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Corporate giants in line for big tax breaks from N.J. under fast-tracked bill

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Assembly Budget Committee holds a hearing on the FY 2024 budget in The New Jersey State House Annex in Trenton on Wednesday, May 17, 2023. Julian Leshay | For NJ Advance Media

By **Derek Hall | NJ Advance Media for NJ.com**

Gov. Phil Murphy’s administration wants to rewrite New Jersey’s corporate tax code with sweeping changes that some experts warn will amount to significant tax advantages for the largest and most powerful corporations doing business in the state.

The state Senate Budget Committee is set to vote Monday on a 51-page bill that lawmakers are moving swiftly through the Democratic-controlled New Jersey Legislature even as Murphy, a Democrat, and legislative leaders negotiate a record-breaking $53 billion state budget.

Proponents of the measure, including state Treasury officials and corporate lobbyists, say the changes are meant to simplify the corporation business tax and to make New Jersey more competitive with neighboring states.

“The bill is intended to improve tax administration and compliance; this is not a tax cut,” according to state Division of Taxation Director John Ficara, a former corporate tax executive who has led the division since 2016.

Several tax experts who reviewed the legislation for NJ Advance Media have taken issue with that. They say there are provisions in the bill that are “highly concerning” and would grant a competitive advantage to multinational corporations at the expense of small businesses.

“If one must cut taxes on corporations, then it would be better to cut taxes broadly by lowering the rate so smaller and local firms can benefit,” said Darien Shanske, an expert on state and local taxation and a law professor at the University of California, Davis School of Law.

“But (this bill) concentrates its tax breaks on the largest and most aggressive taxpayers,” Shanske told NJ Advance Media. “If one must give such largesse to the biggest taxpayers, then at least one ought to get something in return for New Jersey’s citizens.”

The state’s tax division wrote the legislation in collaboration with the corporate lobby, something state lawmakers and business leaders say should be celebrated as a win for the Garden State and its residents.

New Jersey citizen advocates and policy analysts say it should raise a red flag.

“There’s been a narrative that we’ve been told that this is a great success story: Here is taxation and the industry being regulated coming together,” Peter Chen, a senior analyst with left-leaning think tank New Jersey Policy Perspective, said during a recent budget committee hearing in May.

“A system in which the regulators and the regulated party come together to write the regulations doesn’t necessarily serve the people who are supposed to be protected by those regulations,” Chen said.

N.J.’s plan to break with a federal provision called GILTI

The bill includes dozens of complex technical changes to the corporate tax code, including some revisions that are expected to raise revenue, potentially offsetting some of the tax breaks.

“There are several positive steps (the bill) makes to improve New Jersey’s tax system,” Shanske said. “However, it contains two fairly spectacular missteps.”

At the core of those “missteps” is a decades-long debate swirling around multinational corporations and their ability to utilize a wealth of resources to shift profits out of the U.S. tax base and into subsidiaries located in tax havens overseas.

One of the most contentious changes being proposed is a repeal of New Jersey’s conformity with a federal provision commonly referred to as GILTI, which created a new category of corporate income known as global intangible low-taxed income.

The provision was enacted in 2017 as part of a suite of corporate tax cuts under former President Donald Trump. According to U.S. lawmakers, the intent was to claw back some of the income that bad actors were improperly shifting overseas, an issue that has long been a major problem in the U.S.

A 2022 Congressional Research Service study showed U.S. multinational corporations reported profits in the tax haven nations of Barbados, Bermuda, the Cayman Islands, Jersey and Mauritius in 2018 that were much larger than the economic output of those countries, “an arithmetic and economic impossibility,” according to Michael Mazerov, a senior fellow with the State Fiscal Project at the Center on Budget and Policy Priorities in Washington.

Prominent economists Ludvig Wier and Gabriel Zucman estimated in a separate 2022 study that corporate tax revenues at the federal level were reduced by 23% in 2018 and 16% in 2019 as a result of income shifting.

Most states simply follow the federal government, both with corporate and individual tax codes, according to Steve Rosenthal, a senior fellow in the Urban-Brookings Tax Policy Center and former staff director of the D.C. Tax Revision Commission, an independent body that provided recommendations for improving D.C.'s tax code.

"Here, New Jersey is departing from the scheme that Congress established for multinationals and how they pay tax on their foreign income. My read of the statute is that New Jersey wants to exempt that income completely," Rosenthal told NJ Advance Media.

"That's sort of a generous allowance to New Jersey corporations, or at least multinationals" doing business in the state, Rosenthal said.

In an analysis of the bill released Thursday, New Jersey's nonpartisan Office of Legislative Services estimated the repeal of the GILTI provision would cost the state about $106.6 million each year, a figure that was higher than the estimates Treasury officials presented to state lawmakers during a budget committee hearing in May.

In its analysis, the OLS noted that the bill's effect on state revenue and expenditures would vary from year to year, and it said it lacked "the informational basis to either agree or disagree" with Treasury's assessment that it would be revenue neutral in the long-term.

Ficara and Treasury officials say the repeal of GILTI will not weaken the Division of Taxation's ability to combat abusive income shifting, and other changes in the bill will offset any loss of revenue.

