New York State Corporation Tax Reforms of 2014

BY RUSSELL W. BANIGAN, DIRECTOR, KENNETH A. JEWELL, DIRECTOR AND MARY JO BRADY, SENIOR MANAGER, DELOITTE TAX LLP

Perspective

Tax Policy

This spring, New York enacted sweeping tax legislation that changes many aspects of its state tax law. In this article, Russell Banigan, Kenneth Jewell and Mary Jo Brady, of Deloitte Tax LLP, discuss New York's current tax provisions and explain the major changes coming to the state's corporate franchise tax in 2015. Among the major changes discussed are the unification of Article 32 (Franchise Tax on Banking Corporations) into Article 9-A (Franchise Tax on Business Corporations) and the modifications to the net income tax base, the state's move to a bright-light statutory nexus threshold to determine whether out-of-state corporations are subject to corporate franchise tax, and apportionment and combined reporting reforms.

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By Russell W. Banigan, Kenneth A. Jewell and Mary Jo Brady

Russell W. Banigan, CPA, and Kenneth Jewell, JD, LLM, serve as Directors with Deloitte Tax LLP's Multistate Practice. Mary Jo Brady, JD, LLM, is a Senior Manager at Deloitte Tax LLP, also with the firm's Multistate Practice.

Introduction

On March 31, 2014, Gov. Andrew Cuomo (D) signed into the law the most significant New York state corporation franchise tax reforms in nearly four generations.[1] The overall effect was to eliminate some of the more arcane elements of the corporation franchise tax and institute rules that are more in line with those of other major states. In particular, the reforms include the merger of the New York State Banking Corporation Tax (Article 32 of Chapter 60 of the New York Tax Law) into the General Corporation Franchise Tax (Article 9-A of Chapter 60 of the New York Tax Law) so as to end disparate treatment of banking corporations with other financial services corporations who in mod-

[1] Chapter 59, Laws of 2014.

ern times are direct competitors of such banking corporations. The corporation tax reforms also expand New York's use of bright-line statutory nexus thresholds, institute combined reporting based on the unitary business principle and expand the use of market sourcing of receipts to a full range of service industries. The tax law reforms take effect for taxable years beginning on or after Jan. 1, 2015, unless otherwise noted.[2]

The discussion below will focus on these changes and contrast them with the current tax law, which is in effect for taxable years beginning before Jan. 1, 2015.

Summary of Major Reforms

The major elements of the New York state corporation tax reforms are as follows:

1. Eliminating the Banking Corporation Tax (Article 32) so that banking corporations will now be taxed under the Corporate Franchise Tax (Article 9-A);

2. Reducing the tax on entire net income to 6.5 percent (for taxable years starting on or after Jan. 1, 2016), with that rate being set at zero percent for qualified New York manufacturers (for taxable years beginning on or after Jan. 1, 2014) and 5.9 percent for qualified emerging technology companies (''QETC'') (for taxable years beginning in 2014, with the rate declining until it is 4.875 percent for taxable years beginning on or after Jan. 1, 2018);

3. Scheduling a phase-out of the alternative tax on business capital, which is set at 0.15 percent for taxable years beginning before Jan. 1, 2016, and then gradually reduced until the rate is zero percent for taxable years beginning on or after Jan. 1, 2021 (there is a separate phase-out for ''qualified New York manufacturers,'' though the zero rate is obtained at the same time as for other taxpayers);

4. Increasing the maximum amount of alternative tax on business capital from $1 million to $5 million (for qualified New York manufacturers, the maximum tax is $350,000);

5. Repealing the alternative tax on minimum taxable income (AMT);

6. Increasing the alternative ''fixed'' minimum tax to $200,000 for taxpayers with New York gross receipts over $1 billion (this is also applied to each member of the New York combined group, other than the parent, with New York gross receipts of $10,000 or more);[3]

7. Adopting broad-based bright-line statutory nexus thresholds;

8. Changing the starting point in calculating New York entire net income for non-U.S. corporations with New York nexus from worldwide taxable income to federal ''effectively connected income'' (''ECI''), determined without regard to tax treaties (note: non-U.S. corporations with ECI are included in the combined return if they otherwise satisfy the combined return requirements enacted as part of these tax reforms);

9. Changing the apportionment formula to provide for customer (market) sourcing rules for selling digital products, providing financial services, and licensing intangible property (in particular, with respect to sourcing royalties from various types of intangible property and other services);

10. Adopting water's-edge unitary combined reporting (and eliminating the need for substantial intercorporate transactions or the existence of distortion as a requirement for combination);

11. Limiting what constitutes investment capital and investment income (generally, dividends and gains from stock in non-unitary corporations held for more than six months, and income that New York is prohibited from apportioning as business income under U.S. Constitutional principles), and exempting investment capital and investment income from taxation;

12. Eliminating the additional tax on subsidiary capital and eliminating most exclusions for income from subsidiaries, while retaining an exemption for dividends and ''exempt CFC income'' (as defined in Internal Revenue Code, ''I.R.C.'' §951(a)) from unitary subsidiaries;

13. Limiting the attribution of expenses against exempt income to interest expense and creating a safe harbor election whereby aggregate nontaxable investment and exempt income is reduced by a flat 40 percent in lieu of being subject to interest expense attribution;

14. Providing that investment income is also reduced by losses, deductions and expenses of transactions that serve as hedges against losses from investment capital;

15. Changing the net operating loss (''NOL'') provisions from a pre-apportionment to a post-apportionment computation, ending the requirement that the NOL be limited to the amount of corresponding federal NOL usage and providing transition rules for converting NOL deductions arising in pre-tax reform taxable years for use in subsequent taxable years;[4]

16. Providing a three-year carryback period for NOLs incurred in post-reform taxable years, provided that no NOL can be carried back to a taxable year beginning before Jan. 1, 2015 (carryforward period remains 20 years);

17. Modifying the Metropolitan Transportation Authority (''MTA'') Surcharge on New York franchise tax to provide a bright-line statutory nexus threshold and increasing the MTA Surcharge rate to 25.6 percent for taxable years beginning on or after Jan. 1, 2015, and before Jan. 1, 2016 (and the rate thereafter is subject to annual adjustment as determined by the tax commissioner in accordance with the state's financial projections);

18. Continuing three-factor apportionment[5] for determining business activities in the MTA Surcharge area, while adjusting the MTA receipts factor to reflect new customer (market) sourcing provisions; and

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[2] Section 113, Part A, Chapter 59, Laws of 2014.

[3] For ''qualified New York manufacturers'' and emerging technology companies, the maximum ''fixed'' minimum tax is $4,500 (at $25 million of New York receipts) for taxable years beginning before Jan. 1, 2015, and is scheduled to gradually decline to a maximum of $3,750 for taxable years beginning on or after Jan. 1, 2018.

[4] Generally, the prior net operating loss conversion subtraction in a taxable year is limited to 1/10th of the entire prior NOL conversion pool, plus any portion of the 1/10th subtraction not used in a preceding taxable year. However, taxpayers may elect to take a subtraction equal to one-half of the pool for taxable years beginning in 2015 and 2016. The election is made on taxable return for the tax year beginning in 2015.

[5] With respect to the MTA Surcharge property factor, property is valued at adjusted basis used for federal income tax purposes. However, taxpayers can make a revocable election on their first tax return due on or after Jan. 1, 2015, to use fair market value in lieu of adjusted basis.

19. Modifying the MTA Surcharge applicable to the amount of New York franchise tax before the application of tax credits.

Article 32 Merged Into Article 9-A and Modifications to Net Income Tax Base

Summary of Current Law

Article 9-A and Article 32

New York taxes general business corporations and many types of financial services corporations under Article 9-A, while banking corporations and most bank holding companies are taxed under Article 32. Under current Article 9-A, corporations are taxed on the highest of four alternative tax bases: a tax at the rate of 7.1 percent on the amount of entire net income apportioned to New York; a tax at the rate of 0.15 percent on business and investment capital that has been apportioned to New York (up to a maximum capital tax of $1 million); a tax at the rate of 1.5 percent on minimum taxable income; or a ''fixed'' minimum income tax ranging from $25 to $5,000 based on the amount of the taxpayer's New York gross receipts.[6] In addition, there is added to the highest tax base a tax on the value of subsidiary capital allocated to New York at the rate of 0.09 percent.[7] Certain manufacturers are eligible for reduced tax rates (as low as 3.25 percent on entire net income, $350,000 maximum tax on investment and business capital tax, 0.75 percent on minimum taxable income and a ''fixed'' minimum tax that is one half of that imposed on other taxpayers).[8]

Under current Article 9-A, income, expenses, gains, losses and capital are classified as being derived from subsidiary, investment or business capital.[9] Income, expenses, gains and losses from subsidiary capital are excluded from the computation of entire net income, while subsidiary capital is subject to the add-on tax, as noted above.[10] Income, expenses, gains and losses from investment capital are included in entire net income and investment capital is included in the alternative tax on investment and business capital, but the amounts of investment income and capital are apportioned to New York based on how much capital the corporations and governmental units invested in by the taxpayer have employed in New York (see ''Apportionment Reforms,'' below).[11] Business income and capital are apportioned to New York based on the portion of the taxpayer's New York sourced gross business receipts over its total gross business receipts.[12] Receipts are sourced in a hybrid fashion, where receipts from the sale of tangible personal property are sourced to the location of the buyer, while services generally are sourced to the location of where they are performed. Receipts from the sale or rental of real property are sourced to the location of the property, while receipts generated from intangible property, such as patents, copyrights and trademarks, tend to be sourced to where the intangible property is used.[13]

Under Article 32, banking corporations are taxed on the highest of four alternative bases: a 7.1 percent tax on the amount of entire net income apportioned to New York; a tax ranging from 0.002 percent to 0.01 percent on taxable assets; a 3 percent tax on alternative entire net income; and a fixed minimum tax of $250.[14] There is no subsidiary capital tax under Article 32, nor is there an investment capital concept. In contrast to Article 9-A, Article 32 provides only partial exclusions from entire net income of items of income from subsidiary capital (60 percent for dividends and gains and 17 percent for interest income, in contrast to full exclusions for those items under Article 9-A).[15] But, Article 32 taxpayers can exclude from entire net income 22.5 percent of interest income from Federal and New York obligations held for investment.[16] Another Article 32 benefit in contrast to Article 9-A, is that there is no attribution of interest and other expenses against subsidiary capital or the 22.5 percent interest exclusion.[17]

