



Income From S Corporations

Bulletin GIT-9S

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New Jersey Treatment of Federal S Corporation Income

Effective for all tax years beginning after July 7, 1993, both the New Jersey Corporation Business Tax Act and Gross Income Tax Act provide for the recognition of S corporation status for New Jersey tax purposes. Until P.L. 1993, c.173 was signed into law, New Jersey did not recognize S corporations. All S corporations were taxed as C corporations for Corporation Business Tax purposes, and all S corporation shareholders were taxed as C corporation shareholders for gross income tax purposes. Consequently, residents were only required to include in gross income the amounts which were **actually** distributed during the year. Nonresidents were not subject to the gross income tax on any income distributed by an S corporation even if the S corporation was located or doing business in New Jersey.

As a result of the 1993 legislation, S corporation shareholders are now subject to the gross income tax on their pro rata share of an S corporation's income, whether or not such income was actually distributed. This income will be reported on the New Jersey gross income tax return in the category of income called "Net pro rata share of S corporation income."

"Net pro rata share of S corporation income" is calculated on a limited flow-through basis. The income, gain, or loss earned by an S corporation does not maintain its character when passed through to the individual shareholders. An S corporation shareholder will report the income from the S corporation only in the category of net pro rata share of S corporation income.

Reconciliation Worksheet B takes the information from your Schedule K-1, Federal Form 1120S and converts it into your pro rata share of S corporation income as defined by the New Jersey Gross Income Tax Act. Because of the significant differences between the federal income tax treatment and the New Jersey income tax treatment of federal S corporations, you **must** complete Reconciliation Worksheet B every year, as well as Worksheets C and E, for each nonelecting S corporation in which you are a shareholder, **whether you are a resident or a nonresident.**

You should not submit any of the completed worksheets with Form NJ-1040, NJ-1040NR, or NJ-1041. Be sure, however, that you retain your completed worksheets along with a copy of your completed income tax forms and schedules for as long as you own the S corporation shares.

Shareholder Reporting Requirements

New Jersey Electing S Corporation

If a federal S corporation makes the election to be treated as an S corporation for New Jersey purposes, the pro rata share of a New Jersey resident shareholder will be his pro rata share of the S corporation's income, regardless of where the income is allocated. The pro rata share of a nonresident shareholder will be his share of the S corporation's income that is allocated to New Jersey.

Nonelecting Federal S Corporation

If a federal S corporation does not make the New Jersey election (i.e., nonelecting S corporation) then the resident shareholder's pro rata share will only include his pro rata share of the S corporation's income that is **not** allocated to this State. A nonresident shareholder would not be subject to tax on any portion of the nonelecting S corporation's income, even if the income is allocated to New Jersey.

New Jersey "Hybrid" Corporation

A New Jersey "hybrid" corporation is a federal S corporation that has not made the New Jersey S election and the corporation conducts business both within and outside of New Jersey. For Corporation Business Tax purposes the corporation files as a C corporation on Form CBT-100 and calculates their New Jersey allocation factor to determine their net income or loss allocated to New Jersey.

For Gross Income Tax purposes that portion of the income or loss allocated to New Jersey is considered C corporation income or loss and is not reportable by the shareholder. The portion of the income or loss allocated outside New Jersey is considered S corporation income and will be reported as net pro rata share of S corporation income by the resident shareholder. A nonresident shareholder would not be subject to tax on any portion of a "hybrid" corporation's income but would include the income or loss allocated outside New Jersey in the income everywhere column in the same manner as if a resident.

See "Calculating NJ AAA," "Calculating NJ E&P," and "Reporting Distributions" for additional information.

Electing Small Business Trust (ESBT)

A federal Electing Small Business Trust can make an election to be taxed as a New Jersey Electing Small Business Trust if **all** of the trust's income is from federal S corporations that made the New Jersey S election, from federal S corporations that have income allocated outside of New Jersey, or from the disposition of federal S corporation stock. The New Jersey election is made each year by filing Form NJ-1041SB and signing the election statement at the bottom of the return. See Form NJ-1041SB for filing qualifications and requirements.

Payment of Tax by Nonresident Shareholders

Estimated Tax Payments

You should be aware that an S corporation is not required to withhold gross income tax from your pro rata share of S corporation income. Consequently, you should consider making estimated payments of gross income tax to cover the amount of your taxable S corporation income. If you do not make estimated payments you may

be subject to interest on underpayments. For more information regarding your estimated tax responsibilities and interest on underpayments you should request Tax Topic Bulletin GIT-8, *Estimating Income Taxes*.

Nonconsenting Shareholders

If you are a nonresident of New Jersey and become a shareholder in an S corporation which has made the election to be treated as a New Jersey S corporation **and** you have failed to consent to that election, the S corporation is required to withhold gross income tax from your pro rata share of S corporation income. Payments made by the S corporation on your behalf will be reported to you on your Schedule NJ-K-1, Form CBT-100S and must be included as New Jersey estimated tax payments on your Form NJ-1040NR.

Composite Returns for Nonresidents

For tax years beginning after 1995, New Jersey electing S corporations may file a composite return on behalf of qualified nonresident individual shareholders. See Form NJ-1080C for filing qualifications and requirements.

QUESTION S-1. What do I do with the information on the Schedule NJ-K-1, Form CBT-100S that my S corporation gave me?

If an S corporation in which you are a shareholder has made the election to be treated as an S corporation in New Jersey, then the S corporation will prepare and provide you with a Schedule NJ-K-1, Form CBT-100S. This schedule will contain the income information that you need in order to properly prepare your New Jersey gross income tax return. **If you are a shareholder in two or more S corporations, one or more of which has a loss for the tax year, you must**

see Question S-4, page 10 for rules regarding the priority and reporting of S corporation losses.

a. Resident Shareholder

The amount reported as your "Pro rata share of S Corporation Income" on your Schedule NJ-K-1, Form CBT-100S represents the total amount of taxable income from that entity to be included on Form NJ-1040, or Form NJ-1041, as "net pro rata share of S corporation income."

b. Nonresident Shareholder

The amount reported as your “Pro rata share of S Corporation income” in Part II of your Schedule NJ-K-1, Form CBT-100S must be included in Column A, Form NJ-1040NR, or on Form NJ-1041, as “net pro rata share of S corporation income.” This represents your share of the S corporation’s income from both inside and outside of New Jersey and must be used to determine your income from all sources as if you were a New Jersey resident. The amount reported as “S income allocated to New Jersey” in Part II of your Schedule NJ-K-1, Form CBT-100S must be included as “net pro rata share of S corpora-

tion income” in Column B, Form NJ-1040NR, or on Schedule G, Form NJ-1041. This is the amount on which you will actually be taxed. Be sure to include as estimated payments on your Form NJ-1040NR or Form NJ-1041 any amount reported in Part II of your Schedule NJ-K-1 as “Total payments made on behalf of shareholder.”

If the S corporation in which you are a shareholder has no income allocated to New Jersey but you have income from other New Jersey sources, be sure to report the amount of pro rata share of S corporation income from your Schedule NJ-K-1 in Column A, Form NJ-1040NR, or on Form NJ-1041.

QUESTION S-2. What do I report if my nonelecting S corporation did not give me an NJ-K-1, Form CBT-100S?

A federal S corporation which has not made the election to be a New Jersey S corporation is not likely to provide you with a completed Schedule NJ-K-1, Form CBT-100S. Without that completed schedule you will not have the income information necessary to properly prepare Form NJ-1040, Form NJ-1040NR, or Form NJ-1041. You will have to complete Reconciliation Worksheet B to determine the correct amount of your net pro rata share of S corporation income, dividends, and gains, as well as the balances of your New Jersey Earnings & Profits Account, New Jersey Accumulated Adjustments Account, and the New Jersey adjusted basis of your stock. Certain information, such as the amount of taxes

based on income and interest attributable to exempt obligations, will have to be obtained from the S corporation in order to complete the worksheet.

