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Facts for Discussion

Committed to Quality Research on Behalf of New Jersey Employers

New Jersey's Tax Climate – How Taxes are Affecting New Jersey's Industrial, Commercial and Small Business Sectors

Issue: New Jersey's Overall Tax Climate

Located in a prime location between the metropolitan areas of Philadelphia and New York City, the Garden State is home to many business headquarters. New Jersey currently plays host to 37 Fortune 1,000 companies and seven FSB 100 (Fortune Small Business) companies. It is also estimated that more than 20 percent of the nation's Fortune 500 companies are headquartered in or within close proximity of the State.[1] According to the US Census Bureau, an estimated 60 million consumers live within a four-hour drive of the State.[2]

Yet, job growth in New Jersey has lagged in recent years. On average, the private sector has produced only 543 new jobs a year from December 2000 to December 2007, well below the employment growth boasted by the State in the 1980s and 1990s of roughly 70,000 new private-sector jobs a year.

In contrast, public-sector employment has grown rapidly at the State and local government level. New Jersey has experienced an expansion of public-sector employment by 54,800 jobs over those same seven years, more than 14 times the number of private sector jobs.[3] Almost 94% of the newly created jobs in New Jersey from 2000 through 2007 were in the public sector which contributes to increased public budget costs. Increasing employment in the public sector during a period in which the State is in a budget deficit, forces elected officials and public managers to either re-prioritize spending or raise taxes.

Correcting a downward slide of private-sector jobs requires states to increase economic activity through the attraction of new businesses and preservation of existing businesses. Companies tend to migrate to states that offer the greatest competitive advantage, and all other factors being equal, they will usually choose to locate within states that offer more favorable tax systems. Each state's competitiveness in attracting new businesses and keeping existing businesses is often contingent on how its tax system is organized.

This report explains how New Jersey's high taxes are a direct factor discouraging business investment and job creation in the State, and these high tax rates will continue to hurt the Garden State's level of competitiveness with neighboring states.

Facts about New Jersey's Tax Climate

• New Jersey Ranks 49th in the Nation in Business Tax Climate.[4]

The Tax Foundation ranked New Jersey 49th in the nation in its 2008 State Business Tax Climate Index. New Jersey's nearby states all had better rankings: Pennsylvania – 27, New York – 48, Delaware – 9, Connecticut – 38, Massachusetts – 34 and Maryland – 24. New Jersey slipped one spot in the 2008 ranking, having been 48th for the previous two years.

The Tax Foundation index rates each state on a scale of 0 (worst) to 10 (best) with 5.00 as the US average. This year New Jersey was given an index score of 3.88, which is down from last year's score. Interestingly, New Jersey experienced the steepest decline from the 2007 rankings to the 2008 rankings showing that a bad business tax climate was only made worse.

New Jersey's income and property tax rankings were among the worst two, and the corporate and sales tax rankings were in the bottom ten. The State is average in unemployment insurance taxes in comparison to other states.

• New Jersey's Individual Income Tax Top Rate Ranks 6th Highest Nationally.[5]

New Jersey's individual income tax system has a top rate of 8.97 percent, the 6th highest rate in the nation, for incomes of $500,000 or more. The system consists of seven brackets, with a rate of 1.4 percent for incomes smaller than $20,000. According to the 2007 State Business Tax Climate index, New Jersey has the worst individual income tax system in the country.

New Jersey is one of the few states with no standard deductions, so that the tax is levied on a much broader basis. It means that income tax rates in New Jersey are higher than they appear because in other states and with the Federal income tax, there are more deductions, exemptions and credits to lower taxable income.

Each state's tax system is important in influencing an individual's decision to become an entrepreneur or remain self-employed. New Jersey's individual income tax system can be hard on small businesses, because sole proprietorships, partnerships, LLCs and S-corporations report their business income through individual income tax filings.

