A Business Owner's Practical Guide to the New Jersey Business Alternative Income Tax (BAIT)

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History

The federal tax law that only allowed individuals to deduct state and local taxes up to $10,000 had a big impact on business owners in states with higher taxes. These states challenged the law, which was first effective in 2018, soon after it was enacted. Their challenges were either denied or significantly limited by the IRS, so there are only limited instances when the deduction for a state-imposed tax can exceed $10,000. New Jersey's Pass-Through Business Alternative Income Tax (BAIT) meets the IRS requirements so that, starting in 2020, owners of many New Jersey businesses can do just that.

Qualifying Businesses

A pass-through business is any business that does not pay New Jersey tax on its own. The income from a pass-through business is reported by its owners and the tax is paid on the owner's return.

To qualify for BAIT, it must have New Jersey source income and at least one owner must be subject to New Jersey personal or corporate business tax. It can be any type of partnership (general, limited, or limited liability), a corporation that elects to be taxed as a New Jersey S-Corporation, or a Limited Liability Company (LLC) that elects to be taxed as a partnership or a New Jersey S-Corporation.

Sole proprietors, single member LLC's, and corporations that do not elect to be taxed as a New Jersey S-Corporation are not eligible for this tax.

How it Works

When a pass-through business elects to participate in BAIT and pays the tax, the federal income of the business is reduced. This has the same (or better) effect as deducting state or local taxes on an owner's individual federal income tax return. The individual owner then takes a credit for its share of the payment on its New Jersey tax return.

It is important to note that all owners are affected by this election, and each owner's tax situation may be different. Some complicating factors that are not discussed here include:

- One owner may have a high balance due while another does not
- An owner may be another business
- An owner may be a not-for-profit entity

These and other factors must be considered when considering participation in BAIT.

The New Jersey Pass-Through Business Alternative Income Tax is not required, and any business that decides to participate must make an annual election to do so. For 2020, a business must elect to participate and pay the tax by March 15th of this year. This decision is difficult because 2020 has already passed and the rules are not complete.

For 2021 and later the election due date is unclear, however the tax must be paid quarterly on the 15th of April, June, September, and January 2022. If a business overpays the tax during the year, it can request a refund on the annual tax return.

How to Compute BAIT

The tax is based on the New Jersey source income of the pass-through business. The rates range from 5.675% on the first $250,000 of income to 10.9% on income over $5,000,000. The tax rates or circumstances of each owner is not considered.

For example, if a pass-through business has New Jersey source income of $200,000, the BAIT is $11,350. Assuming there are two owners that each own 50% of the business, each owner will get a credit of $5,675 on its respective tax return.

How to File

Like many other New Jersey taxes, BAIT forms and payments must be submitted electronically either through e-filing or the online portal on the state website. Keep in mind that an electing business must still file its regular Partnership or S-Corporation return.

The election to participate is the first step, and must be done each year. Currently both the 2020 and 2021 election forms are available online.

An electing business must file an annual tax return, Form PTE-100, to calculate its New Jersey source income and the resulting tax. The form includes Schedule PTE-K-1, which reports the income and tax credit for each owner.

A business can submit Form PTE-200-T to request an extension of time to file Form PTE-100, but at least 80% of the tax must be paid by March 15th for a valid extension. Penalties and interest will be charged for late filing and/or payment.

Where to Go from Here

Each qualifying business should carefully consider the impact of BAIT. While the federal tax benefit can be significant, it may be outweighed by unplanned complications in the filing and tax payment requirements of the law.

You are not alone if you have questions about how this tax could affect you or your business. Professional tax advisors are still asking questions, and some related forms have not even been issued. You should contact an advisor familiar with this tax if you need advice.