A separate Reconciliation Worksheet B must be completed for each S corporation from which you received a Federal Schedule K-1, Form 1120S but not a corresponding Schedule NJ-K-1, Form CBT-100S.

NOTE: If you are a shareholder in two or more S corporations, one or more of which has a loss for the tax year, you must see Question S-4, page 10 for rules regarding the priority and reporting of losses.

NOTE: A nonresident shareholder must complete Reconciliation Worksheet B. This will provide you with the proper amounts to include in Column A, Form NJ-1040NR, or on Form NJ-1041, if you have income from other New Jersey sources. In addition, it will provide the information you need to determine the balances of your New Jersey Earnings & Profits Account, New Jersey Accumulated Adjustments Account, and the New Jersey adjusted basis of your stock.

WORKSHEET B
RECONCILIATION SCHEDULE K-1, FEDERAL FORM 1120S

S corporation Name _____ Employer ID Number _____
Tax Year _____

PART I—Determining New Jersey S Corporation Income

- 1. Ordinary Income (Loss)..... 1. _____
- 2a. Net Income (Loss) from Rental Real Estate Activities..... 2a. _____
- 2b. Net Income (Loss) from Other Rental Activities..... 2b. _____
- 2c. Interest Income 2c. _____
- 2d. Dividends..... 2d. _____
- 2e. Royalties 2e. _____
- 2f. Net Short-Term Gain (Loss)..... 2f. _____
- 2g. Net Long-Term Gain (Loss) 2g. _____
- 2h. Other Portfolio Income (Loss)..... 2h. _____
- 2i. Net Gain (Loss) from IRC Section 1231 Property..... 2i. _____
- 2j. Other Income 2j. _____
- 2k. Federally Exempt Interest Income 2k. _____
- 2l. Other Tax-Exempt Income 2l. _____
- 3. Income Subtotal (Add Lines 1 through 2l)..... 3. _____
- 4. Subtractions:
- 4a. IRC Section 179 Expense..... 4a. _____
- 4b. Excess Meal & Entertainment Deduction 4b. _____
- 4c. Interest and Gains included in Line 3 from Obligations
Exempt in New Jersey 4c. _____
- 4d. Charitable Contributions from Federal Schedule K-1 4d. _____
- 4e. Other Subtractions—Specify 4e. _____
- 4f. Total Subtractions (Add Lines 4a through 4e) 4f. _____
- 5. Total (Line 3 minus Line 4f) 5. _____
- 6. Additions 6. _____
- 6a. Interest Income from State and Municipal Bonds other
than New Jersey..... 6a. _____
- 6b. Taxes Based on Income, Business Presence or Activity 6b. _____
- 6c. Expenses Included on Line 3 and Incurred to Generate
Tax-Exempt Income 6c. _____
- 6d. Losses Included on Line 3 from Obligations Exempt from
Tax Pursuant to N.J.S.A. 54A:6-14 and 6-14.1 6d. _____
- 6e. Total Additions (Add Lines 6a through 6d) 6e. _____
- 7. New Jersey S Corporation Income (Line 5 plus Line 6e)..... 7. _____

PART II—Determining New Jersey Allocated Income

- | | | |
|---|----|-------|
| 1. New Jersey S Corporation Income from Line 7, Part I..... | 1. | _____ |
| 2. Allocation Factor _____% | | |
| 3. New Jersey Allocated Income (Line 1 multiplied by Line 2)..... | 3. | _____ |
| 4. Income Not Allocated to New Jersey (Line 1 minus Line 3) | 4. | _____ |

INSTRUCTIONS FOR SHAREHOLDER’S RECONCILIATION WORKSHEET B

S Corporation Information

Enter the name and federal identification number of the S corporation which issued the Schedule K-1, Federal Form 1120S which is being reconciled. Enter your tax year.

Part I—Determining New Jersey S Corporation income

Line 1 - Ordinary Income (Loss)

Enter on Line 1 the amount of ordinary income (loss) reported on Line 1, Schedule K-1, Federal Form 1120S.

Line 2a through 2l - Other Income

Enter the amounts of income (loss) as reported on the corresponding lines of your Schedule K-1, Federal Form 1120S.

Line 3 - Income Subtotal

Add the amounts on Line 1 and Lines 2a through 2l and enter the result on Line 3.

Line 4a - IRC Section 179 Expense

Enter on Line 4a any IRC Section 179 expense deduction reported on your Federal Schedule K-1, Federal Form 1120S.

Line 4b - Excess Meal and Entertainment Expense

Enter on Line 4b the balance of your meal and entertainment expenses which was not deductible for Federal income tax purposes. If this information has not already been provided, you must obtain it from the S corporation.

Line 4c - Interest Income and Gains from Exempt Obligations

Enter on Line 4c any interest income or gain that is excludable from gross income pursuant to N.J.S.A. 54A:6-14, 6-14.1, and 5-1c, *which is already included in the amount reported on Line 3, above*. Amounts to be reported on this line include interest income derived from and gain attributable to the disposition of obligations of the State of New Jersey or any of its political subdivisions and obligations of the federal government or any of its territories or instrumentalities. If this information has not already been provided, you must obtain it from the S corporation.

Line 4d - Charitable Contributions

Enter on Line 4d any charitable contributions reported on your Federal Schedule K-1.

Line 4e - Other Subtractions - Specify

Enter on Line 4e any other items which are excludable or deductible from S corporation income under the New Jersey Gross Income Tax Act. You should include on this line any expenses incurred to generate interest income which is excludable for Federal income tax purposes but which is includable in New Jersey gross income, i.e. interest income from the obligations of states other than New Jersey. Do not include unreimbursed business expenses or interest you paid on indebtedness incurred to purchase your shares of S corporation stock, as they are not deductible in determining net pro rata share of S corporation income.

Line 4f- Total Subtractions

Add the amounts on Lines 4a through 4e and enter the result on Line 4f.

Line 5 - Total

Subtract the amount on Line 4f from the amount on Line 3 and enter the result on Line 5.

Line 6a - Interest Income from Other State and Municipal Bonds

Enter on Line 6a the amount of any interest income which was derived from the obligations of states, **other than New Jersey**, and their municipalities and political subdivisions *which is not already included in the amount reported on Line 3, above*. If this information has not already been provided, you must obtain it from the S corporation.

Line 6b - Taxes Based on Income

Enter on Line 6b your share of any taxes paid or accrued to the United States, a state, including New Jersey, a political subdivision thereof, or the District of Columbia, on or measured by profits or income, or business presence or activity,

including income taxes paid or accrued by the S corporation on behalf of, or in satisfaction of the liabilities of, shareholders of the corporation. Any amount reported on this line must have been taken as a deduction by the S corporation on Federal Form 1120S in determining the ordinary income (loss) which you reported on Line 1, above. If this information has not already been provided, you must obtain it from the S corporation.

Line 6c - Expenses to Generate Exempt Income

Enter on Line 6c any interest on indebtedness incurred or continued; expenses paid and incurred to purchase, carry, manage, or conserve; and expenses of collection of the income or gain from tax-exempt obligations of the federal government or any of its territories or instrumentalities and obligations of the State of New Jersey or its political subdivisions. *Any amount reported on this line must already be included in the amount reported on Line 3, above*. If this information has not already been provided, you must obtain it from the S corporation.

Line 6d - Losses from Exempt Obligations

Enter on Line 6d any losses which are attributable to tax-exempt obligations of the federal government or any of its territories or instrumentalities and obligations of the State of New Jersey or its political subdivisions. *Any amount reported on this line must already be included in the amount reported on Line 3, above*. If this information has not already been provided, you must obtain it from the S corporation.

Line 6e - Total Additions

Add the amounts on Lines 6a through 6d and enter the result on Line 6e.

Line 7 - New Jersey S Corporation Income

Add the amounts on Lines 5 and 6e and enter the result on Line 7. If the S corporation has income from New Jersey sources, proceed to Part II.

