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THE TAX COURT COMMITTEE ON OPINIONS

PATRICIA A. DOHERTY & THE ESTATE OF JAMES ROBERT DOHERTY, JR., Plaintiffs,	TAX COURT OF NEW JERSEY
v.	DOCKET NO: 011661-2016
DIRECTOR, DIVISION OF TAXATION, Defendant.	

Approved for Publication
In the New Jersey
Tax Court Reports

Decided: August 17, 2018

Robert E. Salad for Plaintiffs (Cooper, Levenson, attorneys).

Ramanjit K. Chawla for Defendant (Gurbir S. Grewal, Attorney General of New Jersey, attorney).

CIMINO, J.T.C.

I. INTRODUCTION

Under the Gross Income Tax (GIT) Act, a resident of the State of New Jersey is taxed on 100% of income regardless of whether the income is generated in-state or out-of-state, or a combination thereof. However, certain credits are allowed against taxes assessed on income earned in other states.

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Plaintiffs, James Robert Doherty, Jr., later the Estate of James Robert Doherty, Jr., and Patricia A. Doherty (taxpayers), argue that the intent of the Legislature is that so long as the credit does not erode the full amount of taxes due on income allocated to New Jersey, a credit is permissible against the Gross Income Tax assessed. On the other hand, defendant, the Director of the Division of Taxation (Director) argues that the Legislature set forth by statute how the credit is calculated, and this statute represents the intent of the Legislature in dealing with the issue. While this court agrees that there is a general goal of providing a credit for out-of-state taxes, the Legislature decided to implement the credit provisions at issue through a specifically defined credit calculation that does not necessarily guarantee, or is required to guarantee, that all out-of-state taxes are credited.

This matter comes before this court on cross-motions for summary judgment. Our Supreme Court has indicated that summary judgment provides a prompt, business-like and appropriate method of disposing of litigation in which material facts are not in dispute. Brill v. Guardian Life Ins. Co. of Am., 142 N.J. 520, 530 (1995). While not definitive, cross motions for summary judgment may represent to the court the ripeness of the matter for adjudication. Spring Creek Holding Co. v. Shinnihon U.S.A. Co., 399 N.J. Super. 158, 177 (App. Div. 2008).

II. STATEMENT OF FACTS

The taxpayers are residents of southern New Jersey living in Moorestown, New Jersey. Both taxpayers own shares in a family business, David Weber Company, Inc., located in Philadelphia, Pennsylvania. David Weber Company, Inc. is in the business of manufacturing corrugated boxes.

The business is incorporated under the laws of the Commonwealth of Pennsylvania. However, the shareholders of the corporation have elected that the corporation be treated as a Subchapter S corporation under federal law, 26 U.S.C. §§ 1361-1379, as well as under the laws of this State and Pennsylvania. Generally speaking, a Subchapter S corporation is not directly subject to taxation. Rather, the income passes through the corporation to be taxed as income of each individual shareholder.

The taxpayers duly filed their personal income tax returns for 2011, 2012 and 2013 with the federal government as well as New Jersey and Pennsylvania. They were thereafter subjected to audit by the Director for each of those years. On each GIT return, the taxpayers reported their pro-rata share of S corporation income in accordance with the calculation as dictated by the GIT Act. For their New Jersey taxes, they reported their pro-rata share of income from the S corporation to be $2,108,894 for 2012.[1] The

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[1] All figures are for the taxpayers' share of income. For example, in 2012, taxpayers have a 68.5396% interest in the

Director does not dispute that the taxpayers correctly reported total income.

On the Pennsylvania tax returns for the S corporation, the share of income was reported as $2,252,820. Both New Jersey and Pennsylvania start with the amount reported on the S corporation federal return as ordinary business income. N.J.S.A. 54A:5-10, 72 Pa. Stat. Ann. § 7307.8. However, the respective states allow differing adjustments to arrive at S corporation income.

As non-residents of Pennsylvania, the taxpayers only paid Pennsylvania tax on the income allocated to Pennsylvania. 72 Pa. Stat. Ann. § 7310, 61 Pa. Code § 109.5. To determine how much income is allocated, Pennsylvania mandates the use of an allocation formula. Ibid. The formula utilized by Pennsylvania determined that 81.7087% of the income was attributable to Pennsylvania and 18.2913% was attributable to New Jersey. This resulted in 81.7087% of the $2,252,820, or $1,840,750 of the income of the corporation being taxed by Pennsylvania. The Pennsylvania tax rate is a flat 3.07% resulting in a tax liability of $56,511. On their New Jersey

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corporation. The total income of the corporation as reported on the New Jersey returns is $3,076,898. The taxpayers' interest in the total is $2,108,894.

