

# New Jersey Law Journal

VOL. 217 NO. 9

MONDAY, SEPTEMBER 1, 2014

An ALM Publication

## Tax Law

# Court Offers Instructive Opinions on Gross Income Tax and Real Property Tax

By Robert J. Alter

The New Jersey Supreme Court term 2014 was a noteworthy one for tax, with practitioners benefiting from two instructive judicial opinions affecting the practice area.

### Gross Income Tax

In *Harlan W. Waksal and Carol Waksal v. Director, Division of Taxation*, 215 N.J. 224 (Aug. 13, 2013), the Supreme Court in a unanimous opinion by Justice Patterson affirmed Appellate Division and Tax Court judgments which held that taxpayers are not entitled to deduct worthless nonbusiness debt owed to them under the New Jersey Gross Income Tax Act.

In reaching its decision, the court acknowledged that while for federal income tax purposes under IRC §166(d) (1)(B), a taxpayer may claim the worthlessness of a nonbusiness bad debt as a short-term capital loss and that taxpayers offset the nonbusiness bad debt against their capital gains, no provision allows for such a deduction in the act.

The court's underlying rationale recognized the fundamental distinction between the federal and New Jersey income tax laws, and that the New Jersey Gross Income Tax statute does not mirror the Internal Revenue Code's treatment of deductions for capital losses. In contrast to the Internal Revenue Code, the tax act is a tax on gross income reduced only by certain limited deductions and credits, and there was no provision in the act expressly authorizing a deduction for worthless non-



*Alter is a partner at McElroy, Deutsch, Mulvaney & Carpenter in Morristown, N.J., and past chairman of the Section of Taxation of the N.J. State Bar Association. He specializes in representing business and individual clients in civil and criminal tax disputes with state and federal authorities.*

business debt.

In that regard, in resolving the second issue presented by this appeal, the court also rejected the taxpayers' argument (the taxpayers reported the worthless debt as a loss from the disposition of property) that N.J.S.A. 54A:5-1c incorporates a Section 166 deduction for worthless nonbusiness debts through its reference "methods of accounting allowed for federal income tax purposes," and held that language only applies to items that are sales, exchanges or other dispositions of property and that a bad nonbusiness loan could not be deducted as a loss because it was not a sale, exchange or other disposition of property.

Lastly, the court rejected the taxpayers' argument that because the subject note became worthless, it was effectively abandoned and a disposition took place.

From a tax-planning viewpoint, the *Waksal* opinion raises the question of whether a taxpayer can enter into a bona fide sale (for an amount supported by an appraisal) of a nonperforming nonbusiness loan in order to be in a stronger position to argue that a disposition of property occurred.

### Real Property Tax

In *Advance Housing v. Township of Teaneck*, 215 N.J. 549 (Sept. 25, 2013), Justice Albin writing for a unanimous court addressed the issue in this appeal of whether plaintiff nonprofit corporations' residences for individuals with psychiatric disabilities, in which they live and receive supportive counseling, are actually used for charitable purposes as required under

## Tax Law

N.J.S.A. 54:4-3.6, entitling the properties to tax-exempt status.

The Supreme Court held that the non-profit plaintiff, which was a provider of housing and counseling for people with mental disabilities, was entitled to exemption from property taxes, and reversed a Tax Court judgment which found that the plaintiff did not fit the definition of a charitable purpose because it essentially just provided housing for people with psychiatric problems, which was not enough to warrant a property-tax exemption. Organizations that provide living space for the mentally disabled will benefit from this ruling, which held that the plaintiff's residences for individuals with psychiatric disabilities, where they live and receive supportive counseling, are entitled to tax-exempt status.

In reaching its determination, the court set forth the criteria that must be satisfied under N.J.S.A. 4-3.6 to obtain tax-exempt status. First, an entity has to show that it is organized exclusively for a charitable purpose. Second, it has to show that its property is actually used for such a charitable purpose and, third, that its use and operation of the property is not for profit.

In making the fact-specific determination of whether a nonprofit corporation organized for a charitable purpose is "actually" using property for a charitable purpose, the court set forth the following principles which should guide the courts in the future: (1) whether the charitable work done by the private entity will spare

the government an expense that ultimately it must bear; (2) the private entity must not be engaged in a seeming commercial enterprise; (3) the property must be used in a manner to further the charitable purpose; (4) the receipt of government subsidies or funds is not contraindicative of a charitable purpose; (5) financial support and recognition by the state of a private entity's charitable work may be indicative that its property is used for a charitable purpose; and (6) the private entity is carrying out its charitable mission through the use of its property and is addressing an important and legitimate government concern.

Applying the foregoing principles to the facts of this case, the court found that Advance Housing actually used its residences for the charitable purposes set forth in its certificate of incorporation. Its provision of housing with integrated supportive services to mentally disabled citizens, who otherwise would be dependent on governmental relief, was in furtherance of New Jersey express policy. Its property served a vital need that would otherwise be borne by the state at a much greater cost, by providing services to its clients in their residences—services that help facilitate the transition from institutionalization to independent living.

In *Princeton Office Park v. Plymouth Park Tax Services*, 218 N.J. 52 (June 25, 2014), the Supreme Court decided the issue of whether, under New Jersey law, a tax-sale certificate purchaser holds a tax lien.

The court's analysis of this issue was prompted by a certified question of law from the U.S. Court of Appeals for the Third Circuit, stemming from a voluntary Chapter XI bankruptcy petition filed by Princeton Office Park, wherein its reorganization plan proposed execution of a note and mortgage, securing its obligation to Plymouth Park with interest accrued at a rate of 6 percent beginning on the plan's effective date, versus the statutory rate of 18 percent on the redemption amount due to Plymouth Bank following its purchase of a tax sale certificate for property owned by Princeton Office Park.

Plymouth Park objected, arguing that it had obtained a tax lien under New Jersey law, having previously purchased at a public auction a tax sale certificate, and that the Bankruptcy Court was not authorized to reduce the statutory rate of 18 percent on the redemption amount.

The Supreme Court, in analyzing several provisions of the tax-sale law, held that the purchaser of a tax-sale certificate possessed a tax lien on the encumbered property. The court reasoned that such a holding was consistent with the statute's purpose to provide the sale of tax-sale certificates as a source of municipal revenue. Furthermore, the court opined that the statutory language reflected the legislature's intent that a property owner's tax delinquency survives the sale of a tax certificate, and that certificate holders hold a lien based on that delinquency. ■