If the S corporation did not have any income from New Jersey sources, this is the amount to include on your Form NJ-1040 or Form NJ-1041 as “net pro rata share of S corporation income” from this entity. If you are a nonresident and have income from other New Jersey sources, this is the amount to include on your Form NJ-1040NR, Column A, or Form NJ-1041 as “net pro rata share of S corporation income” from this entity.

Part II—Determining New Jersey Allocated Income

You do not need to complete Part II if the S corporation did not have any income from New Jersey sources.

Line 1 - New Jersey S Corporation Income

Enter on Line 1 the amount reported on Line 7, Part I of this worksheet.

Line 2 - Allocation Factor

Enter the allocation percentage from Schedule J, Part III, Form CBT-100. If this information has not already been provided, you must obtain it from the S corporation.

Line 3 - New Jersey Allocated Income

Multiply the amount on Line 2 by the amount on Line 1 and enter the result on Line 3.

Line 4 - Income not Allocated to New Jersey

Subtract the amount on Line 3 from the amount on Line 1 and enter the result on Line 4. If you are a New Jersey resident shareholder you must also include this amount on your Form NJ-1040 or Form NJ-1041 as the “net pro rata share of S corporation income” from this entity. If you are a nonresident and have income from other New Jersey sources, include this amount on your Form NJ-1040NR, Column A, or Form NJ-1041 as “net pro rata share of S corporation income” from this entity to determine the amount of income from all sources as if you were a resident. **Do not** include this amount in Column B, Form NJ-1040NR, or on Schedule G, Form NJ-1041.

QUESTION S-3. How do I determine my net pro rata share of S corporation income if I was a part-year resident?

a. Part-year resident return (Form NJ-1040)

As a part-year resident you are required to file a part-year resident return, Form NJ-1040, covering the portion of your tax year that you were a resident. Your part-year Form NJ-1040 must include the portion of your net pro rata share of S corporation income prorated to your period of New Jersey residency. This is determined based on your residency percentage.

Calculating the residency and nonresidency percentages: The residency percentage is the number of days of the S corporation’s year, whether fiscal or calendar, that you were a New Jersey resident divided by 365 days, or 366 days for a leap year. For example, if the S corporation’s fiscal year is October 1 through September 30 and you moved out of New Jersey on April 15, then you were a New Jersey resident for 197 days of the S corporation’s fiscal year. Dividing 197 by 365

results in a residency percentage of 54%. The nonresidency percentage is determined by subtracting the residency percentage from 100%, which in this example is 46%.

i. Electing S corporation. To determine the prorated residency portion of your pro rata share of S corporation income from an S corporation which has made the New Jersey S election, multiply the total amount of pro rata share of S corporation income from your NJ-K-1 by your residency percentage. The result is the “net pro rata share of S corporation income” to be included on your Form NJ-1040.

ii. Nonelecting S corporation. To determine the prorated residency portion of your pro rata share of S corporation income from an S corporation which has not made the New Jersey S election, multiply the amount of income not allocated to New Jersey from Part II, Reconciliation Worksheet B, or, if Part II was not completed, the New Jersey S Corporation Income amount from Part I, Reconciliation Worksheet B, by the residency percentage, as determined above. Enter the result as “net pro rata share of S corporation income” on Form NJ-1040. For more information regarding Reconciliation Worksheet B, see Question S-2 on page 4.

**b. Part-year nonresident return
(Form NJ-1040NR)**

If you were a part-year nonresident and had income from New Jersey sources during that period, you are required to file a part-year Form NJ-1040NR covering that portion of your tax year. In Column A of your part-year Form NJ-1040NR you must include your net pro rata

share of S corporation income as prorated based on the nonresidency percentage. In Column B you must include your net pro rata share of S corporation income allocated to New Jersey as prorated based on the nonresidency percentage.

i. Electing S corporation. To determine the prorated amount of your net pro rata share of S corporation income from everywhere, multiply the amount of pro rata share of S corporation income from Part II of your NJ-K-1 by your nonresidency percentage as determined above. Enter the result as “net pro rata share of S corporation income” in Column A, Form NJ-1040NR.

To determine the prorated portion of your pro rata share of S corporation income from New Jersey sources, multiply the amount of S corporation income allocated to New Jersey from Part II of your NJ-K-1 by your nonresidency percentage, as determined above. Enter the result as “net pro rata share of S corporation income” in Column B, Form NJ-1040NR.

ii. Nonelecting S corporation. If you are a part-year nonresident and a shareholder of an S corporation which has not made the election in New Jersey, you are not subject to tax on the portion of your S corporation income that is attributable to the part of the year that you were a nonresident. If, however, you have income from other New Jersey sources during the portion of the year that you were a nonresident, you must include in Column A, Form NJ-1040NR, the prorated portion of the S corporation income that is not allocated to New Jersey for the period of nonresidency.

To determine the amount to be reported in Column A, multiply the amount of income not allocated to New Jersey from Part II, Reconciliation Worksheet B, or, if Part II was not completed, the New Jersey S

Corporaton Income amount from Part I, Reconciliation Worksheet B, by your non-residency percentage, as determined above. For more information regarding Reconciliation Worksheet B, see Question S-2, page 4.

QUESTION S-4. As a shareholder in multiple S corporations, how can I use S corporation losses on my gross income tax return?

You may use the pro rata share of loss from one S corporation to offset the pro rata share of income from another S corporation as long as the income and loss occurred in the same tax year. However, you may only use a loss to the extent that it does not exceed your New Jersey adjusted basis in that S corporation.

You may not use a loss from a prior year to offset a current year's income and you may not carry an unused loss into a subsequent tax year. Any S corporation losses which you are unable to use in the current year will be an adjustment to the basis of that S corporation when you sell your shares. Because there are no passive loss limitations in the New Jersey Gross Income Tax Act, any federal limitations regarding passive losses do not apply when determining the portion of a loss that can be used to offset income.

Rules of priority for determining the use and assignment of S corporation losses are only necessary when the following conditions are satisfied:

- You are a shareholder in 3 (three) or more S corporations;
- Your total usable S corporation losses exceed your total pro rata share of S corporation income; **and**
- The losses were generated by 2 (two) or more S corporations.

Shareholder in 2 (two) S corporations.

If you are a shareholder in only two S corporations, rules for determining the priority of losses are unnecessary. Instead, you should follow these rules:

- a. If both S corporations have income, you must report the combined amount.
- b. If one S corporation has income and one S corporation has a loss, compare the New Jersey adjusted basis of the S corporation that generated the loss against the amount of its loss to determine the usable portion of that loss. Only the usable portion of the loss can be used to offset the income from the other S corporation.

- i. If the income exceeds the usable loss, reduce the income only by the amount of the usable portion of the loss and report the net amount as your net pro rata share of S corporation income.
- ii. If the usable portion of the loss exceeds the income, report your net pro rata share of S corporation income as “0” (zero).
- c. If both S corporations have a loss, report your net pro rata share of S corporation income as “0” (zero).

Shareholder in 3 (three) or more S corporations.

As a shareholder in 3 (three) or more S corporations you must use the following steps to determine the correct amount of the net pro rata share of S corporation income to be reported on your gross income tax return.

Step 1.

Determine the total amount of your pro rata share of S corporation income.

Step 2.

- a. Determine the total amount of your usable loss from each S corporation by comparing the New Jersey adjusted basis of that S corporation to the amount of its loss. You may only use the portion of each S corporation’s loss that does not exceed its New Jersey adjusted basis to offset income from other S corporation(s). For example, if an S corporation has a loss of \$1,000 and its New Jersey adjusted basis is \$800, then you may only use \$800 to offset another S corporation’s income. The remaining \$200 loss may only be used to adjust your basis when you sell your shares. See Question S-8, page 25 for

information on determining your New Jersey adjusted basis. Add the amount of usable loss from each S corporation to determine the total amount of usable S corporation losses received from the S corporations for the tax year.

- b. Determine the amount of unusable loss for each S corporation by subtracting the amount of usable loss, as computed in Step 2a above, from the pro rata share of S corporation loss received from that S corporation. The unusable loss, if any, for each S corporation may only be used to adjust your basis when you sell your shares of that S corporation.