The court is using tax year 2012 for purpose of the analysis, and for ease and simplicity. The findings and reasoning, however, are applicable to tax years 2011 and 2013. Each tax year involved the same issues.

return, the taxpayers claimed a credit for the entire tax paid to Pennsylvania.

However, under the allocation formula mandated by New Jersey, only 69.5464% of the income of the S corporation was allocable to Pennsylvania and 30.4536% was allocable to New Jersey. Thus, of the total pass-through S corporation income of $2,108,894, New Jersey determined that 69.5464%, or $1,466,660, is allocable to Pennsylvania.

Using both the lower overall pass-through S corporation income amount reported to New Jersey, and the allocation to Pennsylvania as determined by New Jersey law, the Director limited the credit so it was not against corporation income allocated to this State. In other words, per New Jersey law, the total income was $2,108,894. The allocation to Pennsylvania was 69.5464%, resulting in $2,108,894 times 69.5464%, or $1,466,660 upon which the credit could be calculated. Multiplying $1,466,660 by the Pennsylvania tax rate of 3.07% results in a credit of $45,026. Since the taxpayers claimed a credit of $56,511 based upon both the higher pass-through income and the allocation to Pennsylvania as determined under Pennsylvania law, the Director assessed a deficiency for the difference.

While Pennsylvania has a flat 3.07% tax rate, New Jersey has progressive tax rates with the top marginal rate of 8.97% for the years in question. The taxpayers argue that so long as New Jersey

gets its full share of taxes on the portion of the corporate income allocated to New Jersey, a credit for all Pennsylvania taxes should follow. Since the New Jersey rate is nearly triple that of Pennsylvania, the taxpayers argue that despite Pennsylvania allocating to itself, and taxing a greater amount of income, New Jersey will still get all tax revenues for income that is determined and allocated per New Jersey law. They maintain that this methodology conforms to the general legislative intent underlying the grant of a credit. While it is mathematically correct that the tax on New Jersey allocated income is not eroded, since New Jersey taxes all income regardless of allocation, the taxpayers do not point to any specific provision in the law that indicates the credit is calculated in the way they propose. Rather, the taxpayers argue that it is the intent of the Legislature to allow such a credit.

III. CONCLUSIONS OF LAW

A. Background

In 1976, the State Legislature enacted the New Jersey Gross Income Tax Act, N.J.S.A. 54A:1-1 to 54A:10-10. The tax primarily applies to individuals. N.J.S.A. 54A:2-1. For the tax years at issue, 2011 through 2013, the tax was at marginal rates from 1.4% through 8.97%. *Ibid.* The Act reaches income earned by a resident regardless of whether the income is from out-of-state or in-state

sources. N.J.S.A. 54A:5-1. In other words, the Act taxes 100% of a resident's income.[2]

Constitutionally, a state is permitted to tax 100% of a resident's income regardless of whether it is from in-state or out-of-state sources. New York ex rel. Cohn v. Graves, 300 U.S. 308, 312-13 (1937); Hough v. Dir., Div. of Tax'n, 2 N.J. Tax 67, 72 (Tax 1980), aff'd, 4 N.J. Tax 528 (App. Div. 1981). "Neither the federal nor state constitutions require a state to provide an income tax credit for income taxed by a foreign jurisdiction." Laurite v. Dir., Div. of Tax'n, 12 N.J. Tax 483, 491 (Tax 1992), aff'd, 14 N.J. Tax 166 (App. Div. 1993).

Despite taxing income from both in-state and out-of-state sources, New Jersey has allowed residents a credit for taxes paid to other states. N.J.S.A. 54A:4-1. "Credit is a matter of grace and a state may impose conditions on its application." Laurite, 12 N.J. Tax at 491. The issue in this case is the calculation of the credit. Taxpayers argue that the Legislature was focused on the bottom line in that so long as the tax due for income attributable to New Jersey is not diminished, a credit is allowed. On the other hand, the Director alleges that the Legislature set forth a procedure for the calculation of the credit and that method of calculation must be followed.

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[2] Parenthetically, for non-residents, only income earned in New Jersey is taxed. N.J.S.A. 54A:5-7, -8.

