

FEBRUARY 10, 1960

HONORABLE JOHN A. KERVICK  
*State Treasurer*  
State House  
Trenton, New Jersey

## FORMAL OPINION 1960—No. 2

DEAR MR. KERVICK:

You have asked for our legal opinion as to whether the gain realized by corporations subject to the New Jersey Corporation Business Tax Act, N.J.S.A. 54:10A-1 et seq., is taxable to such corporations in either of the following two situations; i.e., first, where a parent corporation liquidates its wholly owned subsidiary and receives the latter's net assets having a present fair market value in excess of the tax basis of the parent's investment in the subsidiary, and pursuant to Internal Revenue Code of 1954, § 332, no gain is recognized for Federal Income Tax purposes; and secondly, where one corporation conveys all of its net assets to a second corporation, or to the latter's subsidiary, solely in consideration for the capital stock of the transferee which has a fair market value in excess of the tax basis of the transferor's net assets, and pursuant to Internal Revenue Code of 1954, § 368(a)(1)(c), no gain is recognized for Federal Income Tax purposes.

Section 5 of the Corporation Business Tax Act imposes a "franchise tax to be annually assessed to and paid by each taxpayer" upon, *inter alia* "1 $\frac{3}{4}$ % of its entire net income or such portion thereof as may be allocable to this State as provided in Section 6." Therefore, whether the described transactions give rise to income which is taxable under that Act depends on whether the parent corporation in the first situation and the transferor of the assets in the second realize "entire net income" within the meaning of N.J.S.A. 54:10A-4(k).

The statutory definition of "entire net income" reads as follows:

"'Entire net income' shall mean total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the U. S. Treasury Department for the purpose of computing its Federal income tax; provided, however, that in the determination of such entire net income. . . ."

This definition employs the same language used by the courts to describe income which is subject to taxation under the 16th Amendment to the Constitution of the United States. See *Eisner v. Macomber*, 252 U.S. 189 (1920). Although this constitutional definition lies at the basis of the Federal income tax law, the implementation of the 16th Amendment in a workable tax system has required an enormously more elaborate specification of what constitutes taxable income.

New Jersey's Corporation Business Tax Act does not include the detailed specification of what constitutes "entire net income." Refinements of this definition are

left to administrative regulation (N.J.S.A. 54:10A-27) and the Internal Revenue Code. The New Jersey statute incorporates by reference various provisions and concepts of the Internal Revenue Code. For example, a taxpayer's fiscal reporting period is required to be the same for New Jersey purposes as for Federal. N.J.S.A. 54:10A-4(i). Receipts, for purposes of the allocation factor (N.J.S.A. 54:10A-5(c)) must be based on the same accounting method, cash or accrual, as used for the Federal tax. N.J.S.A. 54:10A-6(B). Adjustments of income made by Federal authorities must be reported to the New Jersey Corporation Tax Bureau within 90 days thereafter; and amended Federal returns must be reported to New Jersey within the same period. N.J.S.A. 54:10A-13. The Director of the New Jersey Division of Taxation, may require any taxpayer to submit copies or pertinent extracts of its Federal income tax returns to the New Jersey Bureau. N.J.S.A. 54:10A-14.

The regulations issued by the New Jersey Corporation Business Tax Bureau pursuant to Section 27 of the New Jersey Corporation Business Tax Act recognize the dependence of our statute on Federal law to supply necessary definitions and concepts. For example, accounting periods are to be those used for Federal income tax purposes. Regulation 16:10-2.110. The method of accounting is to be the same as the Federal. Regulation 16:10-3.125. "Federal taxable income" is to be adjusted where the franchise tax period of liabilities differs from the Federal reporting period. Regulation 16:10-3.300. The New Jersey receipts and payroll allocation factors follow the reporting basis used for the Federal tax. Regulations 16:10-4.200 and 16:10-4.270. Generally, the assets allocation factor adopts the basis of assets used for Federal tax purposes; the limiting word, "generally," refers to the New Jersey rule of restoring book values for fully depreciated assets which are still in use. Regulation 16:10-4.320. Changes in tax accounting years will not be permitted by New Jersey unless first authorized by the Commissioner of Internal Revenue. Regulation 16:10-5.120.

It is in this context that we must construe the operative definition of "entire net income" in the New Jersey statute; i.e., ". . . the amount of a taxpayer's entire net income shall be deemed *prima facie* to be equal in amount to the taxable income before net operating loss deductions and special deductions which the taxpayer is required to report to the U. S. Treasury Department for the purpose of computing its Federal income tax; providing . . . ." It has been suggested that the use of the term "prima facie" in this definition connotes a presumptive identity between the concepts of Federal taxable income and New Jersey entire net income and that this presumption of identity can be rebutted under some unspecified circumstances. However, the Corporation Tax Bureau, which is responsible for administering the New Jersey statute, has rejected this interpretation. Its Regulation 16:10-3.300 states:

"Taxable income before net operating loss deduction and special deductions', hereinafter referred to as Federal taxable income, is the starting point in the computation of entire net income. After determining such Federal taxable income it must be adjusted as follows:

"a. Add to Federal taxable income: [various statutory adjustments];

"b. Deduct from Federal taxable income: [various statutory adjustments]."