Step 3. Income exceeds losses.

If the total amount of usable losses exceeds the total amount of income, go to Step 4. If the total income exceeds or is equal to the total usable losses, reduce the total income by the total usable losses and report the net amount as your net pro rata share of S corporation income. If the total usable losses are equal to the total amount of income then you must report your net pro rata share of S corporation income as “0” (zero).

Step 4. Losses exceed income.

If the total amount of usable losses exceeds the total amount of income, then rules of priority must be used. You must prorate each S corporation’s usable loss in the proportion that it bears to the total amount of usable losses for the period.

- a. Determine the prorated amount of each S corporation’s usable loss by dividing that S corporation’s usable loss by the amount of total usable losses for the period and multiplying it by the total amount of your S corporation income.

- b.** Subtract the prorated usable loss of an S corporation from its full usable loss to determine the remainder of usable loss for that S corporation.
- c.** Subtract the total amount of prorated usable losses from the total pro rata share of S corporation income and report the net amount on your gross income tax return as net pro rata share of S corporation income. If the total amount of prorated usable losses is equal to the total amount of income, then you must report your net pro rata share of S corporation income as “0” (zero).
- d.** Add each S corporation’s unusable loss from Step 2b and the remainder of usable loss from Step 4b, if any, to determine the total unused loss for each S corporation. The total unused loss for each S corporation may only be used to adjust your basis at the time you sell your shares in that S corporation. Be sure that you maintain an ongoing total of each S corporation’s unused loss for your records so that your basis can be properly adjusted upon disposition of your shares.

OBSCOLET

EXAMPLE 1

Jayne is a New Jersey resident shareholder in 4 different S corporations. Her pro rata share from each S corporation for tax year 2003 is as follows:

S CORP	Pro rata share	New Jersey Adjusted Basis
ABC	\$4,000	\$4,500
XYZ	(\$1,000)	\$1,500
UFO	(\$2,500)	\$3,000
BMOC	(\$1,500)	\$2,000

Because Jayne is a shareholder in 4 different S corporations (3 of which generated losses), and her total pro rata share of S corporation losses exceeds her total pro rata share of S corporation income, she **must** use the rules of priority to determine the portion of each S corporation's loss that may be used to offset her total pro rata share of S corporation income.

Step 1:

Total pro rata share of S corporation income from ABC: \$4,000

Step 2:

a. Usable S corporation losses:

S CORP	Loss	New Jersey Adjusted Basis	Usable Loss
XYZ	(\$1,000)	\$1,500	(\$1,000)
UFO	(\$2,500)	\$3,000	(\$2,500)
BMOC	(\$1,500)	\$2,000	(\$1,500)
Total amount of usable S corporation losses:			(\$5,000)

b. Unusable S corporation losses:

S CORP	Loss	- Usable Loss	= Unusable Loss
XYZ	(\$1,000)	(\$1,000)	\$0
UFO	(\$2,500)	(\$2,500)	\$0
BMOC	(\$1,500)	(\$1,500)	\$0

Step 3:

Since total usable losses exceed total S corporation income, Jayne goes to Step 4.

EXAMPLE 1, continued

Step 4:

a. Prorated portion of usable S corporation losses:

			Total Income		Prorated amount of usable loss
XYZ usable loss	(\$1,000)	= (.20)	× \$4,000	=	(\$800)
Total usable losses	(\$5,000)				
UFO usable loss	(\$2,500)	= (.50)	× \$4,000	=	(\$2,000)
Total usable losses	(\$5,000)				
BMOC usable loss	(\$1,500)	= (.30)	× \$4,000	=	(\$1,200)
Total usable losses	(\$5,000)				
Total prorated usable losses:					(\$4,000)

b.

S CORP	Usable loss	-	Prorated usable loss	=	Remainder of usable loss
XYZ	(\$1,000)		(\$ 800)		(\$200)
UFO	(\$2,500)		(\$2,000)		(\$500)
BMOC	(\$1,500)		(\$1,200)		(\$300)

Any remainder of usable loss will be added to the unusable loss to adjust Jayne's basis when she sells her shares of the S corporation.

c.

Total pro rata share of S corporation income:	\$4,000
Less: Total amount of prorated usable losses:	(\$4,000)
Net pro rata share of S corporation income to be reported:	\$0

d.

S CORP	Unusable loss	+	Remainder of usable loss	=	Total unused loss
XYZ	\$0		(\$200)		(\$200)
UFO	\$0		(\$500)		(\$500)
BMOC	\$0		(\$300)		(\$300)

The total unused loss for each S corporation may only be used to adjust Jayne's basis when she sells her shares in the S corporation.

EXAMPLE 2

John is a shareholder in 5 different S corporations. His pro rata share from each S corporation for tax year 2003 is as follows:

S CORP	Pro rata share	New Jersey Adjusted Basis
Whatchamacallit	\$27,600	\$ 3,098
Thingamajig, Inc.	(\$49,192)	\$10,580
Doohickey Corp.	\$32,358	\$11,267
Widget, Inc.	(\$18,628)	\$13,756
Loophole & Co.	(\$85,726)	\$17,125

Step 1:

Pro rata share of S corporation income from:	Whatchamacallit	\$27,600
	Doohickey Corp.	<u>\$32,358</u>
Total pro rata share of S corporation income:		\$59,958

Step 2:

a. Usable S corporation losses from:

S CORP	Loss	New Jersey Adjusted Basis	Usable Loss
Thingamajig, Inc.	(\$49,192)	\$10,580	(\$10,580)
Widget, Inc.	(\$18,628)	\$13,756	(\$13,756)
Loophole & Co.	(\$85,726)	\$17,125	(\$17,125)
Total amount of usable S corporation losses:			<u>(\$41,461)</u>

b.

S CORP	Loss	- Usable Loss	= Unusable Loss
Thingamajig, Inc.	(\$49,192)	(\$10,580)	(\$38,612)
Widget, Inc.	(\$18,628)	(\$13,756)	(\$ 4,872)
Loophole & Co.	(\$85,726)	(\$17,125)	(\$68,601)

Any unusable loss will be added to the remainder of prorated loss, and may only be used to adjust John's basis when he sells his shares of the S corporation.

Step 3:

Since the amount of total usable losses is less than total pro rata share of S corporation income, there is no need to prorate the losses. Total pro rata share of S corporation income is reduced by the total usable losses:

Total pro rata share of S corporation income:	\$59,958
Less: Total usable losses:	<u>(\$41,461)</u>
Net pro rata share of S corporation income to be reported:	\$18,497

EXAMPLE 3

Nancy is a shareholder in 5 different S corporations. Her pro rata share from each S corporation for tax year 2003 is as follows:

S CORP	Pro rata share	New Jersey Adjust
Helpme, Inc.	\$15,493	\$ 6,428
Can'tlose, Inc.	\$26,189	\$93,186
Bummer & Co.	(\$13,872)	\$ 9,842
Nowinner, Inc.	(\$54,975)	\$36,871
Gonefishin'	(\$73,478)	\$16,984

Step 1:

Pro rata share of S corporation income from:	Helpme, Inc.	\$15,493
	Can'tlose, Inc.	<u>\$26,189</u>
Total pro rata share of S corporation income:		\$41,682

Step 2:

a. Usable S corporation losses from:

S CORP	Loss	New Jersey Adjusted Basis	Usable Loss
Bummer & Co.	(\$13,872)	\$ 9,842	(\$ 9,842)
Nowinner, Inc.	(\$54,975)	\$36,871	(\$36,871)
Gonefishin'	(\$73,478)	\$16,984	<u>(\$16,984)</u>
Total amount of usable S corporation losses:			(\$63,697)

b.

S CORP	Loss	- Usable Loss	= Unusable Loss
Bummer & Co.	(\$13,872)	(\$ 9,842)	(\$ 4,030)
Nowinner, Inc.	(\$54,975)	(\$36,871)	(\$18,104)
Gonefishin'	(\$73,478)	(\$16,984)	(\$56,494)

Step 3:

Since the total amount of usable S corporation losses exceeds the total pro rata share of S corporation income Nancy goes to Step 4.

