

Income/Franchise:

New Jersey: Income Allocated to Restore Negative Capital Account Deemed Not Taxable

Case No. 169-2021, N.J. Tax Ct. (3/28/23). In an unpublished opinion, the New Jersey Tax Court (Court) vacated a New Jersey Division of Taxation assessment related to a \$2.3 million allocation on paper from a bankrupt limited liability company (LLC) to an individual member of the LLC (*i.e.*, the taxpayer) to zero out a negative capital account, holding the allocated amount was *not* subject to New Jersey gross income tax (*i.e.*, New Jersey's personal income tax) because, under the facts, this amount did not represent economic gain or recovery of a past tax benefit. Referencing New Jersey Supreme Court caselaw that concluded New Jersey gross income tax statutes express an intent to tax only those transactions in which an individual derives an economic gain or has derived a tax benefit, the Court reasoned that the economic reality in this case is that the individual did *not* gain (or lose) anything from this mere ledger transaction and recovery of a past tax benefit was not implicated. To hold otherwise, according to the Court, would erroneously elevate "form over substance." Please contact us with any questions.

URL: <https://www.njcourts.gov/sites/default/files/court-opinions/2023/000169-21.pdf>

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