

May 2026

Not As Easy As ABC: How NJ Can Recover More Than \$120 Million From a Tax Break for the Wealthy

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New Jersey’s Alternative Business Calculation (ABC) has drifted from its original purpose: closing a gap in the tax code for individuals with business income. It is now a \$190 million expense that disproportionately benefits high-income residents.¹ In the last decade, the Alternative Business Calculation has grown rapidly and tilted further toward the wealthiest filers:

- The benefit is highly concentrated: 60 percent of the benefits go to roughly 0.6 percent of New Jersey tax filers, all with more than \$1 million in annual income.²
- The cost is growing quickly: Since 2016, the deduction has more than doubled in size, outpacing all other personal income tax deductions combined.³
- In that time, it has skewed even more toward the wealthy: tax filers making \$2.5 million or more now claim more in ABC benefits than all tax filers below \$500,000 combined.⁴

Reforming this deduction would raise much-needed revenue for a state facing a structural deficit, **without affecting tax returns for 99 percent of New Jersey households.**⁵ Gov. Sherrill’s Fiscal Year 2027 budget proposal does exactly that, reining in the ABC’s cost and limiting its benefits to high-income households.⁶

What is the Alternative Business Calculation?

The Alternative Business Calculation is a state tax provision that lets filers with certain kinds of business income use losses in one business category to reduce taxable income from another — cutting their personal income tax bill. Filers can deduct 50 percent of these losses, and they can carry unused losses forward for up to 20 years.

The provision was meant to fix a quirk in how New Jersey taxes business income. Generally, New Jersey’s gross income tax, as the name suggests, taxes a filer’s gross income — their income before expenses.

For business owners, the state counts income **after** counting business losses.

Illustration: Revenue and losses at Joe's hardware store

If Joe's hardware store sells \$500,000 in products but has \$400,000 in business expenses like payroll and rent, Joe's business income for New Jersey tax purposes is \$100,000.

If Joe's hardware store sells \$400,000 in products but has \$500,000 in expenses, his business income is \$0.

Before 2011, New Jersey's income tax let business owners cancel out losses only within the same type of business. Two sole proprietorships? A loss from one could offset profit from the other. But a sole proprietorship plus a partnership? Those were treated as separate buckets — a loss in one bucket couldn't reduce income in the other.⁷

The Alternative Business Calculation changed that. Filers with business income can now offset losses across four categories: sole proprietorships, rental and royalty income, partnership income, and S corporation income.⁸ They can claim 50 percent of these losses against their other income in the same categories.⁹ The ABC also lets filers "carry forward" losses for 20 years, applying them to reduce business income in future tax years.¹⁰

The result: a filer with business income today can partially offset profits in one category with a loss in another.

Illustration: Joe's alternative business calculation treatment of a rental income loss

Say Joe's hardware store has a business profit of \$100,000, but Joe loses \$50,000 on a rental property. Joe can claim 50 percent of the rental loss as a deduction under the ABC. Joe can subtract \$25,000 from his hardware store profit, reducing it to \$75,000.

Joe can also carry that \$25,000 loss to a future tax year. So if Joe had no other business income this year, he could reduce next year's business income (or any year for the next 20) by \$25,000 instead.

What's the problem with the ABC?

A loss on paper can quickly become a generous deduction to offset high income and reduce tax liability.

In theory, an individual with a \$100,000 gain and a \$100,000 loss would have \$0 in income. Without the Alternative Business Calculation, that person would not be able to offset the gain.

But this deduction can quickly expand to include “paper” losses, even when the filer’s actual financial position has not changed.

Illustration: How Joe lowers his income with a “paper” loss

Joe’s hardware store makes \$100,000 in business income this year.

Joe also owns a second home in Florida. Joe pays \$20,000 in maintenance, fees, and taxes on the home each year. This year, Joe rents the home to his brother for a below-market value of \$10,000. Joe claims a rental income loss of \$10,000. He can now subtract 50 percent of this “loss” from his business income, reducing his taxable income by \$5,000.

Had Joe left the home vacant or used it himself, none of the \$20,000 in maintenance, fees, and taxes would have been deductible. Those would have been personal expenses on a second home. By renting to his brother below cost, Joe converts \$5,000 in personal expenses into a tax deduction.

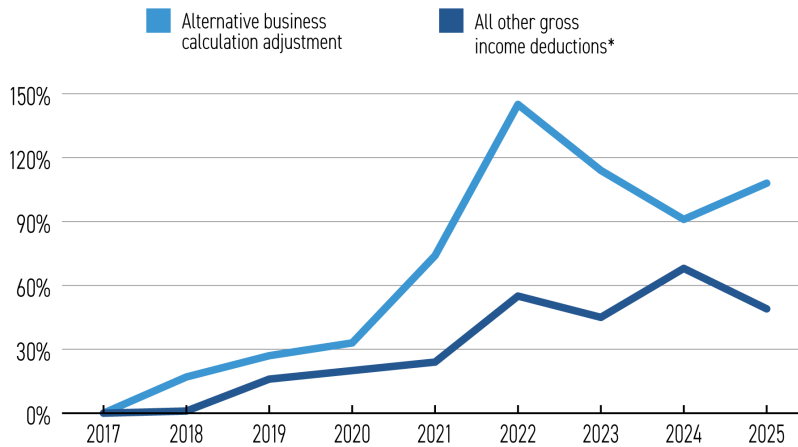
This seems like a small loophole, but it can drive substantial losses for the state that are difficult to track — losses that tax lawyers and accountants can exploit. Sophisticated tax filers can shift losses around on paper through royalty payments, multiple partnerships, or S corporations to inflate losses and offset business income. The types of businesses with income subject to the ABC are growing in number and complexity, making tax enforcement increasingly difficult.¹¹ Large energy, investment, and law firms are often organized as partnerships, with income passing through multiple entities and owners.¹²