• New Jersey Ranks 8th Highest Nationally Among States with a Corporate Income Tax.[6]

New Jersey currently has the eighth highest top corporate income tax rate according to the Tax Foundation. Presently, New Jersey has a top rate of 9.36 percent on corporate income for corporations earning $100,000 or more. On the other hand, New Jersey levies a tax of 7.8 percent on corporations that earn a net income of less than $100,000 but greater than $50,000. Corporations that earn a total net income smaller than $50,000 are taxed at a rate of 6.76 percent. These rates include a temporary 4 percent surcharge on tax liability that ends in July 2009.

• New Jersey Property Tax Per Capita is the Highest in the Nation.[7]

New Jersey currently has the highest property tax collection per capita, $2,206, which is more than double the 50-state average. New Jersey residents and businesses pay 4.68 percent of their income for property taxes. New Jersey businesses pay approximately a quarter of the property taxes in the State, and that amounts to more than $5 billion.

Because businesses pay property taxes whether they are profitable or not, local property taxes often influence where entrepreneurs decide to start new businesses. New businesses often are not profitable in their first few years, so property taxes can be a significant factor in their location decisions.

Property taxes also play a major role in attracting and retaining employees, therefore their exorbitant level makes it harder for NJ businesses to find and keep employees.

• Unemployment Insurance[8]

The Garden State has diverted $4.6 billion in payroll tax revenues from its Unemployment Insurance (UI) Trust Fund since 1993. In addition, New Jersey has increased unemployment insurance benefits to eligible citizens, causing the trust fund balance to fall to a 20-year low, $900 million. By comparison, the fund balance reached a record high of $3.1 billion in 2001. If money from the UI fund were to again be diverted to balance the State budget then this will automatically trigger higher UI taxes on employers. Currently the unemployment insurance tax ranks as one of the few taxes where New Jersey is not among the worst in the nation, but any diversions would threaten that status.

Areas of New Jersey's Tax Code Important to Business

• Policy on Net Operating Losses (NOL)[9]

Carrybacks and Carryforwards: The laws for recapturing a tax benefit from annual net operating losses (NOLs) operate differently under New Jersey laws than the laws that apply to NOLs on the federal level and in neighboring states. The federal government allows for both a carryforward and carryback benefit to help businesses that incurred losses greater than their income in a given tax year. The principle of carryforward allows a company to deduct its NOL from the given tax period to a future taxable year, while the principle of carryback allows a company to adjust prior year taxes by applying NOLs. Unlike the federal government, New Jersey does not allow carrybacks of NOLs to prior tax years, and it limits carryforwards to seven years. In comparison, New York and Delaware apply the federal government's policy of a two-year carryback and 20-year carryforward.

• Energy Taxes

New Jersey is currently ranked 7th highest in the nation in the cost of electricity for industrial users and 11th highest for commercial users.[10] Driving these high costs are taxes and assessments charged on consumer electric bills, which total approximately 13.5 percent of the cost. Sales and use taxes make up 7 percent of this; the Societal Benefits Charge and the Transitional Energy Facility Assessment account for the remaining 6.5 percent.

Neighboring states such as New York and Pennsylvania impose their sales tax on retail sales of electricity to commercial and industrial customers with rates of 4 and 6 percent respectively. Connecticut does not impose its sales tax on electricity, but instead levies an 8.5 percent rate on the transmission and distribution of electricity to nonresidential consumers. Delaware, which has no state sales tax, has a

Public Utilities Tax of 4.25 percent on the distribution of electricity.[11]

New Jersey's Societal Benefits Charge (SBC)[12] is imposed on all energy consumers to raise funds for social programs and to allow utility companies to recover costs and fund infrastructure improvements. The SBC is approximately 3 percent of each consumer's gas and electric consumer's bill. The Fund has six uses:

1. Social programs.
2. Nuclear plant decommissioning.
3. Demand-side management and energy efficiency programs, and class I renewable power such as wind, solar, and fuel cells.
4. Manufactured gas plant remediation.
5. Consumer education.
6. Universal service fund, which provides for social programs such as the Lifeline Credit Program and Low Income Home Energy Assistance Program.