Another significant difference between Articles 9-A and 32 is that under the former, a foreign corporation that is doing business in New York is required to apportion its worldwide net income and capital to New York, while a banking corporation is only required to apportion to New York its U.S. effectively connected income and total assets related to such effectively connected income.[18] Furthermore, Article 32 taxpayers with deposits from and loans to foreign persons can treat a portion of the receipts and expenses as attributed to an international business facility (''IBF''). The IBF is treated as a foreign branch of a taxpayer and therefore its net income (or net loss) is excluded from the Article 32 taxpayer's entire net income. The net income or loss of the IBF is determined under either a separate accounting approach or through certain adjustments to the numerators of the taxpayer's business apportionment ratios.[19]

Entire net income and taxable assets are apportioned under Article 32 based on the average of the following factors – New York receipts to total receipts, New York payroll to total payroll and New York deposits to total deposits.[20] The receipts and deposit factors are double weighted for the entire net income and taxable asset

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[6] N.Y. Tax Law §210.1(a)-(d).
[7] N.Y. Tax Law §210.1(e).
[8] N.Y. Tax Law §210.1(a)-(d).
[9] *See* Banigan, 2200-2nd T.M., *New York State and City Corporation Income Taxes*, §2200.01.A.4.
[10] N.Y. Tax Law §§208.9(a)(1) and (b)(6) and 210.1(e)(1).
[11] N.Y. Tax Law §§208.9, 210.3(b) and (c) and 210.5. For a more complete discussion of what constitutes investment income and capital and how those items are apportioned, *see* Banigan, 2200-2nd T.M., *New York State and City Corporation Income Taxes*, §2200.08.
[12] N.Y. Tax Law §§210.3(a) and 210.4.
[13] N.Y. Tax Law §210.3(a). For a more complete discussion of how New York apportions net business income and capital, *see* Banigan, 2200-2nd T.M., *New York State and City Corporation Income Taxes*, §2200.09.
[14] N.Y. Tax Law §1455(a) and (b).
[15] *Compare* N.Y. Tax Law §§208.9(a)(1) and 1453(e)(11).
[16] N.Y. Tax Law §1453(e)(12).
[17] *See* N.Y. Tax Law §§208.9(b)(6) and 1453(b); N.Y. Dept. of Taxn. and Fin., TSB-M-88(5)C (Oct. 14, 1988) and TSB-M-95(2)C (Jan. 8, 1996).
[18] With respect to Article 9-A, *see* New York Tax Law §§208.9(c) and 210.1(b)(1). *See also Bass Ratcliff Gretton Ltd.*, 266 U.S. 271 (1924) and *Reuters Ltd.*, 603 N.Y.S.2d 795 (1993). With respect to Article 32, *see* N.Y. Tax Law §§1453(b)(1) and 1455(b)(1)(v)(A).
[19] N.Y. Tax Law §§1453(f) and 1454(b)(2).
[20] N.Y. Tax Law §1454.

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bases, but given only single weighting for the tax on alternative entire net income.[21]

There are also differences between Article 9-A and 32 regarding how and when related entities are permitted or required to file combined returns (see the combined return discussion, below),[22] how NOLs are determined[23] and what credits are available.[24]

The differing approaches were developed decades ago due to federal restrictions on the activities and taxation of national banks.[25] However, with the enactment of the Federal Gramm-Leach-Bliley Act in 1999 (''GLBA''), most of the previous restrictions barring cross ownership of banks and securities firms were repealed.[26] Thus, banks, securities firms and other financial services providers were placed more directly into competition with each other than ever before.

Since to a large extent the classification as an Article 32 taxpayer was based on the definition of activities that were permissible under federal law for banks and bank holding companies, New York enacted provisions (''GLBA transition provisions'') to temporarily freeze the Article 9-A and Article 32 classifications of the various financial services corporations until comprehensive corporation franchise tax reforms could be enacted.[27] While the GLBA transition provisions were originally enacted for only two years, those provisions have been repeatedly extended over a period of nearly 15 years so that they are still in effect at the present time.[28]

Reforms

Unification of Article 9-A and Article 32

Under the enacted tax reforms, Article 32 has been repealed, effective for taxable years beginning on or after Jan. 1, 2015.[29] Corporations previously taxed under Article 32 will now be subject to taxation under Article 9-A. As a result, there will be more uniformity in how income and capital of financial services firms are taxed by New York State. In addition, modifications were made to Article 9-A so that the tax is the highest of the tax on business income, business capital or the fixed minimum tax. The AMT and the additional tax on subsidiary capital have been eliminated.

There will be more uniformity in how income and capital of financial services firms are taxed by New York State.

Tax on Business Income

For taxable years beginning on or after Jan. 1, 2015, the Article 9-A tax rate on business income apportioned to New York[30] will remain at 7.1 percent for most taxpayers.[31] For taxable years beginning on or after Jan. 1, 2016, that tax rate will be 6.5 percent.[32]

For ''qualified New York manufacturers,'' the tax rate on business income is decreased to zero percent for taxable years beginning on or after Jan. 1, 2014. A ''qualified New York manufacturer'' is defined based upon two alternative sets of criteria. Under the first set, the taxpayer must be 1) ''principally engaged'' in ''manufacturing;'' and 2) must have property eligible for the New York investment tax credit with federal adjusted basis of $1 million or more in such property at the end of the taxable year. Under the second set, a taxpayer that does not satisfy the first set of criteria is still a ''qualified New York manufacturer'' if it has at least 2,500 employees in manufacturing in New York and the taxpayer (or the taxpayer's combined group) has property in New York used in manufacturing where the federal adjusted basis in such property is at least $100 million at the close of the taxable year.[33]

For this purpose, the term ''manufacturing'' is defined as the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing. The generation and distribution of electricity, the distribution of natural gas and the production of steam associated with the generation of electricity are explicitly excluded from the definition of ''manufacturing.''[34] ''Principally engaged'' is defined as more than 50 percent of the taxpayer's gross receipts being derived from the selling of goods produced by ''manufacturing.'' For taxpayers included in a New York combined return, the ''principally engaged'' test is determined on the gross receipts of the combined return group.[35]

For ''qualified emerging technology companies'' (''QETC''), the tax rate on business income is 5.9 percent for 2014. That rate steadily declines over four years

[21] N.Y. Tax Law §1454(b)-(d).

[22] *Compare* N.Y. Tax Law §211.4(a) and 20 NYCRR §§6-2.1 to 6-2.8 with N.Y. Tax Law §1462(f) and 20 NYCRR §§21-2.1 to 21-2.7.

[23] *Compare* N.Y. Tax Law §§208.9(f) and 1453(k-1).

[24] For example, Article 9-A taxpayers that are licensed brokers and/or dealers of securities may claim an Employment Incentive Credit of up to 2.5 percent on property for which an investment tax credit was claimed, while Article 32 taxpayers that are licensed brokers and/or dealers of securities cannot. *See* N.Y. Tax Law §210.12-D(a)(i) and N.Y. Dept. of Taxn. and Fin., TSB-M-98(8)C (December 1998).

[25] For a brief history on the taxation of banks and other financial services corporations, *see* BNA State Portfolio 1800-1st: *State Taxation of Banks and Financial Institutions (CA, IL, NY, TN)*, Worksheet 3, *Welcome to the Brave New World of Financial Services: Unexpected State Tax Ramifications of Gramm-Leach-Bliley*, by Russell W. Banigan.

[26] *Id*.

[27] N.Y. Tax Law §1452(h)-(m).

[28] *Id*. For purposes of the New York City Banking Corporation Tax and General Corporation Tax, the GLBA provisions in the New York City Administrative Code were modified to provide for those transitions rules to continue through the end of 2016.

[29] Section 1, Part A, Chapter 59 of the Laws of 2014.

[30] Business income is entire net income less investment income and ''other exempt income.'' New York Tax Law §208.8, *as amended by* Section 4, Part A, Chapter 59 of the Laws of 2014.

[31] N.Y. Tax Law §210.1(a), *as amended by* Section 12, Part A, Chapter 59 of the Laws of 2014.

[32] *Id*.

[33] N.Y. Tax Law §210.1(a)(vi), *as amended by* Section 12, Part A, Chapter 59 of the Laws of 2014.

[34] *Id*.

[35] *Id*.

until taxable years beginning on or after Jan. 1, 2018, when the rate is 4.875 percent.[36]

In general, a QETC is a company that is located in New York state and:

1) whose primary products or services are classified as "emerging technologies"[37] and whose total annual product sales are $10 million or less; or

2) a company that has research and development activities in New York state and whose ratio of "research and development funds"[38] to net sales equals or exceeds the average ratio for all surveyed companies classified, as determined by the National Science Foundation in the most recent published results from its survey of industry research and development, or any comparable successor survey as determined by the New York State Department of Taxation and Finance (the "Department"), and whose total annual product sales are $10 million or less.[39]

For purposes of using the reduced business income tax rate for QETCs, the $10 million limitation on annual sales is disregarded.[40]

Changes to the AMT

The AMT currently imposed under Article 9-A is eliminated for taxable years beginning on or after Jan. 1, 2015.[41] Any minimum tax credits generated in years when the AMT was the highest of the four alternative New York tax bases cannot be used in taxable years beginning on or after Jan. 1, 2015.[42]

Tax on Business Capital

The tax on business capital has also been significantly modified. First, the maximum tax on this base has been raised to $5 million (up from its current maximum of $1 million) for taxable years beginning on or after Jan. 1, 2015. For qualified New York manufacturers and QETCs, the maximum business capital tax remains at $350,000.[43]

The rate of tax on business capital, however, is scheduled to decline for each taxable year beginning on or after Jan. 1, 2016 and before Jan. 1, 2021. For taxable years beginning on or after Jan. 1, 2021, the tax rate is set at zero for all taxpayers. The business capital rates for 2015 through 2020 are as follows:

Tax on Business Capital

Taxable Year Beginning in the Following Years	Business Capital Tax Rate (except as noted in Columns C and D)	Qualified New York Manufacturers and QETCs (Column C)	Cooperative Housing Corporations (Column D)
2015	0.150%	0.150%	0.040%
2016	0.125%	0.106%	0.040%
2017	0.100%	0.085%	0.040%
2018	0.075%	0.056%	0.040%
2019	0.050%	0.038%	0.040%
2020	0.025%	0.019%	0.025%
2021 and after	0%	0%	0%

For taxable years beginning on or after Jan. 1, 2015, a credit can be applied against the business capital tax for taxpayers that pay an "identical" tax in another state.[44] So net worth taxes paid to other states may produce a tax credit for New York business capital tax purposes. However, the requirement that the other state's tax be "identical" to the New York business capital tax could potentially afford the Department room to narrowly construe the credit. The amount of credit used cannot decrease the taxpayer's tax liability to less than that due under the New York "fixed" minimum tax. Any unused credit can be carried forward indefinitely until fully used.[45]

Changes to the "Fixed" Minimum Tax

The "fixed" minimum tax will range from a low of $25 (for taxpayers with not more than $100,000 of New York receipts) to a high of $200,000 (for taxpayers with over $1 billion of New York receipts).[46]

For manufacturers and QETCs, the "fixed" minimum tax will range from a low of $23 (for taxpayers with not more than $100,000 in New York receipts) to a high of $4,500 (for taxpayers with over $25 million of New York receipts) for taxable years beginning in 2014. Those ranges will gradually decrease in succeeding years, until the range is from a low of $19 to a high of $3,750 for taxable years beginning on or after Jan. 1, 2018.

