

**NEW JERSEY DIVISION OF TAXATION
REGULATORY SERVICES BRANCH
TECHNICAL BULLETIN**

TB - 56

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TAX: GROSS INCOME TAX

TOPIC: HEALTH ENTERPRISE ZONES

Effective for taxable years of practices beginning on or after September 2, 2004, an eligible taxpayer may deduct an amount, as defined herein, from his or her gross income. The deduction is known as a Health Enterprise Zone Deduction, or HEZ deduction. It was established by P.L. 2004, c. 139, approved September 2, 2004.

To be eligible for this tax benefit, a taxpayer must be engaged in providing primary care (1) in a practice located within a Health Enterprise Zone or (2) in a qualified practice located within 5 miles of a Health Enterprise Zone.

An "Eligible Taxpayer," for purposes of this benefit, is an individual, estate or trust, as defined by N.J.S.A. 54A:1-2.l., that owns a practice in an HEZ or is a qualified practice.

"Primary Care" means that practice of family medicine, general internal medicine, general pediatrics, general obstetrics, gynecology, and any other areas of medicine which the Commission of Health and Senior Services may define as primary care. Primary care also includes the practice of general dentistry and pedodontics, as well as the professions of nurse-practitioner, certified nurse-midwife, and physician assistant. See, N.J.S.A. 18A:71C-32.

"Qualified Practice" means a practice located in New Jersey at which 50% or more of the total amount received for services at that practice for the taxable year are qualified receipts and 50% or more of the patients whose services are compensated by qualified residents reside in a Health Enterprise Zone.

"Health Enterprise Zone" or "HEZ" means a municipality deemed a "State designated underserved area" and designated as such by the Department of Health and Senior Services.

The current list of Health Enterprise Zones include the following locations:

Municipalities with Populations of 30,000 or more

Atlantic City
Camden City
East Orange City
Newark City
Irvington Township
Paterson City
Jersey City
Perth Amboy City
Trenton City
New Brunswick City
Plainfield City
Elizabeth City
Passaic City
City of Orange
Township Vineland City
Long Branch City
Lakewood Township

Municipalities with Populations of 5,000 to 29,000

Asbury Park City
Salem City
Wildwood City (Cape May)
Bridgeton City
Keansburg Borough
Paulsboro Borough
Pleasantville City
Freehold Township
(Monmouth) Phillipsburg Town
Woodbury City
Millville City
Mount Holly Township
Red Bank Borough
(Monmouth) Burlington City
Glassboro Borough
Highlands Borough
(Monmouth) Newton Town
(Sussex) Lindenwold Borough
(Camden) Middle Township
Absecon City (Atlantic)
Belmar Borough (Monmouth)
Hammonton Town

Carteret Borough (Middlesex)
Commercial Township (Cumberland)
Fairfield Township (Cumberland)
Gloucester City (Camden)
Jamesburg Borough (Middlesex)
Warren Township (Somerset)

Calculation of Benefit

To calculate a HEZ deduction, a taxpayer shall multiply its net income from the practice – location by the practice-location’s “deduction percentage.” The “deduction percentage” is a fraction whose numerator is the qualified receipts of the practice-location (or qualified practice-location) and whose denominator is the practice-location’s gross receipts from services. “Qualified receipts” are amounts received for services from the Medicaid including amounts received from managed care organizations under contract with the Medicaid program, the Family Care Health Coverage Program, and the Children’s Health Care Coverage Program for providing health care services for eligible program recipients. The deduction percentage should be rounded to three decimal places.

If an entity has more than one location, a separate calculation must be made for each qualifying practice-location. The resulting amount of separate amounts are added together, and the total is taxpayer’s HEZ deduction for that practice. It is then deducted from gross income on the taxpayer’s New Jersey Gross Income Tax Return. If a taxpayer does not receive or report taxable income from a particular practice-location, it does not qualify for an HEZ deduction. Therefore, a location that operates at a loss is not entitled to an HEZ deduction. A practice-location must meet the criteria annually to be eligible for an HEZ deduction.

A practice that is an electing New Jersey S Corporation or is recognized for federal purposes as a partnership, located in or that has a practice-location in a Health Enterprise Zone, or a qualified practice or practice-location in New Jersey within 5 miles of a Health Enterprise Zone, shall determine the HEZ deduction percentage and the HEZ deduction allowable. The business shall report the HEZ deduction on the NJ-K1 provided to the partners, shareholders, or members of the practice annually.

Sole proprietors shall determine the HEZ deduction percentage and HEZ deduction allowable annually and attach a supporting schedule to their New Jersey return.

Regardless of the legal, organizational form of the entity, practices and qualified practices that are affected by this law (whether partnerships, LLCs, or S corporations, for example) are required to keep records substantiating their gross receipts, qualified gross receipts, patients’ addresses, and deduction percentage calculations by location for computation and audit verification purposes. Businesses and practices that have more than one location must maintain separate books and records for each location, so that the deduction percentage and net profits from the individual location can be determined.