EXAMPLE 3, continued

Step 4:

a.

		Total Income		Prorated amount of loss
Bummer & Co. usable loss (\$9,842)	=	(.1545) × \$41,682	=	(\$6,440)
Total usable losses (\$63,697)				
Nowinner, Inc. usable loss (\$36,871)	=	(.5789) × \$41,682	=	(\$24,130)
Total usable losses (\$63,697)				
Gonefishin' usable loss (\$16,984)	=	(.2666) × \$41,682	=	(\$11,112)
Total usable losses (\$63,697)				
Total prorated usable losses:				(\$41,682)

b.

	Usable loss	-	Prorated amount of loss =	Remainder of usable loss
S CORP				
Bummer & Co.	(\$ 9,842)		(\$ 6,440)	(\$ 3,402)
Nowinner, Inc.	(\$36,871)		(\$24,130)	(\$12,741)
Gonefishin'	(\$16,984)		(\$11,112)	(\$ 5,872)

c.

Total pro rata share of S corporation income:	\$41,682
Less: Total amount of prorated usable losses:	<u>(\$41,682)</u>
Net pro rata share of S corporation income to be reported:	\$0

d.

	Unusable loss	+	Remainder of usable loss =	Total unused loss
S CORP				
Bummer & Co.	(\$ 4,030)		(\$ 3,402)	(\$ 7,432)
Nowinner, Inc.	(\$18,104)		(\$12,741)	(\$30,845)
Gonefishin'	(\$56,494)		(\$ 5,872)	(\$62,366)

The total unused loss for each S corporation may only be used to adjust Nancy's basis when she sells her shares in that S corporation.

EXAMPLE 4

Leslie is a shareholder in 4 different S corporations. Her pro rata share from each S corporation for tax year 2003 is as follows:

S CORP	Pro rata share	New Jersey Adjusted Basis
Profits R Us	\$50,000	\$10,000
Losers Inc.	(\$20,000)	\$12,000
Deadbeat & Co.	(\$15,000)	\$18,000
Wastingaway	(\$18,000)	\$25,000

Step 1:

Total pro rata share of S corporation income from Profits R Us: \$50,000

Step 2:

a. Usable S corporation losses from:

S CORP	Loss	New Jersey Adjusted Basis	Usable Loss
Losers Inc.	(\$20,000)	\$12,000	(\$12,000)
Deadbeat & Co.	(\$15,000)	\$18,000	(\$15,000)
Wastingaway	(\$18,000)	\$25,000	(\$18,000)
Total amount of usable S corporation losses:			(\$45,000)

b.

S CORP	Loss	- Usable Loss	= Unusable Loss
Losers Inc	(\$20,000)	(\$12,000)	(\$8,000)
Deadbeat & Co.	(\$15,000)	(\$15,000)	(\$ 0)
Wastingaway	(\$18,000)	(\$18,000)	(\$ 0)

Any unusable loss will be added to the remainder of prorated loss, if any, and may only be used to adjust Leslie's basis when she sells her shares of the S corporation.

Step 3:

Since the total amount of usable losses is less than total pro rata share of S corporation income, there is no need to pro rate the losses. Total pro rata share of S corporation income is reduced by the total usable losses:

Total pro rata share of S corporation income:	\$50,000
Less: Total usable losses:	<u>(\$45,000)</u>
Net pro rata share of S corporation income to be reported:	\$ 5,000

QUESTION S-5. As a New Jersey resident shareholder of an S corporation am I entitled to a credit for the taxes I paid to another jurisdiction with respect to my S corporation income?

If you paid income taxes or wage taxes to another jurisdiction on your S corporation income and that income is also taxed in New Jersey in the same tax year, you may be entitled to a credit on Form NJ-1040 or NJ-1041.

Income Not Eligible for a Credit

A credit is *not* allowed:

- For any tax imposed by another jurisdiction on S corporation income which is allocated to New Jersey. **Exception:** When an S corporation allocates 100% of its income to New Jersey and pays a tax based on or measured by income to another jurisdiction and is eligible for a credit against its tax on the New Jersey CBT return, then for gross income tax purposes the corporate income taxed by both the other jurisdiction and on the New Jersey CBT return will be deemed to be S corporation income allocated outside of New Jersey. If the shareholder filed a personal income tax return, or participated in a composite return with the other jurisdiction reporting and paying tax on the S corporation income, the shareholder would be eligible for a credit for taxes paid to other jurisdictions on the income also taxed by New Jersey.
- For any taxes paid or accrued on or measured by profits or income imposed on or paid on behalf of a person other than the taxpayer, whether or not the taxpayer may be held liable for the tax.

- If the New Jersey tax is attributable to distributions received and those distributions are taxable to the taxpayer as dividends or as gains from the disposition of property. For more information regarding dividends and gains see Question S-9, page 26.

To claim a credit for taxes paid to another jurisdiction you must complete Schedule A, Form NJ-1040. If you are claiming a credit for taxes paid to more than one jurisdiction, you must complete a separate Schedule A for each jurisdiction. If, as a shareholder of an S corporation, you participated in 1 (one) or more nonresident composite returns filed by the S corporation on behalf of its shareholders in other states, the Division will accept a certified schedule from the S corporation specifying your share of S corporation income allocated to each state and the amount of tax paid to that state. If you are claiming a credit for S corporation income allocated to New Jersey, you must submit documentation of the taxes paid to the other jurisdiction, both by the corporation as well as the personal income tax paid by you.

See the instruction booklet for Form NJ-1040 for more information regarding the credit for taxes paid to another jurisdiction or request Tax Topic Bulletin GIT-3B, *Credit for Taxes Paid to Other Jurisdictions (Business/Nonwage Income)*.

When completing Line 1, Schedule A, Form NJ-1040, you may only include income which is **actually taxed** by both New Jersey and the other

jurisdiction. If the other jurisdiction requires you to report S corporation income (loss) in separate categories (e.g. S corporation income, interest, gains, or modifications) you must net any

amounts derived from the S corporation when determining the amount of income eligible for the credit.

QUESTION S-6. How do I calculate my New Jersey Accumulated Adjustments Account (AAA)?

Whether you are a resident shareholder in an electing or nonelecting federal S corporation, you are required to make the necessary adjust-

ments to your New Jersey AAA. You must retain all account information until you dispose of your shares of the S corporation.

WORKSHEET C

NEW JERSEY ACCUMULATED ADJUSTMENTS ACCOUNT

1. Beginning balance	1.	_____
2. Net pro rata share of S corporation income	2.	_____
3. Other income/loss	3.	_____
4. Total Lines 1–3	4.	_____
5. Other reductions	5.	_____
6. Distributions	6.	_____
7. Total Adjustments	7.	_____
8. Ending balance (Line 4 minus Line 7).....	8.	_____

It is possible that your New Jersey AAA will have a negative ending balance.

INSTRUCTIONS FOR COMPLETING WORKSHEET C

PLEASE NOTE: Beginning with tax year 1996, the New Jersey Other Adjustments Account (OAA) was eliminated. Any adjustments that would have been made to your New Jersey OAA should have been made to your New Jersey AAA and any ending balance you had in your New Jersey OAA should have been added to the New Jersey AAA balance.

Allocation Factor. The allocation factor inside of New Jersey is calculated by the S corporation and must be provided to you or obtained from the corporation. The percentage of income, gain, loss, or expenses allocated outside of New Jersey is determined by subtracting the inside New Jersey factor from 100%.

Line 1. The beginning balance of your New Jersey AAA will be “0” (zero) for the first tax year beginning after July 7, 1993. For all subsequent years the beginning balance will be the ending balance from the year before. Indicate the date of the beginning balance.

Line 2. Your New Jersey AAA must be adjusted annually by the amount of the net pro rata share of S corporation income (or loss) you received from the S corporation during the tax year. For a resident shareholder in a federal S corporation that made the New Jersey election, the net pro rata share of S corporation income will be the income allocated within and outside New Jersey.