For taxable years beginning on or after Jan. 1, 2015, a credit can be applied against the "fixed" minimum tax for taxpayers that suffer an "identical" tax in another state.[47] Ironically, this credit cannot reduce the taxpayer's obligation to less than the fixed minimum tax imposed by amended New York Tax Law section 210.1(d). However, the unused credit can be carried forward indefinitely until fully used–presumably when the tax on business income or capital is the highest tax base.[48]

[36] N.Y. Tax Law §210.1(a)(vii) and *Summary of Tax Provisions in SFY 2014-15 Budget*, N.Y. Dept. of Taxn. and Fin., April 2014, at 6.

[37] *See* Banigan, 2200-2nd T.M., *New York State and City Corporation Income Taxes*, §2200.12.C.1.b for a description of "Emerging Technologies."

[38] The term "research and development funds" is to have the meaning ascribed to it by the National Science Foundation. N.Y. Pub. Auth. Law §3102–e.1(c).

[39] N.Y. Pub. Auth. Law §3102–e.1(c).

[40] New York Tax Law §210.1(a)(vii) and *Summary of Tax Provisions in SFY 2014-15 Budget*, N.Y. Dept. of Taxn. and Fin., April 2014, at 6.

[41] N.Y. Tax Law §210.1(c), *as repealed by* Section 12, Part A, Chapter 59 of the Laws of 2014.

[42] N.Y. Tax Law §210-B.46(a), *as added by* Section 17, Part A, Chapter 59 of the Laws of 2014.

[43] N.Y. Tax Law §210.1(b), *as amended by* Section 12, Part A, Chapter 59, Laws of 2014.

[44] N.Y. Tax Law §210-B.42(a), *as added by* Section 17, Part A, Chapter 59, Laws of 2014.

[45] N.Y. Tax Law §210-B.42(b), *as added by* Section 17, Part A, Chapter 59, Laws of 2014.

[46] N.Y. Tax Law §210.1(d), *as amended by* Section 12, Part A, Chapter 59, Laws of 2014.

[47] N.Y. Tax Law §210-B.42(a), *as added by* Section 17, Part A, Chapter 59, Laws of 2014.

[48] N.Y. Tax Law §210-B.42(b), *as added by* Section 17, Part A, Chapter 59, Laws of 2014.

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Entire Net Income/Business Income

The starting point for entire net income will continue to be based on federal taxable income and will take into account most of the current Article 9-A modifications.[49] In contrast to current law wherein a foreign corporation (i.e., an alien corporation in New York parlance) conducting business in New York is required to use its worldwide net income to determine its New York entire net income, under the enacted reforms a foreign corporation will only include its U.S. effectively connected income and related expenses in determining its New York entire net income.[50] ''Effectively connected income'' will be defined as that term is defined under the I.R.C., without regard to the provisions of any tax treaties.[51] Thus, the starting point for the reformed Article 9-A will more resemble the current starting point for Article 32 than for current Article 9-A.

The special modifications in determining entire net income, such as the 22.5 percent exclusion for interest from certain government securities and the IBF provisions have been eliminated under the enacted reforms.[52] However, a thrift or a qualified community bank[53] will qualify for additional bad debt deductions if such entity maintains a ''qualified residential loan portfolio,'' as defined. That deduction is equal to the amount of a thrift or qualified community bank's federal bad debt deductions under I.R.C. §166 or 585, net of recoveries, are exceeded by 32 percent of that entity's entire net income.[54] When the thrift or community bank is part of a combined return group, the calculation is made using the entire net income of the combined return group.[55] Qualified community banks and small thrifts[56] will be permitted a subtraction modification for half of the net interest income received from qualifying loans (essentially loans to small businesses and residential mortgages).[57]

The current Articles 9-A and 32 exemptions for income from subsidiary capital will be eliminated.[58] Instead, ''investment income'' and ''other exempt income,'' as defined, will be exempt from tax.[59] Investment income will consist of dividends, gains and losses from stock held for longer than six months if the corporation that issued the stock in question is not unitary with the taxpayer. It also will include income or gain from debt obligations and other securities that cannot be apportioned to New York under the U.S. Constitution.[60] Entire net income will also be reduced by the sum of dividends from stock of unitary subsidiaries not included in the combined group and ''exempt CFC income,'' both of which compose ''other exempt income.''[61] So, in effect, part of the current Article 9-A subsidiary capital concept will survive as part of the new investment capital and ''other exempt income'' concepts. All other dividends, interest income, gains and losses will be business income.[62]

Part of the current Article 9-A subsidiary capital concept will survive as part of the new investment capital and ''other exempt income'' concepts.

Solely for determining whether a unitary business relationship exists, where a taxpayer owns directly or indirectly less than 20 percent of the voting power of stock in a corporation (the investee), the investee will be presumed to be conducting a business that is not unitary with that of the taxpayer.[63] Stock in a corporation that is conducting a unitary business with the taxpayer (such as stock of a unitary foreign subsidiary), stock of a corporation included in a combined return with the taxpayer (which will include a non-unitary subsidiary treated as unitary under the ''commonly owned group election,'' as discussed below) and treasury stock of the taxpayer do not qualify as investment capital.[64]

Deductions for interest expenses directly or indirectly attributable to investment income and ''other exempt income'' will be disallowed (as interest attributable to subsidiary capital is currently disallowed).[65] The revised tax law explicitly states that if the amount of interest expense attributed against investment income and ''other exempt income'' exceeds the amount of such items of income, the excess interest expense is treated as an addition modification in determining entire net income.[66] The revised tax law does not specify a particular method of interest expense attribution, but

[49] N.Y. Tax Law §208.9, *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[50] N.Y. Tax Law §208.9(iv), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[51] *Id.*

[52] New York Tax Law Article 32, *as eliminated by* Section 1, Part A, Chapter 59, Laws of 2014.

[53] A ''qualified community bank'' is one that is organized as a bank or trust company under federal or state law and where the average value of its assets (or the value of the assets of the combined return grouping that includes the community bank) is less than $8 billion. N.Y. Tax Law §§208.9(r)(1)(A) and (s)(2), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[54] N.Y. Tax Law §§208.9(r)(1)(A) and (s)(2), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[55] *Id.*

[56] A ''small thrift'' is a savings bank, savings and loans association or other saving institute adhering to the $8 billion in total assets provision applicable to qualified community banks. New York Tax Law §208.9(s), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[57] N.Y. Tax Law §§208.9(s)(3)(A)(I) and 208.9(s)(3)(C), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[58] N.Y. Tax Law §§208.4, 208.9(a)(1) and (b)(6), *as eliminated by* Section 4, Part A, Chapter 59, Laws of 2014.

[59] N.Y. Tax Law §§208.8 and 210.1(a), *as respectively amended by* Sections 4 and 12, Part A, Chapter 59, Laws of 2014.

[60] N.Y. Tax Law §§208.5(e) and 208.6, *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[61] N.Y. Tax Law §208.6-a, *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[62] N.Y. Tax Law §208.8, *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[63] N.Y. Tax Law §208.5(a), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[64] N.Y. Tax Law §208.5(a), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[65] N.Y. Tax Law §§208.6(a) and 208.6-a(b) and (c), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[66] N.Y. Tax Law §§208.6(a) and 208.6-a(d), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

the language permitting the attributed interest expense to be in excess of the exempt income is suggestive of an asset attribution ratio method being used for indirect attribution, as is done under the current law.[67]

In lieu of suffering the attribution of interest expense against its exempt income, a taxpayer can elect to forego 40 percent of its exclusions for investment income and ''other tax exempt income'' (in effect, electing a 60 percent dividends received deduction (''DRD''), instead of a 100 percent DRD).[68] The revised tax law does not specify when this election needs to be made or its duration, so it appears that it may potentially be made on an amended return and changed from one taxable year to the next.[69] However, the tax law precludes the making of this election with respect to dividends from subsidiaries that are or will be taxable under New York tax law Articles 9 (telecommunications) or Article 33 (insurance companies), where those subsidiaries are part of the dividend recipient's unitary business.[70]

Investment income is also reduced by losses, deductions and/or expenses attributed to any transaction or series of transactions entered into as hedges against price changes or currency fluctuations of investment capital.[71]

The statutory provisions that currently authorize the Department to attribute non-interest expenses against tax-exempt income have been eliminated from the tax law for taxable years beginning on or after Jan. 1, 2015.[72]

Lastly, the new law grants the Department the ability to combine part of the net income of a property-casualty insurance company that is subject to New York premiums taxation with that of its Article 9-A shareholder. This power can be exercised when the insurance company receives 50 percent or less of its gross receipts for the taxable year from premiums. Under that circumstance, the Department can treat the net income of the insurance company that is in excess of its net premiums income as a deemed distribution to its Article 9-A shareholder.[73]

Nexus

Summary of Current Law

Under current law, New York generally applies a physical nexus standard, rather than bright-line statutory nexus thresholds. The one exception is a statutory provision enacted in 2008 under Article 32 that subjects out-of-state banking corporations that issue credit cards to New York residents or have merchant customer contracts with New York merchants to Article 32 taxation without such banks having a physical presence in New York.[74]

Reforms

Effective for taxable years beginning on or after Jan. 1, 2015, New York will be applying a broad-based, bright-line statutory nexus threshold in determining whether corporations are subject to Article 9-A taxation. There will be two such statutory nexus thresholds for determining whether a corporation is doing business in New York (thereby being subject to New York taxation) and an additional two statutory nexus thresholds for determining whether members of an Article 9-A combined return group are New York taxpayers.[75] Taxpayer members of a combined return group, other than the ''designated parent,'' are each subject to the ''fixed'' minimum tax and are jointly and severally liable for Article 9-A taxes imposed upon the combined return group.[76]

New York will be applying a broad-based, bright-line statutory nexus threshold in determining whether corporations are subject to Article 9-A taxation.

