

## **E. MARTIN DAVIDOFF & ASSOCIATES**

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CERTIFIED PUBLIC ACCOUNTANTS

*E. Martin Davidoff, CPA, ESQ.*

*Robbin R. Weiner, CPA*

353 Georges Road - Suite K

P.O. Box 835

Dayton, NJ 08810-0835

EMD@taxattorneycpa.com

TEL: 732-274-1600

FAX: 732-274-1666

### **TESTIMONY OF E. MARTIN DAVIDOFF BEFORE THE NEW JERSEY CORPORATION BUSINESS TAX STUDY COMMISSION MAY 15, 2003**

#### **SCOPE OF THE COMMISSION'S RESPONSIBILITIES**

As you well know, the statute under which you have been formed, asks you to evaluate the corporate tax law reforms adopted by P.L. 2002, Chapter 40. The statute goes on and presents five specific questions to you. However, I ask you to consider the initial wording in the statute wherein you were asked to evaluate "the corporate tax law reforms." To that end, I ask you to interpret the term "corporate tax law reforms" in broad terms to include all of the taxes imposed by Chapter 40 under the guise of making all companies pay their fair share. Specifically, I am asking you to include in your report a position on the \$150 per partner processing fees imposed on many partnerships. Although this is not technically a corporate tax, it was certainly one of the major revenue-raisers on business last year and is one of the most devastating to our state's citizens.

#### **OVERVIEW OF MY TESTIMONY**

Specifically, my testimony below urges you to recommend:

- The repeal of the \$150 processing fee on partnerships;
- Adding relief provisions on the suspension of net operating losses for those companies selling the bulk of their operating assets as part of a plan of liquidation; and
- To reduce the corporate minimum tax back to \$210.

#### **REPEAL THE NEW PROCESSING FEE ON PARTNERSHIPS**

Last year I testified both before the Assembly Budget Committee and the Senate Budget & Appropriations Committee, warning of the unintended impact of this new processing fee. The whole premise of the tax is unfounded. This is neither a tax on income, nor one on wealth. Rather, it is nothing more than a tax in the vein of "if it moves, let's tax it!"

In 1993, I was part of a team put together by Assemblywoman Harriett Derman to bring tax relief to owners of S Corporations experiencing double taxation in New Jersey. As part of the provisions to pay for this tax relief, we added a requirement for the filing of partnership tax returns to raise revenue!

The “processing fee” seems to be based upon a rationale that the filing of partnership tax returns actually cost the state money. In fact, such filings contribute funds to the State’s Treasury.

I am enclosing with my written materials, my testimony before the Assembly Budget Committee on June 17, 2002. That testimony accurately warned of the impact upon small investment clubs and fledgling businesses. Now, nearly a year later, I can say affirmatively that the impact is even more devastating than I had predicted.

With regularity, larger, more sophisticated limited liability companies and limited liability partnerships are locating outside of New Jersey. Small fledgling partnerships are disbanding altogether. They are finding the marginal additional costs enough to make them abandon their business.

History has shown that marginal businesses often become wildly successful and greatly contribute to the economic viability of our state. By providing disincentives at the beginning of their lives, in terms of the “processing fee,” we are killing them in a manner that is no less cruel than a hard frost kills a seedling plant. Through our state’s greed, we are snuffing out business enterprises.

**PROVIDE RELIEF WITH RESPECT TO SUSPENSION OF THE NET  
OPERATING LOSS PROVISIONS**

The suspension of the net operating loss provisions needs some tweaking. It is one thing for one to defer the use of the losses until later years. However, what happens in the case of an enterprise which terminates its operations? This has happened to at least one of my clients who had suspended its operations prior to the passage of the legislation and, in February 2002, sold its real estate and inventory at a substantial taxable gain. Under the new law it was unable to carry forward its \$300,000 net operating loss. The loss is not simply suspended, it is lost forever. What could be more unfair? At the time of the transaction, their loss could be utilized. However, the retroactive law has unfairly cost them substantial dollars. I ask you today to retroactively correct such unintended distortions by doing the following:

- The two year suspension of the net operating losses should not apply to years in which companies sell substantially all of their assets as part of a plan of liquidation. Instead of a deferral of the net operating losses, these companies would suffer the total elimination of their net operating losses; and
- The two year suspension of the net operating losses should not apply to the last or next to last year of a corporation’s operation.