For a resident shareholder of a federal S corporation that has not made the New Jersey election, the net pro rata share of S corporation income will be the income (loss) allocated outside New Jersey. This is the amount from Part II, Reconciliation Worksheet B, or, if Part II is not completed, the New Jersey S Corporation Income amount from Part I.

Line 3. Your New Jersey AAA must be adjusted to include any New Jersey tax-exempt income, gains, or losses earned by the S corporation during the tax year. The total amount of New Jersey tax-exempt income, gains, or losses is determined by subtracting the amount on Line 6d, Part I, Reconciliation Worksheet B from the amount on Line 4c, Part I, Reconciliation Worksheet B.

If you are a resident shareholder of a federal S corporation that has not made the New Jersey election and which had income allocated to New Jersey, you must determine the amount of tax-exempt income, gains, or losses that is allocated

outside New Jersey. The amount of tax-exempt income, gains, or losses that is allocated outside of New Jersey is calculated by multiplying the total of Line 4c minus Line 6d from Part I, Reconciliation Worksheet B by the outside of New Jersey percentage.

Line 4. Add Lines 1 through 3 and enter the result on Line 4.

Line 5. Any other reductions made to your federal AAA or federal OAA must also be made to your New Jersey AAA, provided that these reductions have not already been taken into consideration in calculating S corporation income on Line 7, Part I, Reconciliation Worksheet B. Other reductions include, but are not limited to the following items when made or paid by the S corporation: taxes based on income, business presence or activity; health or life insurance; fines or penalties; club dues; and any foreign taxes. If this information has not already been provided, you must obtain it from the S corporation.

New Jersey AAA must also be reduced by any expenses incurred by the S corporation to generate New Jersey tax-exempt income, gains, or losses. If the S corporation had no income allocated to New Jersey, then enter on this line the amount from Line 6c, Part I, Reconciliation Worksheet B. If, however, the S corporation had income allocated to New Jersey, then you must reduce New Jersey AAA by the portion of expenses incurred to generate tax-exempt income, gains, or losses allocated outside New Jersey by multiplying the amount from Line 6c by the outside of New Jersey percentage.

Line 6. You must reduce your New Jersey AAA by the amount of any distributions you received from the S corporation during the year. For New Jersey gross income tax purposes, distributions must be treated in the same manner as for federal purposes.

Line 7. Add Lines 5 and 6 and enter the result on Line 7.

Line 8. Subtract Line 7 from Line 4 to determine your ending balance for the year. **It is possible that the ending balance of your New Jersey AAA will be negative.** Indicate the date of the ending balance.

QUESTION S-7. How do I calculate the balance of my New Jersey Earnings and Profits (E&P) Account?

a. Initial New Jersey E&P.

i. Electing S corporation. If you are a shareholder in a federal S corporation which has made the election to be a New Jersey S corporation, the initial beginning balance of your New Jersey E&P Account will be the retained earnings of the corporation prior to the New Jersey election. If the retained earnings of the corporation prior to the New Jersey election is a negative amount, enter zero.

ii. Nonelecting S corporation. If you are a shareholder in a federal S corporation which has not made the election to be a New Jersey S corporation, the initial beginning balance of your New Jersey E&P Account will be the total of the beginning balances of your federal Accumulated Adjustments Account (AAA) and your federal Other Adjustments Account (OAA) for the corporation's first tax year that begins on or after July 7, 1993,

plus any remaining federal accumulated E&P at that time. If, however, the total is a negative amount, the initial beginning balance of your New Jersey E&P Account is zero.

iii. "Hybrid" corporations. If you are a shareholder in a "hybrid" corporation, you will calculate the initial beginning balance of your New Jersey E&P Account in the same manner as described above for a nonelecting federal S corporation.

b. Federal S corporation formed after July 7, 1993.

A federal S corporation which is newly incorporated after July 7, 1993, should not have any accumulated E&P. Consequently, the initial beginning balance of your New Jersey E&P Account will be zero. This will be true whether or not the federal S corporation has made the election to be treated as a New Jersey S corporation.

WORKSHEET D

NEW JERSEY EARNINGS AND PROFITS ACCOUNT FOR NEW JERSEY RESIDENT SHAREHOLDERS OF AN ELECTING NEW JERSEY S CORPORATION

- | | | | |
|--|-------|----|-------|
| 1. Beginning Balance on _____ | | 1. | _____ |
| 2. Other Additions/Adjustments | | 2. | _____ |
| 3. Total Lines 1 and 2 | | 3. | _____ |
| 4. Dividends Received..... | | 4. | _____ |
| 5. Ending Balance (Line 3 minus Line 4)..... | | 5. | _____ |

INSTRUCTIONS FOR COMPLETING WORKSHEET D

Worksheet D must be completed annually by a shareholder in an electing New Jersey S corporation so that you can properly track your New Jersey Earnings and Profits Account.

Line 1. See Question S-7a, page 22 to determine the initial beginning balance of your New Jersey E&P Account. For subsequent tax years the beginning balance will be the ending balance from the year before. Indicate the date of the beginning balance.

Line 2. Any other additions or adjustments made to your federal E&P Account must also be made to your New Jersey E&P Account. If this information has not already been provided, you must obtain it from the S corporation.

Line 3. Enter the total of Line 1 plus Line 2.

Line 4. Determine the amount of dividends received from the S corporation during the taxable year and enter the amount on Line 4. For more information regarding dividends and gains see Question S-9, page 26.

WORKSHEET E

NEW JERSEY EARNINGS AND PROFITS ACCOUNT FOR SHAREHOLDERS OF A NONELECTING FEDERAL S CORPORATION OR "HYBRID" CORPORATION

1. Beginning Balance on _____ 1. _____
2. S corporation income allocated to New Jersey.....2. _____
3. Other Additions/Adjustments.....3. _____
4. Subtotal.....4. _____
5. Dividends Received.....5. _____
6. Ending Balance on _____6. _____

INSTRUCTIONS FOR COMPLETING WORKSHEET E

Worksheet E must be completed annually if you are a shareholder in a nonelecting federal S corporation so that you are able to properly track your New Jersey Earnings and Profits Account. A shareholder in a "hybrid" corporation will apply the corporation's allocation factor to determine the income, other additions/adjustments, and dividends received that are allocated to New Jersey.

Line 1. See Question S-7a, above, to determine the initial beginning balance of your New Jersey E&P Account. For subsequent tax years the beginning balance will be the ending balance from the year before. Indicate the date of the beginning balance.

Line 2. Each year the beginning balance of your New Jersey E&P Account must be increased by the amount of any S corporation income allocated to New Jersey for the tax year. If the S corporation had no income allocated to New

Jersey, proceed to Line 3, otherwise, enter on this Line the amount from Line 3, Part II, Reconciliation Worksheet B.

Line 3. Any other additions or adjustments made to your federal E&P Account must also be made to your New Jersey E&P Account. If this information has not already been provided, you must obtain it from the S corporation.

Line 4. Add Lines 1, 2, and 3 and enter the result on Line 4.

Line 5. Determine the amount of dividends received from the S corporation during the taxable year and enter the amount on Line 5. For more information regarding dividends and gains see Question S-9, page 26.

Line 6. Subtract Line 5 from Line 4 and enter the result on Line 6. Indicate the date of the ending balance.

QUESTION S-8. How do I determine my New Jersey basis?

a. Initial New Jersey Basis

i. Resident

If you were a shareholder of an S corporation on January 1, 1994, your initial basis in the stock and indebtedness of the S corporation is the basis of the stock determined on that date as if the S corporation was a C corporation, plus any indebtedness of the S corporation to you. This is true for the basis of both electing and nonelecting S corporations.

