SALES AND USE TAX REVIEW COMMISSION
RECOMMENDATION PURSUANT TO P.L. 1999, C. 416

BILL NUMBER:
A-2207

DATE OF INTRODUCTION:
March 30, 2002

SPONSOR:
Assemblyman Egan
Assemblyman Diegnan

DATE OF RECOMMENDATION:
July 30, 2002

IDENTICAL BILL:
S-1598

COMMITTEE:
Assembly Commerce and Economic Development

DESCRIPTION:
This Bill authorizes the creation of a new urban enterprise zone in New Brunswick, Middlesex County.

ANALYSIS:

This Bill is proposed to amend the Urban Enterprise Zones Act, N.J.S.A. 52:27H-60, et. seq., to allow the creation of a 31st urban enterprise zone in New Brunswick.

The Commission is concerned that the greater the number of municipalities with a 3% sales tax, the more that New Jersey becomes a patchwork of differing sales tax rates. This is contrary to the principle of tax simplicity and uniformity. Adding more zones may create a slippery slope because other municipalities which are similarly situated to New Brunswick may petition to become another urban enterprise zone. This domino effect defeats the original purpose of the Urban Enterprise Zones Act of helping to revitalize the state's economically distressed urban areas. Given the ease with which the Urban Enterprise Zone program is being expanded, it is conceivable that all municipalities in New Jersey will be able to credibly and successfully press for Urban Enterprise Zone status. As originally conceived, the program was to be limited and its benefits restricted to the most dire cases. This Bill does not establish that its provisions would further that purpose.

The Urban Enterprise Zone program has expanded in ways that the original drafters would never have intended. For instance, prior to 1994, ten towns (comprising eleven zones) were designated as Urban Enterprise Zones. In 1994, legislation authorized the creation of ten additional zones. In 1995, legislation yet again added seven more zones. Recent legislation has added three more zones to that list. Also, Urban Enterprise Zone-impacted business districts, areas that have been "negatively impacted" by the presence of two or more adjacent urban enterprise zones, have been created wherein reduced sales tax is collected. There has never been an independent, comprehensive analysis done and report issued that confirms that the Urban Enterprise Zone program has actually been a benefit to the participating communities and to the citizens of the State of New Jersey. The Commission believes that a study is necessary. It also believes and recommends that no further zone be created until and unless their efficiency is proven by objective analysis.

As the number of Zones increase, the challenge of enforcement expands. Due to the highnumber of Zones in existence, New Jersey no longer enjoys the administrative simplicityit once did with sales tax uniformity across the State. The Bill Statement attached to this proposed legislation simply states that New Brunswick would benefit from the economic stimulus that an urban enterprise zone would provide. However, the Bill does not provide an economic study to justify the creation of an urban enterprise zone in New Brunswick. It does not provide any information that would demonstrate that such designation would reverse the economic decline of the affected municipality or attract businesses or customers to that municipality. Conversely, it does not demonstrate that if enacted, it would not draw businesses or customers from other depressed municipalities, or if it would do so, then such an effect is economically justified.

Since the inception of the Urban Enterprise Zones Act, its Constitutional validity has been brought into question. Under the Commerce Clause, a State may not impose taxes on out of state sale transactions that exceed the taxes imposed on in-state transactions. The Urban Enterprise Zone program halves the 6% sales tax rate for sales that take place within a zone. However, New Jersey law imposes a 6% compensating use tax on goods purchased outside of New Jersey but brought into the state for use here. Thus, the law appears to discriminate between a “sale” and a “use” based upon where the transaction occurs. As a result, non-Urban Enterprise Zone New Jersey retailers are forced to compete with out of state retailers that deliver goods into a designated zone, as well as with the in-state Urban Enterprise Zone vendors. To comply with the Commerce Clause, the Division must take the position that a New Jersey purchaser would be able to claim a 3% use tax rate if delivery is taken within the zone. The de facto extension of the 3% rate to retailers outside of New Jersey was never contemplated, but is nonetheless a real consequence of this program. Any expansion or creation of new 3% zones only perpetuates this situation.

Moreover, varying tax rates from municipality to municipality threatens economic neutrality and the idea of horizontal tax equity within the State. The doctrine of economic neutrality promotes a system of taxation that has a limited effect or impact on the marketplace and avoids policy that benefits one segment of the market at the expense of another. The premise, upon which the Urban Enterprise Zones Act is based, is to attract new businesses and consumers to selected economically depressed areas. In doing this, the surrounding municipalities from which business and consumers are drawn suffer negative economic effects. Horizontal equity refers to the concept that tax treatment should be uniform from one transaction to another. The Act creates a lower sales tax rate for certain sales transactions taking place within the urban enterprise zone zones. This disparate treatment violates the doctrine of horizontal equity. Permitting more municipalities to collect reduced sales would exacerbate the already tenuous foundation upon which the Act is based.

