect such taxes on hundreds and thousands of transactions occurring over Internet and satellite connections.

Although the Division of Taxation has published some information,

including its Tax Notes to assist taxpayers and their tax professionals determine the scope and applicability of much of this new legislation, further guidance is needed. One area that will require additional clarification in the form of regulations is the sales tax on "information services." The statute defines "information services" as the furnishing of information of any kind, which has been collected, compiled or analyzed by the seller, and provided through any means or method, other than personal or individual information that is not incorporated into reports furnished to other people. This definition could include a wide range of businesses, from small companies that peripherally deal with database information, to multinational companies that routinely sell database information, such as Dunn & Bradstreet, Bloomberg and Blue Cross/Blue Shield.

The definitions and scope of what constitutes a "report" or the "collection of data" are sure to become contested issues. The stakes are high when identifying whether your client is subject to the applicable sales tax. If not collected and paid to the state, potentially there could be personal responsibility of the business owners and/or corporate officers for the unpaid sales taxes determined to be due. In addition, if determined upon audit that sales taxes were not properly remitted, the interest and penalties that accrue are often higher than the tax liability itself.

An issue that may be contested is

the crossover of exempt services with nonexempt services. For example, attorney services, which remain exempt, include the use of taxable "information services" and "investigation services." Attorneys retain investigators, process servers and utilize databases as an inseparable part of their client services. The Appropriations Act now imposes a sales tax on these previously exempt services, which will then be passed on to clients through attorney invoices. The Division of Taxation recently published in its Tax Notes that the statute does not apply to "charges by a business hired by an attorney to issue subpoenas and court summonses," but skip traces, asset searches, background checks and other investigative services tied to attorney professional services are taxable. In 2004, the state exempted from sales tax, as part of the professional services, electronic filing fees if included in the full invoice for a tax filing prepared by a tax practitioner. Arguably, in addition to process servers, other investigative and information services tied to attorney professional services and made part of the full invoice, should also be exempt from tax.

In addition to widening the tax base, the Appropriations Act taxes certain previously exempt services, while preserving other exemptions. For example, the purchase of magazines and periodicals, whether or not accessed by electronic means, are subject to tax. However, the law still retains the exemption for newspapers, magazines and periodicals sold by subscription. Laundering, previously exempt from sales tax, is now only exempt as it pertains to clothing. As a result, laundering services will be taxable when performed on property such as draperies, carpets and linens. Partially exempt and nonexempt services also include landscaping services, prewritten computer software delivered electronically, installation of flooring and delivery charges for taxable goods and services. It is recommended that over the next few months attorneys and/or accountants that have clients that fall into this category of partially exempt ser-

vices assist them in identifying taxable services and develop new accounting methods to deal with these changes.

The Appropriations Act impacts the New Jersey Urban Enterprise Zone Act that provides a sales tax exemption for certain sales made to a "qualified business" in an Urban Enterprise Zone (UEZ). Generally, to be considered a "qualified business" in an UEZ, 25 percent of the full-time employees must meet one or more of the following three criteria: they must be residents from within the zone; receive public assistance; or low-income individuals. The Appropriations Act limits the point of sale exemption of tax to "qualified small businesses," which are defined as "qualified businesses" with annual gross receipts of less than \$1 million in the prior annual tax period. "Qualified businesses," other than "qualified small businesses," now must submit an application for a refund to the Division to obtain their UEZ sales tax exemption savings.

The UEZ Program also offers a partial sales tax exemption for certain retail sales made by certified vendors for in-person sales. Certified UEZ retailers authorized to charge a 50 percent reduced rate are required to charge and collect sales tax at the rate of 3.5 percent on all qualified taxable sales effective July 15, 2006.

The State of New Jersey implemented transition rules that apply to taxable sales that began before July 15, 2006, and completed on or after July 15, 2006. If property was sold and delivered or services became rendered before July 15, 2006, the tax rate is 6 percent. If the property or services were sold, but the property was not delivered or the services were not rendered until on or after July 15, 2006, the business must charge tax at the rate of 7 percent. This rule applies whether or not payment has been made in whole or in part prior to delivery. Customers may apply to the Division for a refund of the 1 percent increase under certain circumstances.

Changes to the New Jersey Corporation Business Tax and Minimum

Tax have also been enacted. For a three year period (beginning after July 1, 2006, but before July 1, 2009), businesses will be assessed and must pay a 4 percent surtax in addition to the annual corporation franchise tax. The tax will be applied to the amount of tax liability remaining after applying credits against liability, other than credits for installment payments, estimated payments made with a request for extension to file a return, or overpayments from a prior privilege period. For example, if a New Jersey corporation has a tax liability of \$90,000 as a result of a 9 percent business corporation franchise tax as reported on page 1, line 18 of the Form CBT 100, a surtax of 4 percent is due in the amount of \$3,600. As a practical matter, this increases the maximum corporate business tax rate to 9.36 percent.

The Minimum Tax has been increased depending upon the taxpayer's gross receipts (as defined by the Alternate Minimum Assessment "AMA") as illustrated by the accompanying chart (see below).

The minimum corporate tax for affiliated or controlled groups remains the same \$2,000 for each member of a group that has a total payroll of \$5 million or more for an applicable tax period.

It is not all bad news. New Jersey businesses were assured some continuing tax relief. The AMA sunsets for tax periods beginning after June 30, 2006. The Corporation Business Tax Net Operating Loss carry-forward deduction was limited to 50 percent of a taxpayer's pre-apportionment income for the 2004 and 2005 tax years. The Appropriations Act restores the full 100 percent deduction of the Net Operating Loss carry-forwards.

The widening of the sales and use tax base of taxable services and the modifications to the Corporate Business Tax are likely to affect many New Jersey businesses. Such taxpayers should consult their tax advisors to plan accordingly and avoid the pitfalls of noncompliance. ■