First, if a corporation is deriving $1 million or more of its receipts from within New York, that corporation is subject to Article 9-A taxation. New York receipts will be determined under the revised receipts factor provisions, which essentially use marketplace location sourcing rules.[77]

Second, in what essentially mirrors the current Article 32 doing business standard, any corporation that has issued credit cards to 1,000 or more customers who have New York mailing addresses as of the last day of the corporation's taxable year will be treated as doing business in New York (New York cardholders). A credit card issuer is also doing business in New York if it has merchant customer contracts and the total number of New York locations of those merchants is 1,000 or more for which the credit card issuer has remitted payments for credit card transactions during the taxable year (New York merchant contracts). Lastly, if the sum of the number of New York cardholders and New York merchant contracts is 1,000 or more, the credit card issuer is doing business in New York.[78]

A corporation that is a member of a New York combined return group that has at least $10,000 of New York receipts is a New York taxpayer, provided that the

[67] *See F.W. Woolworth Company*, 510 N.Y.S.2d 926 (N.Y. App. Div. 1987), *affirmed* 528 N.Y.S.2d 537 (N.Y. 1988); *Unimax Corp. v. Tax Appeals Tribunal*, 581 N.Y.S.2d 135 (N.Y. 1992); and N.Y. Dept. of Taxn. and Fin., TSB-M-88(5)C (Oct. 14, 1988).

[68] N.Y. Tax Law §§208.6(b), 208.6-a(b) and (c), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[69] N.Y. Tax Law §§208.6(b), 208.6-a(b) and (c), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[70] N.Y. Tax Law §208.6-a(c), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[71] N.Y. Tax Law §208.6(a), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[72] N.Y. Tax Law §§208.6 and 208.9(b)(6), *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[73] N.Y. Tax Law §211.5, *as amended by* Section 19, Part A, Chapter 59, Laws of 2014.

[74] N.Y. Tax Law §1451(c).

[75] N.Y. Tax Law §209, *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

[76] N.Y. Tax Law §§210-C.1 and .6, *as amended by* Section 18, Part A, Chapter 59, Laws of 2014.

[77] N.Y. Tax Law §209.1(b), *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

[78] N.Y. Tax Law §209.1(c), *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

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sum of the New York receipts of all group members having at least $10,000 of New York receipts equals or exceeds $1 million of New York receipts.[79] A credit card issuer that is a member of a New York combined return group that has at least an aggregate of 10 New York cardholders and New York merchant contracts is a New York taxpayer, provided that the sum of the aggregate of New York cardholders and New York merchant contracts by members having at least 10 of such items equals or exceeds 1,000.[80]

The receipts thresholds for determining New York taxation are to be reviewed by the Department at the end of each year. When the Consumer Price Index for all Urban Consumers (''CPI-U''), as set forth by the U.S. Department of Labor's Bureau of Labor Statistics, has changed by 10 percent or more since Jan. 1, 2015, the Department is to reset the receipts thresholds by the cumulative percentage change in the CPI-U. Where a reset had already occurred, another is required if the CPI-U has changed by another 10 percent. Changes to the receipts thresholds become effective for taxable periods beginning after such thresholds have been changed.[81]

A corporate partner in a partnership that is doing business in New York is also considered to be doing business in New York.[82] While this is a new statutory provision, it reflects long existing New York policy that was reflected by regulation and case law.[83]

Activities exempt from New York taxation will continue to be the following:

1) maintaining cash balances with banks and trusts companies in New York;

2) owning shares of stock or securities that are kept in New York, if kept in a safe-deposit box (or its equivalent), pledged as collateral security or held in account by a New York bank, trust company or securities broker;

3) taking action by any such bank, trust company or securities broker that is incidental to the safekeeping or custodian services for such securities held in account;

4) maintaining an office in New York by one or more officers or directors of the corporation who are not employees of the corporation in question, provided that the corporation is not otherwise doing business in New York; and

5) keeping books and records of a corporation in New York.[84]

The exemption for using a New York fulfillment service, however, has been repealed for taxable years beginning on or after Jan. 1, 2015.[85]

A foreign corporation (''alien corporation,'' in New York parlance) that is not treated as a domestic corporation under the I.R.C. and does not have any effectively connected income, as determined under I.R.C. §882, will not be subject to New York taxation solely based upon meeting the bright-line statutory nexus threshold noted above.[86]

Corporations taxable under sections 183 to 184-a of Article 9 (telecommunications corporations) and Article 33 (insurance corporations) remain exempt from Article 9-A taxation. The exemption of banking corporations taxable under Article 32 will be repealed, effective for taxable years beginning on or after Jan. 1, 2015, consistent with the repeal of all of Banking Corporation Tax of Article 32.[87]

Apportionment of Business Income and Capital

Summary of Current Law

As discussed above, under Article 9-A, the net assets of a corporation are classified as being subsidiary, investment or business capital. Interest, dividends, gains and losses from subsidiary or investment capital are respectively classified as income from subsidiary capital or investment capital. Income not falling within these categories is treated as income from business capital. Interest and other expenses are attributed among the three classes of capital in accordance with certain New York administrative pronouncements.[88]

Net income from subsidiary capital is excluded from New York state entire net income. Income from investment and business capital is included in entire net income, but investment income is apportioned within and without New York based upon the taxpayer's investment allocation percentage, while net business income is apportioned based upon the New York sourced business receipts of the taxpayer over its total business receipts (receipts factor).[89] The taxpayer's investment allocation percentage is essentially the ratio of the amount of capital employed in New York by the corporations in which the taxpayer holds minority equity positions or debt instruments issued by such corporations over the total amount of investment capital held by the taxpayer.[90]

With respect to capital taxes, each item of subsidiary capital is apportioned to New York based upon that subsidiary's issuer's allocation percentage (essentially the ratio of capital employed in New York by that subsidiary over that subsidiary's total capital). The sum of New York subsidiary capital is subject to a tax of 0.09 percent that is added to any other tax imposed under Article 9-A. Investment and business capital are respec-

[79] N.Y. Tax Law §209.1(d)(i), *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

[80] N.Y. Tax Law §209.1(d)(ii), *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

[81] N.Y. Tax Law §209.1(e), *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

[82] N.Y. Tax Law §209.1(f), as amended by Section 5, Part A, Chapter 59, Laws of 2014.

[83] *See* 20 NYCCR §1-3.2(a)(6) and *Badische Anilin & Soda Fabrik v. Roberts, Comptroller of the State of New York*, 152 N.Y. 59 (N.Y. 1897).

[84] N.Y. Tax Law §209.2, *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

[85] N.Y. Tax Law §209.2(f), *as removed by* Section 5, Part A, Chapter 59, Laws of 2014.

[86] N.Y. Tax Law §209.2-a, *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

[87] N.Y. Tax Law §209.4, *as amended by* Section 5, Part A, Chapter 59, Laws of 2014.

[88] N.Y. Dept. of Taxn. and Fin., TSB-M-88(5)C (Oct. 14, 1988) and TSB-M-95(2)C (Jan. 8, 1996).

[89] N.Y. Tax Law §210(3).

[90] Certain short-term corporate and government-issued debt instruments constitute ''cash,'' which generally may be classified as investment capital or business capital at the election of the taxpayer. Where the taxpayer elects to classify ''cash'' as investment capital, such ''cash'' is not used in determining the taxpayer's investment allocation percentage.

tively apportioned in the same manner as investment and business income.

In determining the receipts factor, receipts from selling tangible personal property are sourced to where the tangible personal property was delivered.[91] Receipts from services are generally sourced to where the services are performed, though in recent years New York has been asserting that services delivered in some automated fashion should be sourced to the location of the customer.[92] Receipts from the rental of tangible property[93] and the sale of real property[94] are sourced to where the property is located. Royalties from patents and copyrights are sourced to where such intangible property is used.[95] All ''other business receipts'' are sourced to where they are ''earned.''[96] Receipts from the sale of capital assets are excluded from the determination of the receipts factor, though such receipts typically are included in apportionable income.[97] Income from subsidiary capital and investment capital are also excluded from the receipts factor.[98]

Apportionment Reforms

Under the enacted tax reforms, the investment capital concept as currently constituted will be eliminated—and with it the elimination of the investment allocation percentage.[99] Similarly, the subsidiary capital provisions (which will include the current rules for apportioning subsidiary capital) will be eliminated.[100]

All income of the taxpayer will be classified as ''business income,'' except for investment income and ''other exempt income,'' both of which will be excluded from entire net income.

All income of the taxpayer will be classified as ''business income,'' except for investment income and ''other exempt income,'' both of which will be excluded from entire net income.[101] As noted above, dividends, gains and losses from stock that currently constitutes subsidiary capital will be classified as investment income under the enacted tax reforms if the subsidiary is not in a unitary business relationship with the taxpayer and the stock in that subsidiary is held for more than six consecutive months.[102] Dividends from unitary subsidiaries that cannot be included in a combined return with the taxpayer are classified as ''exempt unitary corporation dividends,'' which is a subset of ''other exempt income.'' ''Exempt unitary corporation dividends'' will include dividends received from the following subsidiaries, if they are part of the taxpayer's unitary business:

- corporations taxable under another article of the New York tax law (Articles 9 and 33 for telecommunications and insurance corporations, respectively);
- alien corporations (corporations organized under the laws of a country other than the U.S.) with no effectively connected income; or
- corporations not more than 50 percent directly or indirectly owned by the taxpayer.[103]

Business income and capital will continue to be allocated based on a single receipts apportionment formula.[104] However, in contrast to the current provisions, income generally will be sourced by customer location.