The regulation does not appear to contemplate any departures from Federal taxable income other than those expressly prescribed in the statute. It is our opinion that, as suggested by the quoted regulation, the definition of "entire net income" is always equivalent to Federal "taxable income" and that the presumption, which the use of the term "prima facie" implies is subject to being rebutted, is a presumption as to the correctness of the *amount* of taxable income reported by the taxpayer or determined by the Internal Revenue Service rather than the *concept* of "taxable income." First of all, the intent that the New Jersey tax should be keyed to Federal taxable income is evident from the repeated references in the New Jersey statute and regulations to Federal concepts and definitions. Secondly, the provisions of the New Jersey statute for the imposition of a franchise tax measured by corporate income contain only a cursory definition of income; if a far more detailed definition were not provided by incorporation of the pertinent provisions of the Federal Internal Revenue Code, it is questionable whether the New Jersey statute would contain a sufficiently detailed standard to provide constitutionally adequate guidance for the administration of the act. Thirdly, it is to be presumed that the Legislature adopted a statute whose enforcement and application is administratively feasible; if the New Jersey statute authorized departure from the Federal concepts of taxable income in cases of corporate reorganizations and mergers, extremely difficult administrative problems of valuation and auditing would be created.

The conclusion that the statute does not authorize a departure from the Federal concept of "taxable income" in cases of corporate reorganizations and mergers carried out in compliance with the non-recognition provisions of the Internal Revenue Code is confirmed by consideration of the construction given to the similar New York statute. *McKinney's Consolidated Laws of New York*, Taxation, Section 208, subsection 9, defines "entire net income" as "total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department, or which the taxpayer would have been required to report, if it had not made an election under subchapter s of chapter one of the Internal Revenue Code, except as hereinafter provided." The similarity between the New York and New Jersey definitions of entire net income as well as like similarities between other sections of the two statutes makes it apparent that the form of the New Jersey statute was borrowed in part from that of New York. The New York cases have consistently held that "entire net income" for New York purposes will always be identical in concept with Federal "taxable income" except insofar as the New York statute has specifically prescribed otherwise. The word "presumably" in the quoted definition of New York entire net income is interpreted to permit a departure from reported Federal taxable income in amount, but not in definition. *People ex rel. Conway Co. v. Lynch*, 258 N.Y. 245, 179 N.E. 483 (N.Y. Ct. of App. 1932); *People v. Law*, 237 N.Y. 142, 142 N.E. 446 (N.Y. Ct. of App. 1923); *People ex rel. Barcalo Mfg. Co. v. Knapp*, 227 N.Y. 64, 124 N.E. 107 (N.Y. Ct. of App. 1919). The New York Department of Taxation and Finance, basing itself on these and similar cases, has issued an administrative ruling holding that where gains or losses are not recognized for Federal income tax purposes because of the non-recognition provisions of the Federal Code, such gains or losses will not be included in computing New York entire net income.

We conclude, therefore, that the corporate transactions which prompted your request for an opinion do not give rise to "net income" within the meaning of the

New Jersey Corporation Business Tax Act if they fall within the non-recognition provisions of the Internal Revenue Code.

Very truly yours,

DAVID D. FURMAN  
*Attorney General of New Jersey*

By: MURRY BROCHIN  
*Deputy Attorney General*

FEBRUARY 29, 1960

FREDERICK M. RAUBINGER, *Commissioner*  
*Department of Education*  
175 West State Street  
Trenton, New Jersey

FORMAL OPINION 1960—No. 3

DEAR DR. RAUBINGER:

You have asked for our legal opinion on two related questions: First, whether a candidate who has received the greatest number of votes in an election for member of the board of education of a local school district organized under Chapter 7 of Title 18 of the Revised Statutes is qualified to serve in that position although he will not have been a resident of the territory contained in the district for at least three years prior to the date upon which newly elected members are scheduled to take office; and, secondly, if not, then how the office for which he was a candidate should be filled.

The qualifications for members of the board of education of a local school district organized under Chapter 7 of Title 18 of the Revised Statutes are set forth in R.S. 18:7-11 as follows:

"A member of a board shall be a citizen and resident of the territory contained in the district, and shall have been such for at least three years immediately preceding his becoming a member of the board. He shall be able to read and write. He shall not be interested directly or indirectly in any contract with or claim against the board."

The mandatory character of the quoted residence requirements are emphasized by R.S. 18:7-12 which states:

"A member of a board shall, before entering upon the duties of his office, take and subscribe an oath, before an officer authorized to administer oaths, that he possesses the qualifications prescribed in section 18:7-11 of this Title, and the oath prescribed by section 41:1-3 of the Revised Statutes. The oaths shall be filed with the secretary."

A person who does not have the qualifications set forth in R.S. 18:7-11 cannot take the necessary oath and is therefore disqualified from "entering upon the duties of his office." *Cf. Waldor v. Untermann*, 7 N.J. Super. 605 (Law Div. 1950) *aff'd* 10 N.J. Super. 188 (App. Div. 1950).

In order to be elected as a member of a local board of education, a candidate for that office must have received "a plurality of the votes cast. . ." R.S. 18:7-41.