"The duty of the Director, and this court, is to give meaning to the wording of the statute and, where the words used are unambiguous, apply its plain meaning in the absence of a legislative intent to the contrary. Even if there is an ambiguity attendant to the issue of a tax credit, the rule of construction is one that favors the taxpayer, not the government." Sutkowski v. Dir., Div. of Tax'n, 312 N.J. Super. 465, 475 (App. Div. 1998)(citation omitted). Despite the requirement of a favorable reading towards the taxpayer, the court cannot ignore the common sense and plain meaning of the statute gleaned from the overall legislative scheme and the plain wording of the statute.

B. The initial resident tax credit provision

Upon initial enactment of the Gross Income Tax Act in 1976, subsection (a) of the resident tax credit provision provided:

> A resident taxpayer shall be allowed a credit against the tax otherwise due under this act for the amount of any income tax or wage tax imposed for the taxable year by another state of the United States or political subdivision of such state, or by the District of Columbia, with respect to income which is also subject to tax under this act.
>
> [L. 1976, c. 47, § 54A:4-1.]

The starting point is, despite taxing 100% of a resident's income, the taxpayers are entitled to a dollar-for-dollar credit for any tax on income or wages that is paid to another state.

An issue arises when out-of-state income is taxed by the other state, but not New Jersey. In particular, the question is whether the taxpayers get a credit for the tax on this out-of-state income that is untaxed by New Jersey. In Stiber v. Dir., Div. of Tax'n, 9 N.J. Tax 623 (Tax 1988), the taxpayer had income from a New York partnership. Due to New York using standard depreciation and New Jersey using accelerated depreciation, additional partnership income was taxed in New York. Id. at 627. "[Sub]section (a) clearly restricts the credit to foreign taxed income which is also taxed by New Jersey." Id. at 628. Thus, in Stiber, the court limited the credit to the partnership income which was actually taxed by New Jersey.

The same issue arises here in a slightly different context. Both New Jersey and Pennsylvania start with the same income derived from the federal tax returns for purposes of determining the corporate income. N.J.S.A. 54A:5-10, 72 Pa. Stat. Ann. § 7307.8. The income of the corporate entity as determined by New Jersey is $2,108,894. Conversely, due to various and differing deductions, the income as determined by Pennsylvania for the total of in-state and out-of-state income is $2,252,820. However, Pennsylvania only taxes $1,840,750 since it determines that 81.7087% of the total income is attributable to Pennsylvania.

The threshold issue is the amount of income which is taxed by both New Jersey and Pennsylvania for the purposes of a Stiber

analysis. There are two possible outcomes. The first is that the taxpayers are entitled to a credit for taxes paid to Pennsylvania on income of $1,840,750, since that amount is less than the total taxed by New Jersey of $2,108,894. The second is that the $1,840,750 taxed by Pennsylvania is proportionally reduced to reflect the fact that New Jersey has determined that the total in-state and out-of-state income is only $2,108,894 instead of the Pennsylvania determination of in-state and out-of-state income of $2,252,820. Proportionally, this would be $1,840,750 multiplied by the ratio determined by dividing $2,108,894 by $2,252,820, or $1,723,150. Thus, the income for which the credit can apply under subsection (a) alone can be either $1,840,750 or $1,723,150. The court need not determine the correct result as part of this case since under either scenario, the subsection (c) calculation which is discussed and applied below is independent of how Pennsylvania determines income or allocation, and sets a limitation on the credit which is less than either subsection (a) calculation.[3]

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[3] If the allocation factor of the other state is lower, but the income is higher, the allocated income can be less than the subsection (c) maximum. For example, if the total income determined by Pennsylvania increased to $2,500,000 and the allocation factor determined by Pennsylvania decreased to 60%, Pennsylvania would be taxing $1,500,000. Applying the ratio of New Jersey income to Pennsylvania income for the subsection (a) calculation would result in a potential subsection (a) limitation of $1,265,336. This is less than the subsection (c) limitation discussed below of $1,466,660.