These separate books and records must be available to the Division of Taxation for audit and verification of the HEZ deduction.

HEZ deductions that cannot be utilized on an eligible taxpayer's Gross Income Tax return cannot be carried forward or back to another tax year nor are they transferable to another taxpayer.

The following examples illustrate the calculation and use of the HEZ deduction.

Example 1

XY Medical Services, Inc., a New Jersey S Corporation, is located in a health enterprise zone. It is owned by Dr. Smith and Dr. Jones who are the sole shareholders. The practice also employs two other medical doctors and two physician assistants and, on occasion, brings in a doctor who is a medical specialist.

In 2005 the practice's gross receipts were \$900,000 of which \$600,000 were qualified receipts from the NJ Medicaid program for providing services to qualified recipients. The S corporation's net income for the year was \$240,000.

The S corporation XY Medical Services, Inc. calculates its HEZ deduction percentage as follows:

$$\frac{\text{qualified receipts } \$600,000}{\text{gross receipts } \$900,000} = 66.667\%$$

XY Medical Services, Inc. then calculates the total HEZ deduction allowed for the practice which is then allocated to its shareholders. XY Medical Services, Inc. calculates its HEZ deduction as follows:

$$\text{HEZ deduction percentage, } 66.667\% \times \text{New Jersey S Corp Net Income, } \$240,000 = \$160,000$$

The two shareholders, Drs. Smith and Jones, each own 50% of the practice. Their NJ-K1s provided by the practice, reflect net pro rata share of S corporation income of \$120,000 each and HEZ deduction of \$80,000.

Drs. Smith and Jones each report on their respective New Jersey gross income tax returns net pro rata share of S corporation income of \$120,000 and claim an HEZ deduction of \$80,000 as reflected on their respective NJ-K1s.

The physicians and physicians' assistants employed by the practice are not eligible for a deduction because they would receive wages and not net income from the qualified practice.

Unless the medical specialist that XY Medical Services, Inc. brings into its location on a case-by-case basis maintains a qualified practice of his own, he does not qualify for an HEZ deduction.

Example 2

Dr. Johnson has a medical practice, organized as a single member LLC with two locations. Location one is within five miles of an HEZ, and location two is neither in an HEZ nor within five miles of an HEZ.

For 2005, Dr. Johnson's practice reports the following:

- Location one's gross receipts are \$200,000. Its qualified receipts are \$125,000.
- 60% of location one's qualified receipts, \$75,000, are from patients living in an HEZ.
- Location one is a qualified practice because at least 50% of the gross receipts were qualified receipts and at least 50% of the qualified receipts were from patients living in an HEZ.
- Location one's HEZ deduction percentage would be 62.5% calculated by dividing the location's qualified receipts, \$125,000 by the location's gross receipts, \$200,000.
- Location two's gross receipts are \$300,000. Its qualified receipts are \$130,000.
- 25% of location two's qualified receipts, \$32,500, are from patients living in an HEZ.
- Location two is not a qualified practice because it is neither in an HEZ nor within five miles of an HEZ.
- Net profits from operations for the entire business are \$180,000 as net profits from operations are \$600,000 and location two's net profits from operations are \$120,000.

For tax year 2005, Dr. Johnson, a New Jersey resident, reports \$180,000 as net profits from business on his NJ-1040 return. Dr. Johnson is entitled to an HEZ deduction for location one of \$37,500, calculated as follows:

$$\begin{array}{rcl} \text{HEZ deduction percentage} \times \text{Net profits from the qualified location} & = & \text{deduction} \\ 62.5\% & \quad \quad \quad \$60,000 & \quad \quad \quad \$37,500 \end{array}$$

Dr. Johnson is not entitled to an HEZ deduction for location two because it is not a qualifying practice.

Businesses and practices that have more than one location must maintain separate books and records for each location, so that the deduction percentage and net profits from the individual locations can be determined. These separate books and records must be available to the Division of Taxation for audit and verification of the HEZ deduction.

Example 3

ABC Medical, Inc. has two locations; location one is in an HEZ and location two is neither in nor within five miles of an HEZ. Dr. L. is the sole shareholder of ABC Medical, Inc.

