Tax Aspects of the Receipt and Sale of "Grow NJ" Tax Credits

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Overview

The New Jersey Economic Opportunity Act of 2013 (the "Act") overhauled five of New Jersey's economic development programs granting tax credits to taxpayers and consolidated them into two expanded programs being the Grow New Jersey Assistance Program and the Economic Redevelopment Growth Grant Program (together, the "Programs"). The Act extended the eligibility for tax benefits to businesses in greater geographic areas and also lowered the eligibility thresholds. Under the Programs, the New Jersey Economic Development Authority is authorized to issue tax credits to New Jersey businesses making capital investments and creating jobs in certain areas and to developers of various redevelopment projects. The tax credits issued can be applied only against the New Jersey corporation business tax and the premiums tax on insurance companies. They may not be used against the gross income tax or any other New Jersey taxes. These tax credits are non-refundable tax credits, meaning that if the amount of the available credit exceeds the taxpayer's applicable tax due for the relevant tax period, the taxpayer may not receive a cash refund for the difference. Tax credits in excess of the amount of tax due in any year may be carried forward for 20 years. If the eligible applicant for the credit is a partnership, the applicant is not allowed a tax credit directly but the credit is allocated to the partners of the partnership in proportion to the partners' shares of distributive income or gain of the partnership, whether or not that income or gain is actually distributed, or in such other proportions as are set forth in an agreement of all of the partners which is provided to the New Jersey Division of Taxation. If the eligible business does not expect to be able to utilize the tax credits, it may sell the credits to a taxpayer which can use the credits for a purchase price of not less than 75% of the amount of the transferred credit.

Impact on Taxpayers Receiving Tax Credits

With respect to these non-refundable state tax credits, a taxpayer receiving the credits may either use the credits to reduce the specified state taxes owed by the taxpayer or sell the credits pursuant to a tax credit transfer program run by New Jersey. The receipt of these tax credits does not constitute income to the taxpayer for federal income tax purposes. If the taxpayer uses the credits to offset an applicable state tax, since the taxpayer is not actually paying these state taxes the taxpayer will not receive a federal state tax deduction for the corresponding state taxes which are not actually paid. If the taxpayer sells the tax credits, the sale would constitute a taxable event to the taxpayer. The taxpayer will not have any tax basis in the credits received from New Jersey. The tax credit, as a property right, does not appear to fall into any of the exceptions to an asset qualifying as a capital asset for federal income tax purposes (such as inventory). Accordingly, some courts and even the Internal Revenue Service have treated different non-refundable state tax credits as capital assets, thereby generating capital gain

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to the taxpayer on its sale. However, in order to benefit from the lower federal income tax rates on long-term capital gains, the tax credit would have to be held for more than a year after it is granted by New Jersey to the taxpayer. Otherwise, the sale will generate short-term capital gain taxable at the same rates as ordinary income.

Impact on Taxpayers Purchasing Tax Credits

A taxpayer which purchases a tax credit from the business which was originally issued the tax credit by New Jersey would have a tax basis for the credit equal to the amount paid for the purchase of the tax credit. Since the tax credit is also an asset in the hands of the purchaser, the purchaser would recognize gain or loss when it applies the tax credit against its applicable New Jersey tax liabilities. For example, if a taxpayer purchases a $100 tax credit for a purchase price of $75 from the business to which the credit was originally issued and applies the tax credit against $100 of the taxpayer's state tax liability, the purchasing taxpayer would have federal taxable income of $25 and would receive a federal tax deduction for the deemed payment of $100 of its state tax liabilities. It is unclear whether the application of the tax credit against the purchasing taxpayer's state tax liabilities results in ordinary income or capital gain to the purchasing taxpayer. Because these tax credits may only be used against the New Jersey corporation business tax and insurance company premium taxes, the users of these tax credits will be corporations for which the federal income tax rates are the same for capital gains (whether long-term or short-term) and ordinary income. Accordingly, this characterization issue will be of lesser importance to purchasing corporations than it would be for individual taxpayers who enjoy preferential federal long-term capital gains rates. However, there are other differences between the federal income tax treatment of capital gains and ordinary income for corporations which make the characterization still relevant.

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