C. <u>Amendment to the resident tax credit provision</u>

In 1958, Congress enacted Subchapter S of the Internal Revenue Code providing that closely held corporations with a limited number of shareholders (now no more than 100 shareholders) could elect Subchapter S status which would allow most, if not all, of the income generated to pass through the corporation and only be taxable by the shareholders as personal income. 26 U.S.C. §§ 1361-1379. Technical Amendments Act of 1958, Pub. L. No. 85-866, § 64. 72 Stat. 1606, 1650. The income that the S corporation generates for its shareholders is taxed at one level similar to the taxation of a partnership, rather than at two levels, corporate and shareholder. This is in contrast to the traditional provisions under Subchapter C of the Internal Revenue Code, in which the corporation was taxed on profits, and then the individual shareholders were taxed on the profits distributed as dividends. The Subchapter S corporation is thus recognized as a "pass-through" entity for taxation purposes.

The New Jersey Legislature decided to implement provisions similar to the federal provisions in 1993. As part of the enabling statute, the Legislature amended the resident tax credit provision of the Gross Income Tax Act. Subsection (a) was amended and subsection (c) was added to be specifically applicable to S Corporations. N.J.S.A. 54A:4-1(a), (c). Sections (a) and (c)

compared side by side are as follows:

A resident taxpayer shall be allowed a credit	No credit shall be allowed
against the tax otherwise due under this act	against the tax otherwise due under this act
for the amount of any income tax or wage tax imposed for the taxable year by another state of the United States or political subdivision of such State, or by the District of Columbia,	for the amount of any income tax or wage tax imposed for the taxable year
with respect to income which is also subject to tax under this act,	on S corporation income allocated to this State.
except as provided by subsections (c) and (d) of this section.	
[N.J.S.A. 54A:4-1(a)]	[N.J.S.A. 54A:4-1(c)]

As shown above, subsection (c) parallels the language of subsection (a). Instead of providing a broad basis for the credit against the taxes of other states, subsection (c) provides an exception to the credit in subsection (a).

The unambiguous language of subsection (c) is to trim the scope of the credit available under subsection (a). Subsection (a) is phrased in terms of the "allowed . . . credit" versus subsection (c) which indicates when "[n]o credit shall be allowed." N.J.S.A. 54A:4-1(a), (c). Both sections apply to the tax otherwise

due under the act. Both subsections indicate that the credit is for the income or wage tax imposed for the taxable year.

Subsection (a) describes the credit being available "with respect to income which is also subject to tax" in New Jersey. N.J.S.A. 54A:4-1(a). The income basis for this credit is broad and applies so long as the income is taxed by both jurisdictions as required by Stiber.[4] The amended subsection (a) incorporates by reference and specifically "except[s]" the income addressed in subsection (c). Ibid.

The plain language of subsection (c) indicates that there shall be no credit as it pertains to "S corporation income allocated to this State." N.J.S.A. 54A:4-1(c). "S corporation income allocated to this State" is a defined term which means the portion of S corporation income that is allocated to New Jersey pursuant to the allocation factor set forth in New Jersey Corporation Business Tax (CBT) Act, sections 6 through 10. N.J.S.A. 54A:5-10. See also N.J.S.A. 54:10A-6 to -10. Applying the allocation formula as defined by the CBT results in 30.4536% or $642,234 of the corporation income being allocated to New Jersey and 69.5464% or $1,466,660 allocated to Pennsylvania.

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[4] This not to be confused with subsection (b) which limits the credit proportionally and is discussed later in this opinion. See infra at _____ (slip op. at 15-16).

Pennsylvania determines a greater amount of overall income and allocates more of that overall income to Pennsylvania. The overall income determined by Pennsylvania is $2,252,820 and the allocation is 81.7087% resulting in income taxable by Pennsylvania of $1,840,750. This is greater than the $1,466,660 allocated by the New Jersey CBT to Pennsylvania. This results in Pennsylvania taxing $374,090 in income which is either not taxed by New Jersey[5] or is otherwise allocated to New Jersey per the New Jersey allocation formula.[6]

Subsections (a) and (c) focus on the amount of income subject to tax. Taxpayers incorrectly focus upon the amount of tax. Since the Pennsylvania tax rate is about one-third the New Jersey rate, despite Pennsylvania taxing income which clearly is allocated to New Jersey under New Jersey law or is not otherwise taxed by New Jersey, the amount of the credit sought by taxpayers is not enough to diminish the tax otherwise due on the portion of the income allocated to New Jersey under New Jersey law. However, the plain wording of subsections (a) and (c) looks to the income being taxed, not the amount of tax.

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[5] See discussion of Stiber limitation analysis, supra, at ______ (slip op. at 9-10).

[6] Applying subsection (c) without applying the subsection (a) Stiber analysis provides the same result here since the subsection (c) calculation swamps either method of subsection (a) limitation calculation presented previously.