In particular, the enacted tax reforms include certain provisions for the sourcing of financial services income as arising from ''qualified financial instruments'' (''QFIs'') or nonqualified financial instruments. A QFI is defined as an instrument marked to market under either I.R.C. §§475 or 1256. This includes commodities as well as securities. However, it does not include loans secured by real property.[105]

A taxpayer that has income from QFIs will be required to use customer-based sourcing for each income stream that does not constitute exempt income or may elect to use a ''fixed percentage'' method. Under the fixed percentage method, the taxpayer must treat all income from QFIs as taxable business income and 8 percent of the net income (dividend income, interest income and net gains), not less than zero, from QFIs is included in the numerator of the receipts factor, with all net income, not less than zero, from QFIs being included in the denominator. The fixed percentage method election will be irrevocable and must be made annually on a timely filed original return.[106] It will apply to all members of a combined return group that have QFI income.[107]

There is a myriad of other provisions for sourcing interest and net gains on loans, government and corporate debt obligations, asset-backed securities, federal funds, reverse repurchase agreements, sales of stock and partnership interests and other financial instruments. Some items, such as interest and net gains from federal and New York obligations, are excluded from the numerator but included in the denominator of the New York receipts factor, while for other items, such as

[91] 20 NYCRR §4-4.2

[92] New York Tax Law §210.3(a)(2)(B) and 20 NYCRR, §4-4.3(a). *See also*, the following advisory opinions: N.Y. Dept. of Taxn. and Fin., TSB-M-00(15)C (Dec. 27, 2000); TSB-A-09(5)C (March 9, 2009); TSB-A-09(8)C (June 16, 2009); TSB-A-11(1)C (Dec. 28, 2010); TSB-A-11(8)C (July 12, 2011).

[93] 20 NYCRR §4-4.4(a).

[94] 20 NYCRR §4-4.6(a).

[95] 20 NYCRR §4-4.4(c).

[96] New York Tax Law §210.3(a)(2)(C) and 20 NYCRR §4-4.4(c).

[97] 20 NYCRR §4-4.6(e).

[98] 20 NYCRR §4-4.1(a).

[99] N.Y. Tax Law §208.5, *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[100] N.Y. Tax Law §208.4, *as deleted by* Section 4, Part A, Chapter 59, Laws of 2014.

[101] N.Y. Tax Law §§208.8. and 210.1(a), *as amended by* Sections 4 and 12, Part A, Chapter 59, Laws of 2014.

[102] N.Y. Tax Law §§208.5 and .6, *as amended by* Section 4, Part A, Chapter 59, Laws of 2014.

[103] N.Y. Tax Law §§208.6-a(c) and 210-C.2(c), *as amended by* Sections 4 and 18, Part A, Chapter 59, Laws of 2014.

[104] N.Y. Tax Law §210-A.1, *as amended by* Section 16, Part A, Chapter 59, Laws of 2014.

[105] N.Y. Tax Law §210-A.5(a), *as amended by* Section 16, Part A, Chapter 59, Laws of 2014.

[106] N.Y. Tax Law §210-A.5(a)(1), *as amended by* Section 16, Part A, Chapter 59, Laws of 2014.

[107] N.Y. Tax Law §210-C.5(b), *as amended by* Section 18, Part A, Chapter 59, Laws of 2014.

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net interest on federal funds, there is a mandatory 8 percent inclusion in the receipts factor numerator.[108]

In addition, there are a variety of provisions for registered brokers and dealers in securities and commodities addressing the sourcing of commissions, margin interest, underwriting fees and spreads, account maintenance fees, M&A advisory services fees, interest on loans to affiliates that are not combinable with the taxpayer and on clearing services. These rules tend to be sourced on the location of the customer, though there is a default assumption that 8 percent of such income is sourced to New York.[109]

Provisions governing the sourcing of receipts from credit cards and certain services to investment companies constitute the balance of the sourcing provisions for the financial services industry.[110] Those provisions are essentially the same as found under current tax law.

The sale of electricity delivered to points within New York state will be included in the receipts factor numerator.[111] However, where electricity is treated as a commodity under I.R.C. §475, its sale is governed under the provisions for selling financial instruments (see above).[112] Previously, the sale of electricity was not explicitly addressed in the Article 9-A receipts factor provisions.

Generally, receipts from the sale of digital products will be sourced to New York if the product or service is used in New York.

The enacted tax reforms also contain provisions for sourcing receipts from ''digital products,'' which refers to any property or services or combination of property and services delivered to a purchaser through the use of wire, cable, fiber-optic, laser, microwave, radio wave, satellite or similar successor media, or any combination thereof. Digital products will include items such as information services, video games, books and other literary works, the storage of digital products and computer software.[113] Generally, receipts from the sale of digital products will be sourced to New York if the product or service is used in New York, as determined under the following hierarchy:

1) the customer's primary use location of the digital product;

2) the location where the digital product is received by the customer, or is received by a person designated for receipt by the customer;

3) the apportionment fraction determined pursuant to the enacted apportionment rules for the preceding taxable year for such digital product; or

4) the apportionment fraction in the current taxable year for those digital products that can be sourced using the hierarchy of sourcing methods in subparagraphs 1) and 2) above.[114]

Receipts from the following items will be sourced as they are under current law:

a) sales of tangible personal property (however, sales of tangible personal property treated as commodities under I.R.C. §475 are sourced under the provisions applicable to financial instruments);[115]

b) railroad and trucking activity;[116]

c) air freight forwarding activity;[117]

d) rentals of real and tangible personal property;[118]

e) royalties from the use of patents, copyrights and other intangibles;[119]

f) transportation of gas through pipes;[120]

g) aviation services (other than air freight forwarders);[121] and

h) advertising in newspapers, periodicals, television and radio (however, receipts from internet advertising will be sourced to New York if the potential customers are located in the state).[122]

In contrast to current tax law, receipts from services will generally be sourced to New York if the customer is located in the state.[123]

Combined Reporting

Summary of Current Law

Under the General Corporation Franchise Tax (Article 9-A), New York may permit or require a related group of corporations to file a combined report if certain conditions are met. Specifically, those conditions are the satisfaction of an ownership standard, the existence of unitary business among the entities to be combined and the existence of ''substantial intercorporate transactions'' among the related entities, as that con-

108 N.Y. Tax Law §210-A.5(a)(2)(A) to (I), *as amended by* Section 16, Part A, Chapter 59, Laws of 2014.

109 N.Y. Tax Law §210-A.5(b), *as amended by* Section 16, Part A, Chapter 59, Laws of 2014.

110 N.Y. Tax Law §210-A.5(c) and (d), *as amended by* Section 16, Part A, Chapter 59, Laws of 2014.

111 New York Tax Law §210-A.2(b), *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

112 New York Tax Law §210-A.2(c), *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

113 N.Y. Tax Law §210-A.4(a), *as amended by* Section 16, Part A, Chapter 59, Laws of 2014.

114 N.Y. Tax Law §210-A.4(c), *as amended by* Section 16, Part A, Chapter 59, Laws of 2014.

115 New York Tax Law §210-A.2(a) and (c), *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

116 *Compare* current N.Y. Tax Law §210.3(a)(8) with N.Y. Tax Law §210-A.6, *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

117 *Compare* current N.Y. Tax Law §§210.3(a)(2)(B) and (7)(C) with N.Y. Tax Law §210-A.7(a), *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

118 *Compare* current N.Y. Tax Law §210.3(a)(2)(C) with N.Y. Tax Law §210-A.3(a), *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

119 *Compare* current N.Y. Tax Law §210.3(a)(2)(C) with N.Y. Tax Law §210-A.3(b), *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

120 *Compare* current N.Y. Tax Law §210.3(a)(2)(B) with N.Y. Tax Law §210-A.9, *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

121 *Compare* current N.Y. Tax Law §210.3(a)(7)(A) with N.Y. Tax Law §210-A.7(b), *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

122 *Compare* current N.Y. Tax Law §210.3(a)(2)(B)(i) and 20 NYCRR §4-4.3(d)(2) with N.Y. Tax Law §210-A.8, *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

123 N.Y. Tax Law §210-A.10, *as added by* Section 16, Part A, Chapter 59, Laws of 2014.

cept is described below. Alternatively, where the ownership and unitary business conditions are met, but there are no substantial intercorporate transactions between or among the related corporations, a combined return may still be permitted or required where the activities, business, income or capital will otherwise be misstated in absence of a combined return.

The stock ownership requirement is met if any taxpayer:

1) directly or indirectly owns or controls substantially all the capital stock of one or more other corporations;

2) has substantially all the capital stock owned or controlled, directly or indirectly, by one or more other corporations; or

3) the taxpayer and one or more other corporations are owned or controlled by the same interests.[124]

For decades, the ownership standard was defined as ownership or control of 80 percent of the voting stock of a corporation.[125] Since the current version of the New York state combined return provisions were enacted effective for taxable years beginning in 2007, ownership or control has been defined as controlling 80 percent or more of the of the stock that entitles the holder to vote for the directors of another corporation and the right to receive dividends.[126] For tax years beginning on or after Jan. 1, 2013, the term was modified to mean 80 percent or more of the voting power of all classes of stock of the given entity (as well as the right to receive dividends).[127]

The unitary business requirement has been defined by New York based upon the ''flow of value'' concept as delineated by the U.S. Supreme Court.[128] New York case law has determined this ''flow of value'' to exist in cases where there is centralized management, functional integration and economies of scale resulting from coordinated business operations.[129]

Where the ownership and unitary business requirements have been met, New York requires that there exist ''substantial intercorporate transactions'' between or among two or more related corporations before permitting or requiring the filing of a combined return.[130] For this purpose, the term ''substantial intercorporate transactions'' is defined as:

1) 50 percent or more of a corporation's receipts are from a related corporation or a combinable group of related corporations;

2) 50 percent or more of a corporation's expenditures are to a related corporation or a combinable group of related corporations;

3) 50 percent or more of a corporation's expenditures directly or indirectly benefit a related corporation or a combinable group of related corporations; or

4) there is a substantial intercorporate asset transfer to a related corporation (usually the movement of certain intangible assets or the incorporation of a business unit where the transferred assets or business unit produces 20 percent or more of the gross receipts of the transferee related corporation).[131]

Alternatively, where the ownership and unitary requirements have been met, but substantial intercorporate transactions are lacking, a combined report may be permitted or required where there exist intercorporate transactions or some agreement, understanding, arrangement, or transaction that results in the subject corporation's New York Article 9-A tax liability being improperly reflected unless a combined return is filed.