"The bill, and current law, contain several significant tools to combat abusive or inappropriate behavior by taxpayers," Ficara said.

It was a point echoed by Deborah Bierbaum, a corporate tax consultant and former deputy commissioner of tax policy for the New York State Department of Taxation and Finance. Bierbaum served as an adviser to the corporate lobby in writing the legislation.

“The division has the authority under the statute to adjust income and expenses if they see a situation there,” Bierbaum told NJ Advance Media.

Shanske and other tax experts say this has the effect of removing a clear rule established by GILTI, and puts the onus on public officials to audit corporate income tax returns, which will inevitably lead to challenges from big corporations.

“As for the director’s discretion, and in due respect to the excellence of the Division, no revenue agency in the world is up to policing the returns of all of these multinational corporations,” Shanske said.

“That is why the federal government relies on formulas in GILTI,” he added.

New Jersey is already undertaxing multinational corporations by about $200 million each year, according to calculations from Shanske based on federally reported data from 2018. With the changes being proposed in the legislation, that loss of revenue is likely to only get worse, according to tax experts.

“This repeal has the effect of granting large multinational corporations a tax break in proportion to the income they have shifted out of the U.S. tax base,” Shanske said. “And for this gift New Jersey gets less than nothing in return.”

Compounding the potential problems associated with GILTI is a proposal to repeal a separate provision in New Jersey’s corporate tax code related to royalty and interest payments made between commonly owned companies within a corporate group.

Repeal of the provision would open the door even further for the largest corporations to shift income both domestically and internationally, according to Mazerov.

"There are definitely provisions in this bill that are very positive and will raise revenue for the state, but these two provisions could be very costly in the long run," Mazerov told NJ Advance Media. "I have serious questions about the claim that this bill is revenue neutral."

The most prominent example of tax avoidance related to royalty payments was Toys "R" Us and its transfer of the Geoffrey the Giraffe trademark to a subsidiary in Delaware, a corporate tax haven among U.S. states.

Toys "R" Us stores engaged in "income stripping," according to Mazerov, by paying royalty fees to the Delaware subsidiary for use of the Geoffrey the Giraffe trademark and logo, thereby shifting sales income out of states like New Jersey.

By repealing the provision aimed at combatting this sort of tax avoidance, the Garden State would "lose vitally needed revenue and once again give multinational corporations able to engage in income shifting schemes a substantial and unwarranted advantage in competing with small New Jersey businesses," Mazerov said.

The competitiveness argument

Corporate lobbyists and Treasury officials, including Ficara, say the changes put forward in the bill are essential to maintaining a competitive business environment in New Jersey to attract corporate jobs and investment.

"This bill will absolutely utilize a tool for the business community to go out there and say we are competitive," said Michael Egenton, executive vice president of government relations for the New Jersey Chamber of Commerce.

Business leaders have long argued that New Jersey is an outlier — the state has the highest corporate tax rate in the nation — and the bill is necessary to bring New Jersey more in line with competing states, especially regional competitors like Pennsylvania and New York that are lowering corporate tax rates and the taxation of GILTI.

“We are an outlier, and that outlier status makes us less attractive to these multinational corporations,” said Christopher Emigholz, vice president of government affairs for the New Jersey Business and Industry Association.

“The BIA strongly believes that in the net, in the aggregate, this is a win-win for our corporate taxpayers, and a win for our economy and a win for New Jersey,” Emigholz said.

The competitiveness argument ignores a key facet of New Jersey’s corporate business tax, according to some experts.

The amount a company pays in state corporate taxes is largely the result of how many goods or services that business sells within the state, and not whether it is physically located in New Jersey or growing the economy here.

“The fact that the corporate tax rate is higher doesn’t create any disincentive at the margin,” Mazerov said. “If the company invests more in the state, it’s liability doesn’t go up. If it decides to invest elsewhere, it’s liability doesn’t go down, unless it stops selling to customers in New Jersey.”

Shanske noted that “it is possible some of these other reforms might help competitiveness,” but said they don’t require the state to repeal its conformity with the federal GILTI provision.

In response to questions from NJ Advance Media related to competitiveness, Ficara pointed to what other states are doing, and to a decline over the past five years in the number of states that conform with GILTI.

“The bill would make New Jersey significantly more competitive with other states by eliminating our status as an outlier in a number of areas,” Ficara said. “We would join the majority of other states nationwide by treating GILTI similarly to our neighbors in the region.”

“Since the tax on GILTI has a greater impact on larger multinational corporations, the effective reduction in GILTI will encourage large multinationals to either remain in New Jersey or relocate to New Jersey,” he added.

States have faced an uphill battle in their efforts to conform with the federal provision over the past six years, thanks primarily to an army of corporate tax lawyers and lobbyists that have challenged the constitutionality of the tax and threatened legal action.

At least 20 states across the country currently tax GILTI, and Minnesota’s legislature recently passed a bill to conform with the federal provision despite an onslaught from the corporate tax lobby.

Minnesota had the opportunity to conform with the provision when it was enacted at the federal level in 2017 but chose not to, according to Minnesota state Sen. Ann Rest, a primary sponsor of the bill.

“I think we recognize that the motivation for doing this at the federal level was a valid one, so we adopted that,” Rest told NJ Advance Media.

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