How fair is it to assess a company an additional tax of \$27,000, simply due to the timing of its liquidation? This is what has happened to a company which had operated in New Jersey for three generations, spanning seventy-five years. What makes this situation even more unfair is the fact that its plan of liquidation and the consummating sale took place months before the enactment of the 2002 legislation.

### **CORPORATE MINIMUM TAX**

The \$500 corporate minimum tax is too high! Even California, with the highest minimum tax of \$800 per year, at least gives their break by eliminating the minimum tax for first and second year corporations. Even New York has reduced its minimum tax on many companies to \$100 per year. Simply stated, \$500 is too much.

During the past year I have had companies take the following actions to avoid or eliminate the higher minimum tax:

- They have merged into limited liability companies;
- They have decided to do business in other states;
- They have decided to incorporate out of state (while still operating in New Jersey), erroneously thinking that they would then not be subject to New Jersey's minimum tax;
- They have abandoned their corporations; and
- They have formally liquidated their corporations.

As in the case of the \$150 per partner fee discussed above, the \$500 minimum tax discourages new businesses from forming in New Jersey and encourages marginal businesses to go out of business. In any long term period the cost of the \$500 minimum tax will far outweigh the revenue that is being raised by the state. It is totally out of line with the minimum tax rates in other states and is one of the most irresponsible actions of our State Legislature since 1991.

### **OFFSET/REVENUE RAISERS**

As you consider your recommendations to the Governor and our Legislature, you should be looking to raise revenue to pay for the relief I am requesting, to the extent that such funds have not already been provided by the corporate tax surplus I have been reading about. I encourage you to continue to close loopholes that may still be available to the multi-national corporations and specifically ask you to consider a unitary business concept. This only seems fair in light of the fact that the 2002 legislation placed an unfair burden on small businesses, due in large part to organizations lobbying heavily on behalf of the largest corporations doing business in New Jersey.

As I suggested last year, you may wish to add revenue through a simplification of the corporate rules by eliminating the 100% New Jersey allowance for meals and entertainment and by recoupling the meals and entertainment rules to the federal rules, in which meals and entertainment are only 50% allowable. Although I agree that, as a necessary expense, meals and entertainment should be fully deductible, I would rather lower the corporate minimum tax and raise revenue through a process which simplifies New Jersey tax computations (by minimizing differences from the federal tax base).

Much has been said by the politicians about all of us joining in and sharing in the burden of New Jersey's budget deficits. However, that has not been the reality at all. Instead, at every turn, businesses of every type have been attacked and burdened by additional taxes. Such taxes have been assessed through an unfair amalgamation of new taxes. Ideally, what should have taken place is an across-the-board increase to everyone, coupled with the closing of true loopholes in the tax law.

Last year I proposed that we all share in the burden. To that end, I proposed a surtax as a fairer, simpler solution to our budget deficits. In this manner, everyone would be coming together to close our budget deficit...the burden falls equitably on everyone across the board and in proportion to their current tax burdens. That concept is discussed in my testimony of last year which I have provided to you and which is incorporated herein by reference. In addition, it is set forth in a Business News article from last April, which I have also enclosed for your consideration and for inclusion in the permanent record of today's hearings.

### **CLOSING**

You have a unique opportunity over the coming months to provide your expertise and knowledge of the tax laws and tax policy to recommend gutsy legislation to eliminate the three problems that I have discussed today. Quite simply:

- The \$150 tax processing fee is a wholly inappropriate tax and should be repealed;
- The suspension of the net operating loss has unintended effects which need to be corrected; and
- The minimum corporate tax of \$500 per year is too high.

Correct these inequities and you will have done New Jersey a huge service.

I would like to thank Dan Levine for the support that he provides you today and the leadership that he provided ten years ago when we worked together on the S Corporation tax legislation. I would also like to thank each of you for the time that you have committed to this process. You should be congratulated for your zest for public service and your commitment to the integrity of the process.