With respect to corporations subject to the Franchise Tax on Banking Corporations (Article 32), a bank and bank holding company that is a New York taxpayer and either owns 80 percent or more of the voting stock of another corporation that is also subject to Article 32 taxation or has 80 percent of its voting stock owned or controlled directly or indirectly by another corporation subject to Article 32 is required to file an Article 32 combined return with that other corporation. In addition, Article 32 combined returns are permitted or required where an Article 32 taxpayer:

1) owns 65 percent or more of the voting stock of another banking corporation or bank holding company;

2) has 65 percent or more of its voting stock owned or controlled by another banking corporation or bank holding company; or

3) has 65 percent or more of its voting stock owned or controlled by the same interests that own or control 65 percent or more of the voting stock of one or more other corporations that are the types of entities that are subject to or will be subject to Article 32 taxation had such entities been New York taxpayers.[132]

To permit or require the filing of combined returns under the 65 percent ownership standard, there must be a unitary business among the banks and bank holding companies that are to be combined and the filing of separate returns must result in improperly reflecting Article 32 taxpayer members due to intercorporate transactions or some agreement, understanding, arrangement, or transaction that results in the subject corporation's Article 32 tax liability being improperly reflected unless a combined return is filed.[133]

New York does not permit corporations that are or will be subject to tax under Article 9-A to be combined with corporations that are or will be subject to tax under Article 32.[134] In addition, within Article 9-A certain entities using special apportionment provisions (aviation, railroad and trucking corporations) are not permitted to be combined with Article 9-A taxpayers that do not use the same special apportionment provisions.[135]

Provisions under both Articles 9-A and 32 require that captive REITs, captive RICs and overcapitalized captive insurance companies[136] be subject to combina-

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[124] N.Y. Tax Law §211.4.

[125] Former 20 NYCRR §6-2.2(a)(2).

[126] N.Y. Dept. of Taxn. and Fin., TSB-M-08(2)C (March 3, 2008).

[127] N.Y. Tax Law §211.4.

[128] *See generally*, *Container Corp. of America v. California Franch. Tax Bd.*, 463 U.S. 159 (1983); *Allied Signal Corp. v. New Jersey Dir., Div. of Taxn.*, 504 U.S. 768 (1992).

[129] *British Land (Maryland) Inc. v. Tax Appeals Tribunal*, 85 N.Y.2d 139 (1995); *Heidelberg Eastern Inc.*, DTA Nos. 806890 and 807829 (N.Y. Tax App. Trib., May 5, 1994); and *Sears, Roebuck and CO.*, DTA No. 801732 (N.Y. Tax App. Trib., April 28, 1994).

[130] N.Y. Tax Law §211.4(a)(4) and 20 NYCRR §6-2.1(a).

[131] 20 NYCRR §6-2.3(b).

[132] N.Y. Tax Law §1462(f)(2)(ii) and (iii) and 20 NYCRR §21-2.3(a)(1) and (2).

[133] N.Y. Tax Law §1462(f)(ii) and (iii) and 20 NYCRR §21-2.3(b)(2).

[134] 20 NYCRR §§6-2.5(b) and 21-2.6(b).

[135] N.Y. Tax Law §211.4(a)(2) and (3).

[136] An overcapitalized insurance company is essentially a closely held insurance company that covers the risks of related

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tion with a related group of corporations.[137] However, an affiliated group of banking corporations with no more than $8 billion in assets is not subject to the captive REIT/RIC combination provisions.[138]

Combined Reporting Reforms

Under the enacted tax reforms, the current combined reporting provisions are repealed in full, and the combined reporting provisions contained in new Section 210-C will be effective for tax years beginning on or after Jan. 1, 2015. The new provisions provide for mandatory water's-edge combined reporting for related corporations based on satisfaction of a more than 50 percent ownership or control standard (measured by voting power of capital stock) and the existence of a unitary business among such related corporations. Such a grouping will consist of all domestic corporations, foreign corporations deemed domestic corporations under the I.R.C. (such as certain corporations in contiguous countries, stapled corporations and inverted corporations) and foreign corporations to the extent they have effectively connected income.[139] Also, as the enacted tax reforms repeal Article 32 in its entirety, banking corporations, bank holding companies and other financial service entities currently taxed under Article 32 are eligible for inclusion in a combined filing group. In short, the combined reporting provisions contained in new section 210-C will bring the New York combined reporting regime more in-line with traditional unitary combined reporting requirements used by other states.

Ownership Standard

The stock ownership requirement for combined reporting is met if any taxpayer:

1) directly or indirectly owns or controls more than 50 percent of the voting power of the capital stock of one or more other corporations;

2) has more than 50 percent of the voting power of its capital stock owned or controlled, directly or indirectly, by one or more other corporations; or

3) more than 50 percent of the voting power of the taxpayer's capital stock and one or more other corporations are owned or controlled by the same interests.

This new ''more than 50 percent'' ownership standard brings New York into conformity with the ownership standard used by the vast majority of states that permit or require combined reporting. Corporations meeting these ownership standards are termed ''Related Corporations,'' and will be required to file on a combined report if engaged in a unitary business unless specifically excluded.[140]

Unitary Business

The new law does not define the term ''unitary business,'' but federal and New York case law specify the relevant parameters of this analysis. Further, the new law does nothing to clarify the treatment of pure holding companies. Under the existing regulations, purely passive holding companies are not considered to be in a unitary business with their operating subsidiaries.[141] This could prove problematic in cases where a parent holding company is the obligor on all debt that benefits a group of related corporations. While this, and any other, uncertainty related to the unitary business requirement can be eliminated with the ''common group election'' discussed below, the implications of the election must be carefully considered.

Related Corporations Required to Be Included in a Combined Report

The new law provides that captive REITs and RICs will be included in a combined report unless they are required to be included in a combined report under Article 33.[142] Also, any combinable captive insurance company must be included in the combined filing group. For this purpose a captive insurance company is a combinable captive insurance company if 50 percent or less of its gross receipts consists of premium income.[143] Further the new law limits the definition of ''premiums'' to premiums from arrangements that constitute insurance for federal income tax purposes.[144] Finally, any alien corporation deemed a domestic corporation in accordance with Section 7701 of the I.R.C. or an alien corporation with U.S. effectively connected income as determined under the I.R.C. without benefit of a tax treaty protections must be included in a combined report.[145]

Related Corporations Ineligible for Inclusion in a Combined Report

As under existing law, entities that would otherwise qualify for inclusion in a combined report, but are properly taxable under Article 9 (telecommunications) or 33 (insurance) of the New York tax law, are not eligible for inclusion in an Article 9-A combined report.[146]

The new law also specifies that a REIT that is not a captive REIT and a RIC that is not a captive RIC, as well as New York S corporations, are not eligible for inclusion in a combined report.[147] Any alien corporation that has no effectively connected income is ineligible for inclusion in a combined report.[148] Finally, the new law specifies that a corporation subject to tax under Article 9-A solely by reason of owning a limited partnership in-

corporations and generates 50 percent or less of its gross receipts from insurance premiums. N.Y. Tax Law §2.11. *See also* N.Y. Dept. of Taxn. and Fin., TSB-M-09(10)C (Sept. 8, 2009).

[137] N.Y. Tax Law §§211.4(a)(6) and (7) and 1462(f)(2)(v) and (vi).

[138] N.Y. Tax Law §1462(f)(2)(v)(G).

[139] N.Y. Tax Law §210-C.2(B), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[140] N.Y. Tax Law §210-C.2(A) and (C), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[141] 20 NYCRR §6-2.2, Example 3.

[142] N.Y. Tax Law §210-C.2(B), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[143] N.Y. Tax Law §2.11, *as added by* Section 20, Part A, Chapter 59 of the Laws of 2014.

[144] *Id.*

[145] N.Y. Tax Law §210-C.2(B), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[146] N.Y. Tax Law §210-C.2(C), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[147] *Id.*

[148] *Id.*

terest in a limited partnership doing business in New York, and none of such corporate partner's related corporations are Article 9-A taxpayers, than the corporate partner will not be required or permitted to file on a combined basis with its related corporations.[149]

Commonly Owned Group Election

Another significant aspect of the combined reporting reforms is an election to treat all commonly owned corporations as part of one unitary business group. Effectively, under this election, a commonly owned group of corporations will be treated as a single unitary combined return group and all of its net income (other than such items that are classified as investment income or other tax exempt income, as discussed above) will be subject to formula apportionment, regardless of whether that income is from a corporation or set of activities that is not part of the unitary business that is being conducted in New York (essentially making this a ''full apportionment election'').

This election must be made on an original timely filed tax return of the combined group, and will be binding for that year and the following six years.[150] During the time that this election is in effect, any corporation entering the commonly owned group must be included in the combined report.[151] The election will be deemed automatically renewed at the end of the initial seven year period unless it is affirmatively revoked.[152] Any such revocation must be made on an original timely filed tax return for the first taxable year following the completion of the seven-year term of the election.[153] Once properly revoked, a new common group election cannot be made during the three following tax years.[154] For purposes of both the seven-year term of the election and the three-year prohibition against making a new election following a revocation, short taxable years will not be counted as a tax year.[155]

While this election provides certainty as to the composition of the New York combined return group, it requires that income (and capital) and apportionment inputs from activities not part of the taxpayer's unitary business will become part of the New York combined return group's tax base and apportionment calculation. Accordingly, careful consideration should be given by taxpayers before they enter into this election.

Computation of Combined Business Income and Capital

The combined return group's tax will be the highest of the tax on the apportioned business income of the group, the apportioned business capital of the group or the ''fixed'' minimum tax of the designated agent. In addition, there will be a ''fixed'' minimum tax imposed on each taxpayer member of the combined return group (other than the designated agent).[156]

Except as otherwise provided, the combined group will be treated as a single entity for purposes of computing the tax due on a combined report.[157] Thus, in computing combined business income, all intercorporate dividends will be eliminated, and all other intercorporate transactions will be deferred in accordance with the federal consolidated return regulations promulgated under I.R.C. §1502.[158] In computing the combined business capital of the group, all intercorporate stockholdings, debt and payable/receivable balances will be eliminated.[159] These provisions essentially mirror the current practice.[160]

Apportionment on a Combined Report

In computing the New York apportionment factor for a combined filing group, all apportionment items (e.g., receipts) of all group members (not just the nexus members) are included in the calculation of the group's New York apportionment percentage, and all intergroup receipts are eliminated.[161] As is the case under current law, and consistent with the new law's single entity concept for the group, the so-called *Finnigan* rule will be used to determine nexus for purposes of sourcing receipts to New York.

