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Real Estate ■ Corporate

It May Be Time to Take the BAIT

The Tax Cuts and Job Act ("TCJA") adopted in 2017 limited federal tax deductions for state and local income taxes ("SALT") to $10,000 annually. In high tax states such as New Jersey, the TCJA has posed challenges to taxpayers including owners of certain pass-through entities ("PTEs") – specifically partnerships, S-corporations and limited liability companies, but not single member limited liability companies or sole proprietors for purposes of this article.

In order to mitigate the negative impact of the $10,000 SALT limitation, New Jersey enacted a business alternative income tax ("BAIT") for tax years beginning on or after January 1, 2020. Key points:

- Certain PTEs may be taxed at the entity level rather than at the individual level.
- PTEs may elect to pay taxes due on the owner's share of income, who may then claim a refundable tax credit for the taxes paid by the PTE on their share of the tax base, which is defined in BAIT as "Distributive Proceeds."
- PTEs are not subject to the same federal SALT deduction limitation of $10,000 imposed on individual taxpayers.

Unfortunately, the New Jersey Division of Taxation's narrow interpretation and application of BAIT was somewhat inconsistent with its legislative intent when the tax was originally adopted. For example, non-resident owners of PTEs were required to "double pay" – 1) their non-resident taxes and 2) their BAIT taxes. Often this issue arises in connection with real estate investments owned by multiple members or partners, including residents of Pennsylvania and/or Florida.

Pursuant to a law effective as of January 1, 2022, BAIT was amended to revise and expand the definition of Distributive Proceeds, thereby increasing the expected federal tax benefit to certain taxpayers who may be able to take advantage of it. One of the purposes for this legislative amendment to have BAIT as a SALT cap workaround was to subject more income to the tax and allow New Jersey individual taxpayers to obtain a larger tax benefit. As amended, BAIT provides that certain entities will no longer be required to remit nonresident withholding tax if the nonresident owner reasonably expects to get a refund in the form of a

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tax credit as a result of taking the BAIT election. This may eliminate cash flow issues associated with the duplicate estimated tax payment obligations referenced above.

Some of our clients may have previously reached out to their CPAs regarding the possibility of electing BAIT and decided against it. However, now that the law has been expanded and improved, it may be worthwhile to discuss this option with a CPA or other accounting professionals if federal tax savings can be obtained by making such an election. Since owners of single member limited liability companies cannot make a BAIT election, they may understandably decide that the potential tax savings are not worth the cost, aggravation and loss of complete control over their company by allowing other owners.

Morgan Law LLC is a boutique law firm located in Marlton, New Jersey with a concentration in the areas of transactional real estate and business counseling. Led by founder and principal, Kenneth Morgan, the firm works on behalf of borrowers, landlords and tenants who are acquiring, financing and leasing commercial real estate, as well as assists with residential real estate matters. In addition, Morgan Law LLC represents buyers and sellers of diverse commercial assets in diverse businesses and provides counsel on a variety of other business-related. For more information, visit the firm's website at KenMorganLaw.com or call (856) 375-2985.

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