If you were not a resident shareholder of an S corporation on January 1, 1994, but you became one thereafter, your initial basis in the stock and indebtedness of the S corporation is your federal basis determined as of the **latest** of the following events:

- The date you last became a resident of New Jersey;
- The date you acquired the stock of the S corporation; or
- The effective date of the corporation's most recent federal S election.

ii. Nonresident

If you are a nonresident shareholder your initial basis in the stock and indebtedness of an S corporation shall be "0" (zero) as of the **latest** of the following:

- The date you last became a nonresident of New Jersey;
- The date on which you acquired the stock of the S Corporation;
- The effective date of the corporation's most recent federal S election; or

- The effective date of the corporation's most recent New Jersey S election.

b. Adjustments to New Jersey Basis

Adjustments to your initial New Jersey basis shall be made in accordance with federal rules but are limited to the S corporation income or "hybrid" corporation income that is included in your New Jersey net pro rata share of S corporation income. In addition, you must add back your New Jersey tax exempt gains and income and subtract any expenses paid or incurred in generating such exempt gains and income. Any adjustments made to your federal basis in the S corporation prior to January 1, 1994, cannot be taken into account when determining your New Jersey adjusted basis.

If you are a resident shareholder you must be sure to decrease your New Jersey basis by the amount of any nontaxable distributions you received from the S corporation. See Question S-9, page 26 for information regarding the taxability of S corporation distributions.

In no case can you adjust your New Jersey basis in the stock and indebtedness of the S corporation below zero. S corporation losses which you are unable to use for New Jersey gross income tax purposes to offset income from another S corporation in the year the losses are incurred **may not be used to offset S corporation income in any other taxable year.** However, such unused losses will be used to adjust your New Jersey basis when calculating your gain from the disposition of your shares of the S corporation.

QUESTION S-9. How do I report my distributions?

You must account for and/or report the **actual** total amount of cash, noncash, and property distributed to you from the corporation. A statement should be attached to your return detailing any installment notes you received.

For New Jersey gross income tax purposes the taxability of a distribution from an S corporation is governed by the priority system established in IRC Sections 1368 and 1371 and must be calculated after the close of the S corporation's tax year. In general, to determine the taxability of a distribution you must first apply a distribution against your New Jersey AAA balance, then against your New Jersey E&P balance, and finally against your New Jersey adjusted basis.

A distribution made to a nonresident shareholder is not taxable for New Jersey gross income tax purposes. However, if you are a nonresident shareholder and you have income from other New Jersey sources, you will have to report any taxable portion of your distribution in Column A, Form NJ-1040NR, or on Form NJ-1041, as if you were a resident.

Because you are required to use your New Jersey AAA and the New Jersey adjusted basis of your stock, the portion of the distribution which is not taxable for New Jersey purposes will usually differ from the amount which is not taxable for federal purposes. The same will be true of the taxable amounts of dividends and gains resulting from the distribution since you are using your New Jersey E&P and New Jersey adjusted basis.

You must be sure that you reduce your New Jersey basis by the amount of any nontaxable distribution you received. In addition, you must reduce your New Jersey E&P Account by the amount of dividends you received from the S corporation distribution which are taxable for New Jersey income tax purposes.

New Jersey "hybrid" corporation distributions. A distribution from a "hybrid" corporation, as defined on page 2, must be allocated based on the corporation's New Jersey allocation factor, to both the income earned inside New Jersey and the income earned outside New Jersey. Distributions applicable to the income earned inside New Jersey are taxable distributions from a C corporation and are reportable by a resident shareholder as dividends. The taxability of distributions applicable to the income earned outside New Jersey is governed by IRC Sections 1368 and 1371 as stated above.

Posttermination distributions. A cash distribution from an S corporation during a posttermination transition period will be treated in the same manner for gross income tax purposes as it is for federal purposes under IRC Section 1371. Here again, you must be certain that you use the New Jersey adjusted basis of your stock and your New Jersey AAA and E&P account balances.

EXAMPLE 1

John is the sole shareholder of an S corporation. The federal adjusted basis of his stock at the end of the tax year is \$100,000 which is comprised of:

Federal AAA	\$90,000
Federal Balance of Basis	\$10,000

The New Jersey adjusted basis of his stock at the end of the tax year is \$20,000 which is made up of:

New Jersey AAA	\$10,000
New Jersey Balance of Basis	\$10,000

In addition, the balance of John's New Jersey E&P Account is \$80,000.

A distribution of \$10,000 was made by the S corporation in April 2003, and a distribution of \$30,000 was made in November 2003.

	FEDERAL			
	Distribution	Nontaxable amount	Dividend amount	Capital Gain amount
Total Distributions	\$40,000			
From AAA	-\$40,000	\$40,000		
Totals	<u>0</u>	<u>\$40,000</u>		

	NEW JERSEY			
	Distribution	Nontaxable amount	Dividend amount	Capital Gain amount
Total Distributions	\$40,000			
From AAA	-\$10,000	\$10,000		
	\$30,000			
From E&P	\$30,000		\$30,000	
Totals	<u>0</u>	<u>\$10,000</u>	<u>\$30,000</u>	

Federal AAA	\$50,000	New Jersey AAA	\$0
Federal Balance of Basis	\$10,000	New Jersey Balance of Basis	\$10,000
Federal Adjusted Basis	<u>\$60,000</u>	New Jersey Adjusted Basis	<u>\$10,000</u>
		New Jersey E&P Account	\$50,000

EXAMPLE 2

Mary Jo is the sole shareholder of an S corporation. The S corporation's earnings for the current year were \$10,000 and the federal adjusted basis of her stock at the end of the tax year is \$70,000 which is comprised of:

Federal AAA	\$60,000
Federal Balance of Basis	\$10,000

The New Jersey adjusted basis of her stock at the end of the tax year is \$20,000 which is made up of:

New Jersey AAA	\$10,000
New Jersey Balance of Basis	\$10,000

In addition, the balance of Mary Jo's New Jersey E&P Account is \$50,000.

A distribution of \$70,000 was made by the S corporation in May 2003, and a distribution of \$30,000 was made in October 2003. The S corporation had federal Earnings & Profits of \$500.

	Distribution	FEDERAL Nontaxable amount	Dividend amount	Capital Gain amount
Total Distributions	\$100,000			
From AAA	<u>-\$60,000</u>	\$60,000		
	\$40,000			
From Federal E&P	<u>- \$500</u>		\$500	
	\$39,500			
From Balance of Basis	<u>-\$10,000</u>	\$10,000		
	\$29,500			
□ Gain from sale or exchange	<u>-\$29,500</u>			\$29,500
Totals	<u>0</u>	<u>\$70,000</u>	<u>\$500</u>	<u>\$29,500</u>

EXAMPLE 2, continued

	NEW JERSEY		
	Distribution	Nontaxable amount	Dividend amount
			Capital Gain amount
Total Distributions	\$100,000		
From AAA	-\$10,000	\$10,000	
	<u>\$90,000</u>		
From E&P	-\$50,000		\$50,000
	<u>\$40,000</u>		
From Balance of Basis	-\$10,000	\$10,000	
	<u>\$30,000</u>		
Gain from sale or exchange	-\$30,000		\$30,000
Totals	<u>0</u>	<u>\$20,000</u>	<u>\$30,000</u>
Federal AAA	\$0	New Jersey AAA	\$0
Federal Balance of Basis	\$0	New Jersey Balance of Basis	<u>\$0</u>
Federal Adjusted Basis	<u>\$0</u>	New Jersey Adjusted Basis	<u>\$0</u>
		New Jersey E&P Account	\$0

EXAMPLE 3

Peggy is the sole shareholder of an S corporation. The federal adjusted basis of her stock at the end of the tax year is \$180,000 which is comprised of:

Federal AAA	\$75,000
Federal PTI (Previously Taxed Income)	\$30,000
Federal Balance of Basis	\$75,000

The New Jersey adjusted basis of her stock at the end of the tax year is \$100,000 which is made up of:

New Jersey AAA	\$45,000
New Jersey Balance of Basis	\$55,000

In addition, the balance of Peggy's New Jersey E&P Account is \$60,000.

EXAMPLE 3, continued

Distributions of \$30,000 each were made by the S corporation in April and June 2003, and a distribution of \$40,000 was made in November 2003.