How much does this cost the state?

The Alternative Business Calculation has grown rapidly — from \$92.6 million in cost to the state in tax year 2016, when the current version became law, to \$192.6 million in 2024 — growing at a rate of 108 percent.¹³ All other gross income deductions or exemptions grew by roughly 49 percent.¹⁴

The ABC Deduction Has Grown at Twice the Rate of All Other Gross Income Deductions

Percentage Growth in Size of Revenue Cost of New Jersey Tax Deductions, 2017 to Present



Source: Data on all deductions based on deductions available across all fiscal years in New Jersey Tax Expenditure Reports 2019, 2020, 2021, 2022, 2023, 2024, 2025, 2026. Data on alternative business calculation cost based on tax years 2016-24 from NJ Treasury Department data.

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Claims of these losses as deductions increased even as business owners' profits also rose.

Between 2016 and 2024:

- New Jersey business owners' income rose by 24 percent.¹⁵
- New Jersey business owners' reported alternative business losses rose by 108 percent.¹⁶

Without a comprehensive review of each deduction, this growth could reflect real loss activity carried forward. But whatever the cause, the cost to the state has continued to climb, even as business income for proprietors as a whole has grown. The 20-year carryforward window also makes the deduction's annual cost hard to forecast — filers can hold losses and deploy them in the years that suit them best, leaving the state to absorb the timing.

Who benefits from the ABC deduction?

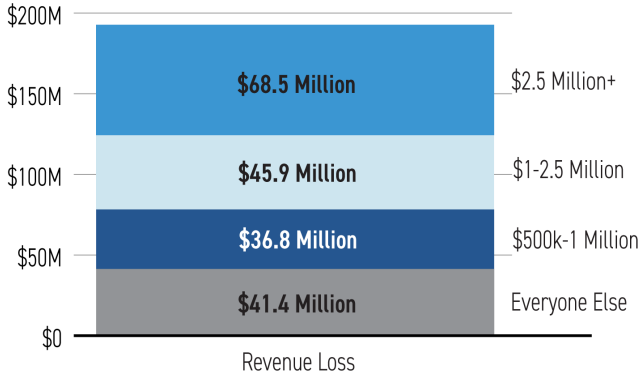
The ABC deduction disproportionately benefits New Jersey's highest-income households. Out of the \$192 million in costs to the state, \$114 million goes directly to households with \$1 million or more in income.¹⁷ That means 60 percent of this benefit goes to less than one percent of households.

Over time, the Alternative Business Calculation deduction’s tilt toward the wealthy has grown even more. For households with less than \$500,000 in income, the deduction amount has grown by about 50 percent since 2016, similar to the growth in other deductions.¹⁸ But for households with more than \$1 million in income, the deduction has grown by 150 percent.¹⁹

Even among households with more than \$1 million in income, the majority of the deduction goes to the even wealthier — those making \$2.5 million or more.²⁰

Benefits of New Jersey's ABC Deduction Disproportionately Go to the Highest-Income Filers

Total Amount of Revenue Loss from ABC Deduction, By Gross Income Level, Tax Year 2024



Source: Based on NJ Dept of Treasury data for Tax Year 2024.

Expanded tax benefits for business income also risk worsening the racial wealth gap. White tax filers on average have substantially more business income than Black or Hispanic filers.²¹ The result of the ABC deduction is a tax benefit that is so tilted towards the very wealthy that income-filers with more than \$2.5 million in income receive more benefit than all households with less than \$500,000 income combined.

How should the state modify the ABC deduction?

New Jersey should reform the ABC deduction. Its cost has more than doubled, and most of the benefit flows to high-income households. Reining in this growth would raise revenue for the state while leaving the vast majority of New Jersey tax filers unaffected.

Set income limits to prevent a shift in revenue to the very wealthy.

Gov. Sherrill's Fiscal Year 2027 budget proposal includes a maximum income of \$1 million for those claiming the deduction. An income cap is a sensible way to rein in the growth of this deduction and prevent it from subsidizing high-income residents, saving the state \$114 million in the process.²²

The Governor's proposal reduces the cost further by halving the benefit for incomes between \$500,000 and \$1 million. This would constrain revenue losses while maintaining some benefit for business proprietors facing genuine losses, raising about \$18 million in revenue.²³

Limit carryforward to fewer years

Another change that could help restrain the growth of the deduction is limiting how far losses can be carried into later years. Currently, the law allows tax filers to carry forward their alternative business loss for 20 years.²⁴ If the goal of the deduction is to allow business owners to control for year-to-year variation in business income, a one- or two-year window makes more sense than one that lasts two decades. If Joe's hardware store loses \$200,000 in year one, those losses should not still be available to reduce his income 10 years later. Reducing the carryforward would also make revenue collection more predictable, since filers would claim losses sooner rather than holding them for the most advantageous year.