Combined NOLs and Tax Credits

A combined NOL is the amount of combined business loss in a given tax year multiplied by the combined New York apportionment percentage from that year.[162] A combined NOL deduction is the amount of the combined net loss plus and applicable carry forwards.[163] NOLs and tax credits will be used by the combined return group, not just the corporation incurring the item.[164] This is the current practice with respect to NOLs; however, this is not necessarily the current practice with regard to tax credits.[165] Though applied on a group basis, qualification for tax credits, including limitations, are determined separately for each member of the combined filing group.[166] A net operating loss conversion subtraction can be applied in computing combined business income.[167]

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[149] *Id.*
[150] N.Y. Tax Law §210-C.3, *as added by* Section 18, Part A, Chapter 59, Laws of 2014.
[151] *Id.*
[152] *Id.*
[153] *Id.*
[154] *Id.*
[155] *Id.*

[156] N.Y. Tax Law §210-C.1, *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[157] N.Y. Tax Law §201-C.4, *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[158] N.Y. Tax Law §210-C.4(B)(I), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[159] N.Y. Tax Law §210-C.4(B)(II), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[160] *See*, 20 NYCRR §3-2.10(b).
[161] N.Y. Tax Law §210-C.5, *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[162] N.Y. Tax Law §210-C.4(D)(I), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[163] *Id.*
[164] N.Y. Tax Law §210-C.4(C) and (D), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[165] *See* 20 NYCRR §3-8.7. *See also H&S Holdings Ltd.*, DTA No. 813573 (Sept. 11, 1997).
[166] N.Y. Tax Law §210-C.4(C), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[167] N.Y. Tax Law §210-C.4(D)(IV)(D-1), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

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Liability for Tax and the Designated Agent

All taxpayer members of the combined filing group shall be jointly and severally liable for the tax due on a combined report.[168] The new law also provides that each combined filing group must designate an agent to act on behalf of the group in administrative matters, such as tax filings, receiving assessments, making payments and executing waivers of the statute of limitations.[169] The designated agent must be a New York taxpayer (nexus) member of the combined filing group.[170] The designated agent will be the parent corporation of the combined filing group, except in cases where the combined group has no parent corporation or the parent corporation is not a New York taxpayer.[171]

NOLs

Summary of Current Law

New York permits general business corporations (subject to taxation under New York Tax Law Article 9-A) and banking corporations (subject to Article 32 taxation) to take NOL deductions.I.R.C. §172, with certain modifications, is used to determining New York NOL deductions.[172] Therefore, New York provides for two-year carryback and 20-year carryforward periods. One of the New York modifications of I.R.C. §172, though, limits the amount of NOL carrybacks to only the first $10,000 of an NOL incurred in any taxable year. The excess over $10,000 is to be carried forward and used in the 20-year period subsequent to when the NOL was incurred.

In addition to restricting the amount of an NOL carryback, New York provides three limitations to the NOL permitted under I.R.C. §172.[173] First, no NOL deduction is allowed for a loss sustained during any year in which the corporation was not subject to the corporation franchise tax under article 9-A or Article 32.[174] With respect to Article 32, an NOL incurred prior to a taxable year beginning on or after Jan. 1, 2001, cannot be carried to another taxable year.[175] The second limitation is that the NOL is adjusted to reflect the New York modifications used in converting federal taxable income to New York entire net income.[176]

The third limitation is that the New York NOL deduction may not exceed the deduction allowable for federal income tax purposes.[177] The amount of the taxpayer's federal NOL for purposes of this limitation is not necessarily the actual amount of the NOL that the taxpayer used for federal tax purposes, but rather the amount of federal NOL that the taxpayer would have used had the taxpayer's federal filing status mirrored its New York filing status (such as if a separate return was filed for New York purposes, then the federal NOL is determined as if a separate federal return had been filed by the taxpayer). This pro forma federal NOL is also determined as if only the first $10,000 of the federal NOL could be carried back.[178] Lastly, the limitation of NOL to the federal NOL also has been interpreted by the Department as requiring the New York loss to originate from the same loss years as when the pro forma federal NOLs were suffered.[179]

For Article 32 taxpayers, the amount of federal NOL used in the third limitation is increased by the excess of the New York addition to the allowance for bad debt over the amount of bad debts allowed for federal income tax purposes for NOLs incurred in taxable years beginning prior to Jan. 1, 2010.[180]

The New York NOL is determined on a pre-apportionment basis, so the year the NOL is utilized determines how much of the NOL is effectively apportioned to New York. If an Article 9-A taxpayer has income from investment capital, then in the year of utilization the NOL is required to be divided between the taxpayer's net investment and business income.[181] So where a general corporate taxpayer has an investment allocation percentage that is considerably less than its business apportionment percentage, this division of the NOL effectively resulted in the loss of a good portion of benefit of the NOL carryforward deduction.

Since New York adopts I.R.C. §172 as the starting point for determining the New York NOL deduction, it has followed the provisions of I.R.C. §381 with respect to corporations succeeding to tax attributes of another corporation in certain corporate reorganization situations. In addition, the limitations of I.R.C. §382 will apply for New York tax purposes—as a result of New York's referencing to I.R.C. §172, as well as New York's requirement that its NOL deduction cannot exceed the corresponding federal NOL deduction, as discussed above. For taxpayers that file New York combined returns, the New York NOL is determined by referencing provisions applicable to federal consolidated returns.[182] As a result, federal provisions such as SRLY and the section 382/SRLY overlap provisions apply to New York combined return situations.[183]

Net Operating Loss Reforms

Effective for taxable years beginning on or after Jan. 1, 2015, in computing the business income base, tax-

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[168] N.Y. Tax Law §210-C.6, *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[169] N.Y. Tax Law §210-C.7, *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[170] *Id.*

[171] *Id.*

[172] N.Y. Tax Law §208.9(f); 20 NYCRR section 3-8.2(a). A corporation that reports as part of a consolidated group for federal income tax purposes but on a separate basis for purposes of article 9-A computes its NOL and its NOL deduction as if it were filing on a separate basis for federal income tax purposes. 20 NYCRR §3-8.1(a). For a more complete discussion of the Article 9-A NOL provisions, *see* Banigan, 2200-2nd T.M., *New York State and City Corporation Income Taxes*, §2200.07.

[173] 20 NYCRR §3-8.2(a).

[174] N.Y. Tax Law §§208.9(f)(2) and 1453(k-1)(2); 20 NYCRR §3-8.2(b)..

[175] N.Y. Tax Law §1453(k-1)(2).

[176] N.Y. Tax Law §§208.9(f)(1) and 1453(k-1)(1); 20 NYCCR §3-8.2(c).

[177] N.Y. Tax Law §§208.9(f)(3) and 1453(k-1); 20 NYCRR §3-8.2(d).

[178] N.Y. Tax Law §208.9(f)(5).

[179] *Re Lehigh Valley Industries, Inc.*, No. 801617 (N.Y. Tax App. Trib. May 5, 1988).

[180] N.Y. Tax Law §1453(k-1)(3) and N.Y. Dept. of Taxn. and Fin., TSB-M-10(4)C (Sept. 7, 2010).

[181] 20 NYCRR §3-8.8.

[182] 20 NYCRR §3-8.7.

[183] N.Y. Dept. of Taxn. and Fin., TSB-A-07(2)C (March 19, 2007).

payers will be allowed both[184] a prior net operating loss conversion subtraction (''PNOL subtraction'')[185] in respect of NOLs sustained prior to the enacted tax reforms (i.e., through 2014) and a net operating loss deduction (as newly defined)[186] in respect of NOLs sustained for tax years beginning in 2015 and after. New York's new NOL will be calculated on a post-apportionment method, and, as described below, will no longer take into account certain historical restrictions.[187] The PNOL subtraction is applied against the business income base before the NOL deduction.[188]

The PNOL Subtraction

In order to calculate the PNOL subtraction, a taxpayer must first calculate the tax value of its NOLs that were not deductible and were eligible for carryover on the last day of the taxpayer's ''base year'' (the last taxable year beginning on or after Jan. 1, 2014 and before Jan. 1, 2015,[189] which means Dec. 31, 2014 for calendar year filers), subject to the applicable limitations for NOL deductions under Article 9-A or Article 32 at the end of 2014.[190] The tax value of the ''unabsorbed NOLs'' is equal to the product of (i) the unabsorbed NOLs at Dec. 31, 2014, (ii) the taxpayer's 2014 business allocation percentage, and (iii) the taxpayer's tax rate in 2014. This product is then divided by 6.5 percent for most taxpayers (or 5.7 percent for qualified New York manufacturers), which result is called the PNOL subtraction pool.

A taxpayer's PNOL subtraction for the taxable year generally equals one-tenth of its PNOL subtraction pool plus any amount of unused PNOL subtraction from preceding taxable years (without regard to the one-tenth limitation) through the tax year ending in 2035. The one-tenth limitation does not apply to small businesses. In lieu of the one-tenth per year subtraction, a taxpayer may elect to utilize up to 50 percent of its PNOL subtraction for each of its 2015 and 2016 tax years. A taxpayer must make such election on its return for the 2015 tax year by the extended due date for such return.[191] If this election is made, no unused amounts may be carried forward. The PNOL subtraction may be used to reduce a taxpayer's tax on allocated business income to the higher of the tax on the capital base or the fixed dollar minimum.[192] Special rules apply to combined groups, as discussed below.