The taxpayers conflate the principles of subsection (b), which focusses upon the overall amount of the credit, with subsections (a) and (c), which focus upon the income that can be used to calculate the credit. Subsection (b) provides:

> The credit provided under this section shall not exceed the proportion of the tax otherwise due under this act that the amount of the taxpayer's income subject to tax by the other jurisdiction bears to his entire New Jersey income.
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> [N.J.S.A. 54A:4-1(b).]

Subsection (b) was part of the original enactment of the Gross Income Tax Act in 1976. "The limitation of [subsection (b)] prevents an intrusion upon New Jersey's tax of New Jersey source income where . . . the rate of tax imposed by the foreign jurisdiction exceeds the rate imposed by New Jersey." Kanarek v. Dir., Div. of Tax'n, 14 N.J. Tax 589, 596 (Tax 1995). In the case at hand, the Pennsylvania rate is substantially less than the top New Jersey rate. Thus, the maximum tax credit limitation of subsection (b) does not come into play.

Nonetheless, taxpayers urge the court to apply subsection (b) without limiting the credit to taxes on income not allocated to New Jersey in accordance with subsections (a) and (c). The taxpayers argue that since the rate is substantially lower in Pennsylvania, the taxpayers can take a credit on taxes paid regardless of whether the income is allocated to New Jersey so long as the maximum credit is not reached.

The general provision in subsection (b) setting a maximum amount of tax credit does not contradict the specific provisions of subsections (a) and (c) dealing with S corporation credit eligibility. This eligibility is determined by whether the income taxed is allocated to New Jersey. Just because a taxpayer has not reached the maximum credit allowable, does not mean that the taxpayer can take a credit on taxes based upon income allocated to this State.

The intent of the Legislature may also be helpful in construing statutory provisions. "When attempting 'to discover the legislative intent, the statute must be read in light of the old law, the mischief sought to be eliminated and the proposed remedy.'" Bd. of Educ. of City of Sea Isle v. Kennedy, 196 N.J. 1, 13 (2008)(citing Brewer v. Porch, 53 N.J. 167, 174 (1969)). In adopting subsection (c) and amending subsection (a), it is plain that the Legislature was aware that without the changes, a difference in allocation between New Jersey and other states would result in a credit of out-of-state taxes on income allocated to New Jersey.

While subsection (c) is unambiguous, requiring the court to apply its plain meaning, the court must still nonetheless inquire whether there is legislative intent to the contrary which may affect the court's conclusions. Sutkowski, 312 N.J. Super at 475.

"It is not the wording alone but the policies underlying the statute, the legislative scheme of which it is a part, and the reasonableness of the proposed interpretation, that guide a court in ascertaining legislative intent." Mahwah Realty Associates, Inc. v. Township of Mahwah, 420 N.J. Super. 341, 352 (App. Div. 2011). "Statutes cannot be read in a vacuum void of relevant historical and policy considerations and related legislation." Borough of Matawan v. Monmouth Cty. Bd. of Tax'n, 51 N.J. 291, 299 (1968); Helfrich v. Township of Hamilton, 182 N.J. Super. 365, 370 (App. Div. 1981). The court must consider the broad legislative scheme of the credit provisions which are part of the GIT Act. To that end, as explained by the first presiding judge of the Tax Court, Judge Lasser, prior to the adoption of the amendments to the resident tax credit adding subsection (c) and amending subsection (a):

> [T]he intent of the act is to avoid double taxation of foreign income by relinquishing all or part of the New Jersey tax on the foreign income, but not to relinquish New Jersey tax on income earned in New Jersey.
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> [Jenkins v. Dir., Div. of Tax'n, 184 N.J. Super. 402, 409, 4 N.J. Tax 127, 133 (Tax 1982).]

Thus, even prior to the amendments creating Subchapter S status, the intent was not to allow a foreign tax credit on income earned in New Jersey. As stated more recently by this court in the context of subsection (c), "[t]he credit is not designed to

protect a resident taxpayer from the tax imposed by a foreign jurisdiction on New Jersey sourced income." Criticare, Inc. v. Dir., Div. of Tax'n, 28 N.J. Tax 169, 179 (Tax 2014). Subsection (c) did not effectuate any change in the policy regarding credits enunciated long ago by Judge Lasser in Jenkins. Rather, subsection (c) continues to protect the New Jersey tax base from being diminished by credits for tax on income not allocated to New Jersey. The Legislature set forth a plain method of arriving at the credit. Taxpayers want to rewrite that provision to provide a greater credit. While it could be argued that the Legislature could have adopted the scheme proposed by taxpayers and still protected the New Jersey tax base, the fact remains that the Legislature instead chose the method set forth in subsection (c) which undisputedly protects New Jersey source income from diminishment by the resident tax credit.