For 2005 ABC Medical, Inc. reported the following:

- Location one's gross receipts were \$400,000. Its qualified receipts were \$325,000.
- 30% of location one's qualified receipts, \$97,500 were from patients living in an HEZ.
- Location one qualifies for an HEZ deduction even though 50% of its qualified receipts were not from patients living in an HEZ because location one is located in an HEZ.
- Location one's profits from operations were \$45,000.
- Location one's HEZ deduction percentage is 81.25% calculated by dividing the location's qualified receipts, \$325,000, by its gross receipts, \$400,000.
- Location one's HEZ deduction is \$35,563, calculated by multiplying location one's net profits, \$45,000, times its HEZ deduction percentage, 82.25%.
- Location two's gross receipts were \$500,000. Its qualified receipts were \$175,000 and 25% of location two's qualified receipts, \$43,750, were from patients living in an HEZ.
- Location two is not a qualified practice because it is neither in nor within five miles of an HEZ.
- Location two's net profits from operations were \$180,000.
- ABC Medical, Inc., an S corporation, for 2005 reports an HEZ deduction of \$35,563 for location one. This amount is reflected on the CBT-100S K1 issued to Dr. L for 2005.
- Net profits from operations for the entire corporation were \$225,500.

For tax year 2005 Dr. L., a nonresident, reports \$225,500 as net pro rata share of S corporation income on his NJ-1040 NR return. Dr. L will also claim an HEZ deduction of \$35, 563, as reflected on his NJ-K1 from ABC Medical, Inc.

Businesses and practices that have more than one location must maintain separate books and records for each location, so that the deduction percentage and net profits from the individual locations can be determined. These separate books and records must be available to the Division of Taxation for audit and verification of the HEZ deduction.

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Example 4

Dr. E is associated with three separate qualified dental practices. He is a member (partner) in HIJ Associates, LLC and KLM Associates, LLC. He is also a shareholder of NOP Orthodontics, Inc., a New Jersey S corporation.

For tax year 2005 Dr. E received the following information on his K-1s from the three dental practices:

HKJ Associates, LLC		
Distributive Share of Partnership Income	\$225,000	
HEZ Deduction	\$ 73,253	
KLM Associates, LLC		
Distributive Share of Partnership Income	(\$ 23,500)	
HEZ Deduction	00	
NOP Orthodontics, Inc.		
Net Pro Rata Share of S Corporation Income	\$ 86,000	
HEZ Deduction	\$ 22,747	

For tax year 2005, Dr. E, a New Jersey resident, reports the following items of income on his NJ-1040 return:

Distributive Share of Partnership Income		
HIJ Associates	\$225,000	
KLM Associates	<u>(\$ 23,500)</u>	\$201,500
Net Pro Rata Share of S Corporation Income		
NOP Orthodontics, Inc.	\$ 86,000	\$ 86,000
HEZ Deduction		
HIJ Associates	\$ 73,253	
KLM Associates	\$ 00	
NOP Orthodontics, Inc.	<u>\$ 22,747</u>	\$ 96,000

Dr. E is not entitled to an HEZ deduction for KLM Associates because he had no taxable net taxable income from the practice. He had a loss.

Example 5

Dr. J has a practice with two locations. Location one is located within an HEZ and location two is located within five miles of an HEZ. For 2005 Dr. J's practice reports the following:

- Location one's gross receipts were \$300,000. Its qualified receipts were \$110,000.
- Location one qualifies for an HEZ deduction because it is located within an HEZ.
- Location one's HEZ deduction percentage is 36.667%, calculated by dividing its qualified receipts, \$110,000, by its gross receipts, \$300,000.
- Location one's net profits from operations were \$85,000.
- Location one's HEZ deduction is \$31,167, calculated by multiplying location one's net profits, \$85,000, times its HEZ deduction percentage, 36.667%.
- Location two's gross receipts were \$400,000, its qualified receipts were \$300,000 and 60% of location two's qualified receipts, \$180,000 were from patients living in an HEZ.
- Location two also qualifies for an HEZ deduction because it meets all the criteria to be a qualified practice.
- Location two's HEZ deduction percentage is 75% calculated by dividing its qualified receipts, \$300,000, by its gross receipts, \$400,000.
- Location two's net profits from operations were \$110,000.
- Location two's HEZ deduction is \$82,500, calculated by multiplying location two's net profits, \$110,000, times its HEZ deduction percentage, 75%.
- Net profits from operations from Dr. J's entire practice were \$195,000.

For tax year 2005, Dr. J a New Jersey resident, will report on his NJ-1040 \$195,000 as net profits from business, \$85,000 from location one and \$110,000 from location two. Dr. J can claim an \$113,667 HEZ deduction, \$31,167 from location one and \$82,500 from location two. Dr. J must attach a schedule to his return showing how he arrived at his HEZ deduction.

Business or practices that have more than one location must maintain separate books and records for each location, so that the deduction percentage and net profits from the individual locations can be determined. These separate books and records must be available to the Division of Taxation for audit and verification of the HEZ deduction.

Note: A Technical Bulletin is an informational document designed to provide guidance on a topic of interest to taxpayers and describe changes to the law, regulations, or Division policies. It is accurate as of the date issued. However, taxpayers should be aware that subsequent changes in the Tax Law or its interpretation may affect the accuracy of a Technical Bulletin. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.