Apply higher scrutiny on pass-through income

The rapid growth in the ABC deduction also points to a growing issue facing state governments: the shift from traditional corporations that pay corporate taxes toward businesses that pay individual income tax instead through their owners.²⁵ More than half of business income nationally now flows through these "pass-through" entities.²⁶ A structure designed for small businesses has become a tool for the ultra-wealthy to hide complex tax-avoidance structures.²⁷

In 2023, a federal Government Accountability Office report detailed the need for more audit and compliance work for partnership income, especially for large and complex partnerships.²⁸ Beyond the more technical recommendations, the report called for expanding the tax compliance workforce and adding resources to address potential noncompliance. This aligns with NJPP's prior recommendation to restore the state's auditor workforce to pre-Christie-era levels.²⁹

Reining in deductions like the Alternative Business Calculation would help ensure that pass-through status serves the small businesses it was meant to support, rather than becoming another tax break for the very wealthy.

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- ¹ State of New Jersey. [Tax Expenditure Report Fiscal Year 2027](#). February 2026. P. 7
- ² NJPP obtained data from the New Jersey Treasury Department to identify alternative business calculation deduction claims and revenue losses over time by income. This data informs the analysis contained in the report.
- ³ Based on New Jersey Treasury Department data on file with the author.
- ⁴ Based on New Jersey Treasury Department data on file with the author.
- ⁵ Based on New Jersey Treasury Department data on file with the author.
- ⁶ State of New Jersey. [Budget in Brief: Summary of Budget Recommendations, Fiscal Year 2027](#). February 2026. P. 48.
- ⁷ Sponsor’s Statement, [S. 2754](#) (2011-12 Session) (2011).
- ⁸ Pub. L. 2011, c. 60. See also N.J. Admin. Code Sec. 18:35-2.8(c) (2025).
- ⁹ Pub. L. 2011, c. 60. See also N.J. Admin. Code Sec. 18:35-2.8(c) (2025).
- ¹⁰ Pub. L. 2011, c. 60. See also N.J. Admin. Code Sec. 18:35-2.8(c) (2025).
- ¹¹ Government Accountability Office. [Report to the Chairman, Committee on Finances, U.S. Senate: Tax Enforcement, IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships \(GAO-23-106020\)](#). July 2023. Pp. 10-19.
- ¹² Mitchell, David. [The other two-tiered U.S. tax system: How pass-through businesses let the ultra-wealthy dodge federal taxes](#). Washington Center for Equitable Growth. April 15, 2026.
- ¹³ Based on New Jersey Treasury Department data on file with the author.
- ¹⁴ Based on New Jersey Treasury Department data on file with the author.
- ¹⁵ U.S. Bureau of Economic Analysis and Federal Reserve Bank of St. Louis, [Proprietors’ Nonfarm Income in New Jersey \[NJONON\]](#), retrieved from FRED, Federal Reserve Bank of St. Louis; April 23, 2026.
- ¹⁶ Based on New Jersey Treasury Department data on file with the author.
- ¹⁷ Based on New Jersey Treasury Department data on file with the author.
- ¹⁸ Based on New Jersey Treasury Department data on file with the author.
- ¹⁹ Based on New Jersey Treasury Department data on file with the author.
- ²⁰ Based on New Jersey Treasury Department data on file with the author.
- ²¹ Gale, W. et al. [Does the Income Tax Discriminate on the Basis of Race and Ethnicity?](#) Tax Policy Center Policy Brief. February 2025. P. 10.
- ²² Based on New Jersey Treasury Department data on file with the author.
- ²³ Based on New Jersey Treasury Department data on file with the author.
- ²⁴ Pub. L. 2011, c. 60. See also N.J. Admin. Code Sec. 18:35-2.8(c) (2025).
- ²⁵ Mitchell, David. [The other two-tiered U.S. tax system: How pass-through businesses let the ultra-wealthy dodge federal taxes](#). Washington Center for Equitable Growth. April 15, 2026.
- ²⁶ Tax Policy Center. [What are pass-through businesses?](#) January 2024.

²⁷ Mitchell, David. [The other two-tiered U.S. tax system: How pass-through businesses let the ultra-wealthy dodge federal taxes](#). Washington Center for Equitable Growth. April 15, 2026.

²⁸ Government Accountability Office. [Report to the Chairman, Committee on Finances, U.S. Senate: Tax Enforcement, IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships \(GAO-23-106020\)](#). July 2023. Pp. 10-19.

²⁹ Chen, P. [Fair and Square: Changing New Jersey's Tax Code to Promote Equity and Fiscal Responsibility](#). New Jersey Policy Perspective. Nov. 14, 2024.