Subsections (a) and (c) of the GIT credit provision make sense when considering the context of the remedy which the Legislature was implementing. Prior to the statutory amendments creating Subchapter S status in New Jersey, out-of-state corporations were only subject to CBT on income allocated to New Jersey. This obviated the need for a credit of New Jersey CBT on out-of-state income.[7] Subsections (a) and (c), through incorporation of the

[7] Parenthetically, shareholders of a corporation were taxed under the GIT Act on dividends received from a corporation

terms defined in N.J.S.A. 54A:5-10, mandate the use of the CBT allocation method to prohibit any credit against the New Jersey GIT on income allocated to New Jersey. Using the allocation factor to limit the credit to income not allocated to New Jersey aligns the GIT credit for out-of-state income of S corporations with the CBT not reaching income allocated outside New Jersey.

Taxpayers also rely upon Beljakovic v. Dir., Div. of Tax'n, 26 N.J. Tax 455 (Tax 2012), another decision involving S corporation pass-through income. Beljakovic is factually different since the S corporation did not have a regular place of business outside New Jersey. Id. at 469-70. At the time, such a corporation was imposed the allocation rate of 100% regardless of the amount of income earned out-of-state. Ibid. This legal fiction resulted in no credit. This 100% deemed allocation was provided for in section 6 of the Corporation Business Tax act. Ibid.

However, subsection (c) uses the term "S corporation income allocated to this State." N.J.S.A. 54A:4-1(c). That term is defined by N.J.S.A. 54A:5-10 which provides that the allocation is determined not only by section 6 of the Corporation Business Tax act, but section 8 as well. Beljakovic, 26 N.J. Tax at 472-73.

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regardless of whether derived from in-state or out-of-state activities.

Section 8 provides for an equitable adjustment if the allocation calculated by section 6 does not comport with reality. Section 8 is utilized in situations in which section 6 does not lead to a fair result. See, e.g., Brunswick Corp. v. Dir., Div. of Tax'n, 11 N.J. Tax 530 (Tax 1991), aff'd, 13 N.J. Tax 136 (App. Div. 1993), aff'd, 135 N.J. 107 (1994); N.J.A.C. 18:7-8.10 (allocation for special industries). In Beljakovic, the court determined that there was evidence that a significant portion of the corporate income was earned out-of-state and the proper result was to apply section 8 and allow a credit for income allocated outside New Jersey. Beljakovic, 26 N.J. Tax at 469-70. The court's holding was also informed by the Director's own regulations which allowed an S Corporation with deemed 100% allocation to New Jersey a reduction for tax paid out-of-state. Id. at 476-77.

Thereafter, in Criticare, the court was faced with a similar situation as in Beljakovic. Like the Beljakovic taxpayer, Criticare did not maintain a place of business outside New Jersey and was subject to 100% taxation. Criticare, 28 N.J. Tax at 173. New York determined that the allocation was 20% to New Jersey and 80% to New York. Ibid. The taxpayer in Criticare submitted that the allocation calculation per section 6 of the CBT Act would apply in the absence of the legal fiction of 100% allocation. Ibid. In reviewing the record, the court applied the CBT allocation formula instead of the deemed 100% allocation. Id. at 183.

Since the tax years at issue in Beljakovic and Criticare, the Legislature repealed the 100% allocation provision for businesses that did not have a regular place of business outside New Jersey. See, L. 2008, c. 120, § 2 (effective July 1, 2010). Nonetheless, the take-away from both Criticare and Beljakovic is that the court was not substituting the allocation or income determinations of another state, but was rather implementing the allocation calculation as defined by the New Jersey CBT Act in section 6, albeit indirectly through section 8.

In contrast, taxpayers here want the court to ignore the allocation provisions of New Jersey law and instead apply the provisions of Pennsylvania law. In essence, taxpayers want a credit for all taxes paid to Pennsylvania, regardless of the allocation under New Jersey law. The problem with taxpayers' approach is that it presumes that Pennsylvania's allocation of income must be accepted despite the New Jersey Legislature specifically determining otherwise. In a broader sense, the taxpayers want New Jersey to cede its method of income allocation to that of another jurisdiction.