In addition, expanding the Urban Enterprise Zone program would further alter the broad-based nature of the sales and use tax. A broad-based tax, imposed with limited exemptions on a wide range of transactions, is easy to understand and administer, and is generally perceived as economically neutral and "fair." When imposed at a fairly low rate, the burden, per transaction, on the individual taxpayer, is relatively small, but the cumulative revenue generated can be enormous. Expanding the Urban Enterprise Zone Program by adding more 3% zones would save an individual taxpayer and vendor a fairly insignificant sum every year. However, the cumulative loss of revenue to the State is substantial, leaving the State to find other means of generating the money lost as a result of expanding the program. This loss of revenue would be considerable because the 3% sales tax collected by qualified vendors is remitted to the municipality in which the urban enterprise zone is located and not to the State's General Fund. Thus, the State would lose the entire 6% sales tax that is currently collected on sales of items in the new urban enterprise zone. This would be a particularly burdensome loss to the State in regard to big-ticket items.

Finally, the major reason many municipalities are now petitioning for Urban Enterprise Zone status stems from the belief that such a designation would replace revenue that the municipality is currently losing from other sources. For instance, a representative testified to the Sales and Use Tax Review Commission on behalf of New Brunswick's Department of Planning, Community and Economic Development that aid and funds that the city is currently receiving are soon due to expire. The main theme in the representative's testimony urging the Commission to approve the Bill, stressed that Urban Enterprise Zone status would replace lost funds for municipal use.

SUGGESTED SOLUTIONS TO URBAN ENTERPRISE ZONE EXPANSION

The Commission believes that there are reasonable and fiscally sound ways to increase municipal revenue from sales tax. The first legislative method involves repealing the partial exemption created under N.J.S.A. 52:27H-80 and amending the provisions of the Urban Enterprise Zones Act regarding depositing a portion of sales tax revenues in enterprise zone assistance funds. In other words, the sales tax rate would remain at 6%, but a portion of the tax collected in each Urban Enterprise Zone would be applied to that zone's assistance fund. This proposal provides several benefits. First, it is easy to administer as the sales tax rate would be the same throughout the state. This proposal also eliminates the risk of discriminating against interstate commerce, thereby removing the constitutional argument provided above. At the same time, it preserves the benefit to the zones of sharing the sales tax revenue generated by transactions in the zones. The purchase exemption for property used or consumed in the zone by a qualified business would stay in effect, but the partial exemption would no longer be available for participating Urban Enterprise Zone businesses. Again, a study could establish whether the 3% sales tax rate actually benefits the zone community rather than a few select businesses that happen to sell higher priced goods.

Another solution would be to repeal the partial exemption for sales of tangible personal property and replace it with a similar partial exemption for local activities, namely services that are subject to sales tax under N.J.S.A. 54:32B-3(b)(3); (c); (d), and (e). These include storage, restaurant meals, hotel room rentals, and admission to places of amusement. A portion of the revenue generated by partially exempt transactions would continue to be deposited in enterprise zone assistance funds and apply to the accounts of the zones where the transaction took place.

Similar to the previous solution, this proposal would eliminate the risk of discriminating against interstate commerce. Sales of tangible personal property would be subject to the regular 6% sales tax rate while use tax on taxable items purchased elsewhere would also remain at 6%. However, the amendments would create a new partial exemption designed to attract customers to a wide range of businesses in the Urban Enterprise Zones, e.g., restaurants, hotels, movie theaters, and sports arenas. Because doing business at these facilities would involve a longer visit to the zone than merely ordering or picking up merchandise at a store, this partial exemption would be even more effective than the current partial exemptions in stimulating economic and social activity in the Urban Enterprise Zone. It would give a boost to high-traffic businesses like theaters, restaurants and hotels, most likely attracting residents of more prosperous communities to the commercial and recreational offerings in the Urban Enterprise Zones. Thus, it would help revitalize both the image and the actual economic status of the zones. This incentive for consumers, combined with the continual sharing of sales tax revenue with the Urban Enterprise Zones, could serve the same purposes as the original legislation, but without keeping the State vulnerable to legal challenges or to declining use tax revenues as businesses and individuals have more goods delivered into the zone from out-of-state suppliers. The transactions taxable at 3% would be strictly local, intrastate transactions, therefore use tax would not become an issue. Pursuant to N.J.S.A. 54:32B-6, the compensating use tax applies only to tangible personal property and certain services to tangible personal property which are taxable under N.J.S.A. 54:32B-3(b)(1) and (2). It does not apply to transactions taxable under N.J.S.A. 54:32B-3(b)(3) through 54:32B-3(e), some of which could be subject to a 3% sales tax rate under this proposal.

These two solutions solve the problem of providing sales tax benefits which give some communities a sales tax rate advantage over others. There are constant demands to expand the program by establishing new Urban Enterprise Zones in neighboring communities that are competitively disadvantaged by their neighbors' favored position. In addition to diluting the very benefits that the program seeks to confer, this expansion then creates even further demands for expansion to other communities that perceive an economic disadvantage resulting from the new zones' favored status. The expansion of the Urban Enterprise Zones also serves to enlarge and perpetuate the fiscal costs to the State in terms of lost tax dollars and the potential legal problems inherent in the 3% sales tax benefit.

There are in fact alternatives for providing funds to local municipalities rather than expanding a program which presents major fiscal, administrative, and legal problems for the State of New Jersey. The Commission again urges the State to undertake an independent and comprehensive review of the enterprise zone program before any additional zones are added.

RECOMMENDATION:

The Commission does not recommend enactment of this Bill.

COMMISSION MEMBERS FOR PROPOSAL: 0

COMMISSION MEMBERS AGAINST PROPOSAL: 7

COMMISSION MEMBERS ABSTAINING: 0

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