

# New Jersey Ruling on Credit Determination

## In Brief

### New Jersey Tax Court Finds for Resident Partner of Large U.S. Partnership -- Taxpayer Correctly Calculated Credit for Personal Income Taxes Paid to Other State

The Tax Court of New Jersey recently released an opinion that may affect New Jersey resident partners of law firm partnerships who also pay personal income tax in states other than New Jersey. In *Mannino v. Director, Div. of Tax'n*, (T.C. N.J. 07/08/09), the court granted the taxpayer's motion for summary judgment, holding that the amount of credit for taxes paid to each jurisdiction can only be reduced by taking into account the greater of the deductions allowed in the other taxing jurisdiction or the New Jersey "Uncommon Business Expenses" deduction allocable to the other jurisdiction, but not both.

A New Jersey resident who pays taxes in other states may be eligible for a tax credit against his New Jersey income taxes if he has income from sources outside New Jersey and his income is subject to both New Jersey income tax and income tax imposed by another state in the same year. The credit must be calculated on a state-by-state basis and cannot exceed the amount of New Jersey tax calculated on the same income.

In *Mannino*, the taxpayer, a partner in a large U.S. accounting firm, had income allocable to 41 states, including his resident state of New Jersey. The taxpayer filed as part of a composite return in 38 states, and filed nonresident income tax returns in New York and California. At issue was the method by which the taxpayer should calculate the amount of tax credit that could be claimed on his New Jersey resident return. New Jersey permits a deduction for "Uncommon Business Expenses" that are not commonly permitted as a deduction in other states. New Jersey argued that the taxpayer's income subject to tax in other states should be reduced in each state by the other states' deductions and the New Jersey Uncommon Business Expenses deduction. The taxpayer argued that he should be required to reduce the other state's income only by the larger of the deductions allowed in the other state or the New Jersey Uncommon Business Expenses deduction, but not both.

Finding for the taxpayer, the Court held that the goal of the credit is to avoid double taxation of other state income by relinquishing all or part of the New Jersey tax on the other income, but not to relinquish New Jersey tax on income earned in New Jersey. Citing *Jenkins v. Taxation Div. Dir.*, 4 N.J. Tax 127, 133 (1982). The Court held that deducting only the greater of the two amounts would achieve this goal.

In *Mannino*, the parties stipulated that no portion of the taxpayer's New Jersey Uncommon Business Expenses were allowed as deductions on his California Return, and no portion of the California deductions were allowed as deductions on the taxpayer's New Jersey resident tax return. The Court relied on *Allen v. Director, Div. of Taxation*, 14 N.J. Tax 385 (1994), *aff'd o.b. per curiam*, 15 N.J. Tax 704 (App. Div. 1996), to find that only the greater of the two amounts should be used to determine the amount of income taxable to both jurisdictions.

We anticipate that New Jersey may appeal this ruling. However, law firm partners resident in New Jersey should review how they have calculated their credit for out of state taxes in prior years and how they should calculate this credit in the future. Our professionals at PwC have extensive experience assisting our clients with New Jersey tax credit issues. If we can assist your firm, please contact Stanley Kolodziejczak at (646) 471-3160, Gregg Sincoff at (646) 471-1335, Nancy Regan at (646) 471-6104 or Paul Bullock at (646) 471-4690.

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