While "[a]llocating income among various taxing jurisdictions bears some resemblance . . . to slicing a shadow," the New Jersey legislature has made a determination of the correct allocation formula to be utilized for New Jersey taxation purposes. See

Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 192-93 (1983). In setting the allocation factor, it was not the intent of the Legislature to cede its authority to another State. Just because there are different methods of allocation available that may pass constitutional muster, does not mean New Jersey has to substitute the Pennsylvania allocation method and provide the credit. The New Jersey Legislature has specifically determined that the CBT's allocation method is to be applied to S corporation credits.

The real quarrel which taxpayers have here is not with New Jersey not allowing the credit, but rather with Pennsylvania allocating too much of the income to Pennsylvania per the allocation factor authorized by the Pennsylvania Legislature.[8] In Estate of Guzzardi v. Dir., Div. of Tax'n, 15 N.J. Tax 395 (Tax

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[8] New Jersey now utilizes single sales factor allocation and was heading in that direction at the time this case arose. For 2011, 50% was allocated to sales and 25% to both property and payroll. For 2012, 70% was allocated to sales and 15% to both property and payroll. For 2013, 90% was allocated to sales and 5% to both property and payroll. N.J.S.A. 54:10A-6.

Single sales factor, as the name implies, only uses sales to allocate income. Pennsylvania continues to utilize three-factor allocation, called the Massachusetts formula, which gives equal weight to property, sales and payroll. 72 Pa. Stat. Ann. § 7310, 61 Pa. Code § 109.5. While it is constitutionally permissible to have three factor apportionment, an allocation formula which relies more on sales as opposed to property or payroll is more likely to be found constitutionally permissible. Cf. Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 134 (1931).

1995), aff'd o.b., 16 N.J. Tax 374 (App. Div. 1996), the taxpayer paid tax to Pennsylvania in 1981 on the full sale proceeds even though the proceeds included installments to be paid in later years. Id. at 398. At the time, Pennsylvania taxed installment sales in the year that the sale was consummated, not when the payments were made. Ibid. Taxpayer subsequently moved to New Jersey. Ibid. The final payment received on the sale was in 1988 and was reported to New Jersey. Id. at 398-99. The taxpayer attempted to credit the 1981 Pennsylvania tax payment against the 1988 New Jersey tax on the final payment. Id. at 399. The resident credit only applied against taxes paid in the same year and the credit was denied in accordance with the plain language of the credit statute. Id. at 405. The court noted that the issue resulted from Pennsylvania's refusal to recognize installment sale accounting, not New Jersey's credit statute. Id. at 408. Likewise, the issue here arises not from New Jersey not allowing a credit against income allocated to Pennsylvania, but rather Pennsylvania allocating too much income to itself and taxing same.

The next step is the subsection (c) calculation. Pennsylvania allocates $1,840,750 or 81.7087% of the corporation income to Pennsylvania and taxes same at a flat rate of 3.07%. As determined by New Jersey, of the total corporation income of $2,108,894, only $1,466,660 or 69.5464% is allocable to Pennsylvania. The remaining amount of $642,234 is S corporation income allocated to New Jersey.

This means that of the $2,108,894 taxed by New Jersey, the taxpayers cannot take a credit for taxes paid on $642,234. This leaves $1,466,660 of the total amount taxed by Pennsylvania available for calculation of the credit. This is well below either method of subsection (a) calculation noted previously. Therefore, the taxpayers are entitled to a credit on tax paid to Pennsylvania on $1,466,660 of income.[9] Multiplying $1,466,660 times the Pennsylvania flat tax rate of 3.07% results in a credit of $45,026 for 2012 which is the same amount reached by the Director. The same reasoning applies to 2011 and 2013. Resultantly, the calculation of the Director stands and the appeal of taxpayers is denied.

CONCLUSION

For the foregoing reasons, taxpayers' motion for summary judgment is denied and the Director's motion is granted. An Order will follow.

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[9] The Pennsylvania non-resident tax is a flat tax. Thus, the order and method of application of a credit for marginal rates in calculating the credit does not need to be decided in this case. Further, a review of taxpayers' returns reveals that there was only activity in two states, New Jersey and Pennsylvania. Adjustments to this calculation of the credit may or may not be necessary if there is activity in three or more states. However, the issue of three or more states is not before the court and need not be decided at this juncture.