There is not one statewide calculation for the SBC; instead, tariffs are set during rate-making procedure and vary from utility to utility as approved by the Board of Public Utilities (BPU). Since businesses use 64 percent of all consumed electricity, almost twice the residential usage, they contribute more money through the SBC. However, businesses do not benefit proportionately to the money they pay into the fund. Businesses subsidize the residential consumer benefits. The BPU Clean Energy Fund guidelines limit the number of energy rebates available to business ratepayers for a given calendar year.

Regardless of the amount of SBC tax paid, residential ratepayers benefit from a number of rebates in a given year, including an air conditioning rebate, lighting upgrade, and New Jersey Energy Star home rebate, while businesses are limited to a $200,000 maximum rebate for an entire site. Furthermore the solar program has been phased out for large commercial and industrial projects with SBC dollars being used to subsidize smaller, mostly residential projects through 2012.

In an attempt to lower energy rates on companies, New Jersey instituted the Transitional Energy Facility Assessment (TEFA)[13] in 1998 as part of an electric energy deregulation initiative. As a result, total taxes on energy were supposed to fall from 13.5 percent to 7.5 percent. As a temporary energy tax, TEFA was scheduled to expire in **2002**, but expiration has been delayed three times, and a phase-out is now set to begin in January 2010. The TEFA temporary energy tax adds 3 to 4 percent on electricity bills, and raised approximately $254 million in 2006.

How New Jersey's Tax Climate Affects its Competitiveness for Business Investment

• New Jersey Is Losing Its Competitive Edge for Business Expansion and Attraction: More Businesses Are Migrating Out-of-State.

From 2000 through 2006, New Jersey's cost competitiveness has decreased nationally and globally, as advanced, leading-edge corporate investment and employment growth in America has, for the most part, taken place outside of New Jersey.[14]

New Jersey is already at a competitive disadvantage for foreign investment, and high corporate tax rates in the State give companies the incentive to relocate more of their operations out of the reach of the State's Division of Taxation. The State also imposes high property and individual tax rates. Those costs are particularly significant for entrepreneurs whose early years of operation typically show losses.

Furthermore, a key concern in New Jersey is the fact that the State is losing corporate headquarters. For example, First Energy of Akron, Ohio acquired New Jersey-based GPU/JCP&L, Conectiv of Wilmington, Delaware acquired Atlantic City Electric, and AGL Resources of Atlanta, Georgia, the largest distributor of natural gas on the east coast, acquired NUI. Other states, not New Jersey, are the desirable destination, and executive authority over these companies is being relocated outside of the State's boundaries.[15]

Conclusion and Policy Implications

New Jersey's poor tax climate is a major issue impacting the decision of companies to invest, create jobs, and preserve jobs in the Garden State. Furthermore, the high costs of doing business are directly affecting small businesses and entrepreneurial survival rates. According to the Small Business & Entrepreneur Council's Small Business Survival Index 2007, New Jersey has the worst policy environment for entrepreneurship of any state in the nation.[16]

The high cost of doing business caused by excessive taxation is impeding the State's ability to remain economically competitive and to generate employment growth in the high-paying sectors of the economy – service, manufacturing, and technology. Evidence proving New Jersey has a tax system that is unfavorable to business is clear in the poor rankings the State receives in an overwhelming number of national studies and reports. In addition, policies unique to New

Jersey, such as excessive property taxes, fewer income tax deductions, the Societal Benefits Charge and the Transitional Energy Facility Assessment, are adding to the decline of the State's competitiveness with other states.

In order to be more competitive on a national level, New Jersey must strive to create a tax system that does not inflict excessive taxes on business activity. Reversing the current trend of New Jersey's economy from one of the least economically competitive states to a leading one will require State policymakers to find ways to reduce business taxes. Unchanged, these factors will continue to increase the migration of businesses out of New Jersey.

Future economic growth in New Jersey is contingent on policymakers in Trenton reforming the policies toward business taxation to ensure that New Jersey will be competitive in the global market. A healthy business climate in New Jersey is essential to promoting a high quality of life for all residents of the Garden State.

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