	FEDERAL			
	Distribution	Nontaxable amount	Dividend amount	Capital Gain amount
Total Distributions	\$100,000			
From AAA	-\$75,000	\$75,000		
	<u>\$25,000</u>			
From Federal PTI	-\$25,000	\$25,000		
Totals	<u>0</u>	<u>\$100,000</u>	<u>0</u>	<u>0</u>
	NEW JERSEY			
	Distribution	Nontaxable amount	Dividend amount	Capital Gain amount
Total Distributions	\$100,000			
From AAA	-\$45,000	\$45,000		
	<u>\$55,000</u>			
From E&P	-\$55,000		\$55,000	
Totals	<u>0</u>	<u>\$45,000</u>	<u>\$55,000</u>	<u>0</u>
Federal AAA	\$0	New Jersey AAA		\$0
Federal Balance of Basis	<u>\$75,000</u>	New Jersey Balance of Basis		<u>\$55,000</u>
Federal Adjusted Basis	<u>\$75,000</u>	New Jersey Adjusted Basis		<u>\$55,000</u>
Federal PTI	\$5,000	New Jersey E&P Account		\$5,000

QUESTION S-10. What is my gain from the disposition of my S Corporation stock?

Your gain from the sale of your shares of an S corporation is determined by subtracting your New Jersey adjusted basis from the amount you received for the sale. The simplest method for determining your New Jersey adjusted basis in the stock at the time of the sale or other disposition is to add the following amounts:

- Initial New Jersey basis;
- Balance of your New Jersey AAA as of the date of the disposition of the stock; and
- Any unused losses from previous years.

In addition, any indebtedness of the S corporation to you that is satisfied at the time of the disposition of your stock must be used to adjust your basis.

Before calculating the gain from the disposition of your S corporation stock be sure that you have adjusted your New Jersey AAA based on the Schedule NJ-K-1, Form CBT-100S which you received for the tax year in which the disposition occurred. Or, if no Schedule NJ-K-1 was received, then adjust your New Jersey accounts based on the information on Reconciliation Worksheet B which you completed from your federal Schedule K-1.

The information contained in this booklet has been written primarily for S corporation shareholders of federal S corporations which did not make the S election for New Jersey purposes. If you still have questions regarding the filing of Forms NJ-1040, NJ-1040NR, or NJ-1041, please see below about obtaining assistance.

For More Information

By Phone

- Call the Division of Taxation's Customer Service Center at **609-292-6400**
- TTY equipment users call **1-800-286-6613** (within NJ, NY, PA, DE, and MD) or **609-984-7300** (anywhere)

Online

- Division of Taxation Web site: www.state.nj.us/treasury/taxation/
- E-mail: taxation@tax.state.nj.us
- Subscribe to *NJ Tax E-News*, the Division of Taxation's online information service, at: www.state.nj.us/treasury/taxation/listservservice.shtml

In Writing

New Jersey Division of Taxation
Information and Publications Branch
PO Box 281
Trenton, NJ 08695-0281

Order Forms and Publications

- Call the Forms Request System at **1-800-323-4400** (Touch-tone phones within NJ, NY, PA, DE, and MD) or **609-826-4400** (Touch-tone phones anywhere)
- Call NJ TaxFax at **609-826-4500** from your fax machine's phone
- Visit the Division of Taxation's Web site: www.state.nj.us/treasury/taxation/

WORKSHEET B

RECONCILIATION SCHEDULE K-1, FEDERAL FORM 1120S

S corporation Name _____ Employer ID Number _____
 Tax Year _____

PART I—Determining New Jersey S Corporation Income

- | | | |
|---|-----|-------|
| 1. Ordinary Income (Loss)..... | 1. | _____ |
| 2a. Net Income (Loss) from Rental Real Estate Activities..... | 2a. | _____ |
| 2b. Net Income (Loss) from Other Rental Activities..... | 2b. | _____ |
| 2c. Interest Income | 2c. | _____ |
| 2d. Dividends..... | 2d. | _____ |
| 2e. Royalties | 2e. | _____ |
| 2f. Net Short-Term Gain (Loss)..... | 2f. | _____ |
| 2g. Net Long-Term Gain (Loss) | 2g. | _____ |
| 2h. Other Portfolio Income (Loss)..... | 2h. | _____ |
| 2i. Net Gain (Loss) from IRC Section 1231 Property..... | 2i. | _____ |
| 2j. Other Income | 2j. | _____ |
| 2k. Federally Exempt Interest Income | 2k. | _____ |
| 2l. Other Tax-Exempt Income | 2l. | _____ |
| 3. Income Subtotal (Add Lines 1 through 2l)..... | 3. | _____ |
| 4. Subtractions: | | |
| 4a. IRC Section 179 Expense | 4a. | _____ |
| 4b. Excess Meal & Entertainment Deduction | 4b. | _____ |
| 4c. Interest and Gains included in Line 3 from Obligations
Exempt in New Jersey | 4c. | _____ |
| 4d. Charitable contributions from federal Schedule K-1..... | 4d. | _____ |
| 4e. Other Subtractions—Specify | 4e. | _____ |
| 4f. Total Subtractions (Add Lines 4a through 4e) | 4f. | _____ |
| 5. Total (Line 3 minus Line 4f) | 5. | _____ |
| 6. Additions: | | |
| 6a. Interest Income from State and Municipal Bonds other
than New Jersey..... | 6a. | _____ |
| 6b. Taxes Based on Income, Business Presence or Activity | 6b. | _____ |
| 6c. Expenses Included on Line 3 and Incurred to Generate
Tax-Exempt Income | 6c. | _____ |
| 6d. Losses Included on Line 3 from Obligations Exempt from
Tax Pursuant to N.J.S.A. 54A:6-14 and 6-14.1..... | 6d. | _____ |
| 6e. Total Additions (Add Lines 6a through 6d) | 6e. | _____ |
| 7. New Jersey S Corporation Income (Line 5 plus Line 6e)..... | 7. | _____ |

PART II—Determining New Jersey Allocated Income

- | | | |
|---|----|-------|
| 1. New Jersey S Corporation Income from Line 7, Part I..... | 1. | _____ |
| 2. Allocation Factor _____% | | |
| 3. New Jersey Allocated Income (Line 1 multiplied by Line 2)..... | 3. | _____ |
| 4. Income Not Allocated to New Jersey (Line 1 minus Line 3) | 4. | _____ |

WORKSHEET C

NEW JERSEY ACCUMULATED ADJUSTMENTS ACCOUNT

- | | | |
|---|----|--|
| 1. Beginning balance | 1. | |
| 2. Net pro rata share of S corporation income | 2. | |
| 3. Other income/loss | 3. | |
| 4. Total Lines 1-3 | 4. | |
| 5. Other reductions | 5. | |
| 6. Distributions | 6. | |
| 7. Total adjustments..... | 7. | |
| 8. Ending balance (Line 4 minus Line 7)..... | 8. | |
-

WORKSHEET D

NEW JERSEY EARNINGS AND PROFITS ACCOUNT FOR NEW JERSEY RESIDENT SHAREHOLDERS OF AN ELECTING NEW JERSEY S CORPORATION

- | | | |
|--|----|--|
| 1. Beginning Balance on _____ | 1. | |
| 2. Other Additions/Adjustments | 2. | |
| 3. Total Lines 1 and 2 | 3. | |
| 4. Dividends Received..... | 4. | |
| 5. Ending Balance (Line 3 minus Line 4)..... | 5. | |
-

WORKSHEET E

NEW JERSEY EARNINGS AND PROFITS ACCOUNT FOR SHAREHOLDERS OF A NONELECTING FEDERAL S CORPORATION OR "HYBRID" CORPORATION

- | | | |
|---|----|--|
| 1. Beginning Balance on _____ | 1. | |
| 2. S corporation income allocated to New Jersey.... | 2. | |
| 3. Other Additions/Adjustments | 3. | |
| 4. Subtotal..... | 4. | |
| 5. Dividends Received..... | 5. | |
| 6. Ending Balance on _____ | 6. | |