The NOL Deduction Under the Enacted Tax Reforms

As noted above, effective for taxable years beginning on or after Jan. 1, 2015, an NOL deduction is permitted in computing the business income base. An NOL will be the amount of a business loss incurred in a particular tax year multiplied by the apportionment factor for that year (as determined under the enacted tax reforms). Such a deduction from one or more taxable years may be carried forward or back as described below. The maximum NOL deduction that is allowed in a taxable year is the amount that reduces the taxpayer's tax on allocated business income to the higher of the tax on the capital base or the fixed dollar minimum.[193] Such deduction and loss are determined in accordance with the following:

- the NOL deduction will not be limited to the amount allowed under I.R.C. §172 or the amount that would have been allowed if the taxpayer had not made a federal subchapter S election;
- the NOL deduction will not include any net operating loss incurred during any taxable year beginning prior to Jan. 1, 2015, or during any taxable year in which the taxpayer was not subject to tax in New York;
- a taxpayer that files as part of a federal consolidated return but on a separate basis in New York will compute its deduction and loss as if it were filing on a separate basis for federal income tax purposes;
- an NOL may be carried forward for 20 taxable years following the taxable year of the loss and may be carried back to each of the three taxable years preceding the taxable year of the loss, although no loss can be carried back to a tax year beginning prior to Jan. 1, 2015; a taxpayer must apply both of these limitations in computing its NOL deduction;
- an NOL deduction will not include any NOL incurred during a year when the taxpayer was a New York S corporation, although a New York S corporation year will be treated as a taxable year for purposes of determining the number of taxable years to which an NOL may be carried forward; and
- where there are two or more NOLs, or portions thereof, carried forward to be deducted in one particular tax year, the earliest NOL must be applied first.

PNOL Subtraction for Combined Groups

If a taxpayer was included in a tax year 2014 combined report under Article 9-A or Article 32 and the members of the combined group for that year are the same as the members of the combined group for the tax year 2015, the combined group calculates its PNOL subtraction pool using the combined group's total unabsorbed NOL, 2014 business allocation percentage and 2014 tax rate.[194]

If a combined group includes additional members in the tax year 2015 that were not included in the combined group during the tax year 2014, each tax year 2014 combined group and each taxpayer that filed separately in 2014 but is included in the combined group in the tax year 2015 will calculate its PNOL subtraction pool, and the sum of the pools will be the combined PNOL subtraction pool of the combined group.[195]

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[184] N.Y. Tax Law §210.1(a)(viii), *as added by* Section 12, Part A, Chapter 59 of the Laws of 2014.
[185] *Id.*
[186] N.Y. Tax Law §210.1(a)(ix), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[187] *Id.*
[188] N.Y. Tax Law §210.1(a)(viii), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[189] N.Y. Tax Law §210.1(a)(viii)(b)(1)(I), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[190] N.Y. Tax Law §210.1(a)(viii)(b)(1)(II), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[191] N.Y. Tax Law §210.1(a)(viii)(b)(2)(IV), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[192] N.Y. Tax Law §210.1(a)(viii)(b)(4), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[193] N.Y. Tax Law §210.1(a)(ix), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[194] N.Y. Tax Law §210.1(a)(viii)(B)(3)(I), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.
[195] N.Y. Tax Law §210.1(a)(viii)(B)(3)(II), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

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If a taxpayer was properly included in a combined report for the tax year 2014 and files a separate report in a subsequent taxable year, then the amount of remaining PNOL subtraction allowed to such taxpayer will be proportionate to the amount that such taxpayer contributed to the PNOL subtraction pool on a combined basis, and the remaining PNOL subtraction allowed to the remaining members of the combined group will be reduced accordingly.[196]

If a taxpayer filed a separate report for the tax year 2014 and is later included in a combined report in a subsequent taxable year, then the PNOL subtraction pool of the combined group will be increased by the amount of the remaining PNOL subtraction amount allowed to the taxpayer at the time the taxpayer is included in the combined group.[197]

Tax Credits

As proposed, the New York tax reforms would have extensively changed certain tax credits. In particular, the investment tax credit (''ITC'') would have only applied to new property, the definition of ''manufacturing'' would have been narrowed and the ITC for financial service firms would have been eliminated.[198] New eligibility standards were also proposed for the Brownfields Credit program.[199] None of the proposed narrowing of existing tax credits was enacted. Instead, certain existing credits were extended or expanded and new credits were added to the tax law.

New Tax Credits

Real Property Tax Credit for Manufacturers

Effective for taxable years beginning on or after Jan. 1, 2014, there is a new Real Property Tax Credit available to ''qualified New York manufacturers'' (see discussion of ''qualified New York manufacturers,'' above). The credit is equal to 20 percent of the New York real property taxes paid on New York real property that is principally used in manufacturing.[200] The real property taxes upon which the credit is claimed cannot be deducted in determining entire net income.[201] In addition, those real property taxes cannot be used in determining any other New York tax credit.[202]

The real property tax credit can be claimed with respect to real property taxes that are assessed by a local government for the general welfare of its jurisdiction.[203] A qualified New York manufacturer can claim the credit for real property taxes paid on leased real property, as well as that owned by the manufacturer. With respect to the former, the manufacturer must be explicitly required to pay the real property taxes under the terms of the lease and the manufacturer must make the payments directly to the local taxing authority.[204] For manufacturers that are part of a combined return group, the conditions can be satisfied if one group member is the lessee and another makes the tax payments.[205] Payments in lieu of taxes on real property do not qualify as real property taxes for this credit.[206]

The real property tax credit is not a refundable credit for Article 9-A taxpayers. Instead, it can be used to reduce the Article 9-A tax to no less than $25 for the taxable year.[207] The amount of credit claim is recaptured to the extent of any subsequent reduction of the real property taxes that served as the basis for the credit.[208] There are no carryover provisions for this credit.

Since a ''qualified New York manufacturer'' will have a zero percent net income tax rate, the real property tax credit will serve to reduce the manufacturer's alternative taxes on business capital and the ''fixed'' minimum tax.

START-UP New York Credit for Telecommunications Excise Taxes

For taxable years beginning on or after Jan. 1, 2014, taxpayers participating in the START-UP New York program can take a refundable tax credit with respect to certain New York telecommunications excise taxes. The New York telecommunications excise tax is imposed under New York Tax Law §186-e at the rate of 2.5 percent on New York telecommunication services. To claim the tax credit, the taxpayer must have the §186-e tax separately stated on invoices from its telecommunications carrier. In addition, the tax must be on telecommunications services used in a tax-free area.[209] Tax-free areas are all State University of New York

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[196] N.Y. Tax Law §210.1(a)(viii)(B)(3)(III), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[197] N.Y. Tax Law §210.1(a)(viii)(B)(3)(IV), *as added by* Section 18, Part A, Chapter 59 of the Laws of 2014.

[198] *See* Part R of S6359-A/A8559-A and Banigan, Jewell and Brady, *Proposed New York Tax Reform: Setting the Stage for New Legislation*, Weekly State Tax Report, Bloomberg BNA, Dec. 20, 2013.

[199] *See* Part Q of S6359-A/A8559-A and Banigan, Jewell and Brady, *Proposed New York Tax Reform: Setting the Stage for New Legislation*, Weekly State Tax Report, Bloomberg BNA, Dec. 20, 2013.

[200] N.Y. Tax Law §210.48, *as added by* Section 1, Part R, Chapter 59, Laws of 2014, applicable to taxable years beginning on or after Jan. 1, 2014 and before Jan. 1, 2015, and N.Y. Tax Law §210-B.43, *as added by* Section 17, Part A, Chapter 59, Laws of 2014, applicable for taxable years beginning on or after Jan. 1, 2015. Section 10, Part R provides that Part R is effective for 2014. Section 17 of Part A is effective for 2015 and thereafter per Section 113 of Part A.

[201] N.Y. Tax Law §208.9(b)(21), *as added by* Section 2 of Part R and Section 4 of Part A, Chapter 59, Laws of 2014.

[202] N.Y. Tax Law §§210.48(a) and 210-B.43(a), *as amended or added by* Section 1 of Part R and Section 17 of Part A, Chapter 59, Laws of 2014.

[203] N.Y. Tax Law §§210.48(b)(1) and 210-B.43(b)(1), *as amended or added by* Section 1 of Part R and Section 17 of Part A, Chapter 59, Laws of 2014.

[204] N.Y. Tax Law §§210.48(b)(2) and 210-B.43(b)(2), *as amended or added by* Section 1 of Part R and Section 17 of Part A, Chapter 59, Laws of 2014.

[205] *Id.*

[206] N.Y. Tax Law §§210.48(b)(3) and 210-B.43(b)(3), *as amended or added by* Section 1 of Part R and Section 17 of Part A, Chapter 59, Laws of 2014.

[207] N.Y. Tax Law §§210.48(d) and 210-B.43(d), *as amended or added by* Section 1 of Part R and Section 17 of Part A, Chapter 59, Laws of 2014

[208] N.Y. Tax Law §§210.48(c) and 210-B.43(c), *as amended or added by* Section 1 of Part R and Section 17 of Part A, Chapter 59, Laws of 2014.

[209] N.Y. Tax Law §§210.49 and 210-B.44, *as amended or added by* Section 3 of Part T and Section 17 of Part A, Chapter 59, Laws of 2014.

campuses, other designated colleges and universities and certain New York state prisons.[210]

Musical and Theatrical Production Credit

For taxable years beginning on or after Jan. 1, 2015, taxpayers engaged in musical and theatre productions in New York state, but outside of New York City, are eligible for a tax credit equal to 25 percent of qualified production and transportation expenditures. The credit may not reduce the Article 9-A tax to less than the ''fixed'' minimum tax. However, any excess amount of this credit is refundable.[211]

Workers With Disabilities Tax Credit

For taxable years beginning on or after Jan. 1, 2015, taxpayers may claim a credit equal to 15 percent and 10 percent of the respective qualified wages paid to full-time and part-time workers who are developmentally disabled.[212] This credit is nonrefundable and cannot reduce a taxpayer's Article 9-A tax obligation to less than that of the fixed minimum tax. Any unused credits can be carried over to the following three years.[213] To claim this credit, employers must apply for eligibility with the New York State Department of Labor. There is $6 million in the aggregate allocated annually to this credit by New York state. The annual allocations expire on Jan. 1, 2020.[214]

Existing Tax Credits That Were Extended or Expanded

The Empire State Commercial Production Tax Credit, which was set to sunset for taxable years beginning or after Jan. 1, 2015, has been extended until taxable years beginning on or after Jan. 1, 2017.[215] The threshold minimum qualified production costs for claiming this credit for commercials recorded outside of the Metropolitan Commuter Transportation District (*see* MTA Surcharge discussion below) has been reduced from $200,000 to $100,000.[216]

Effective Jan. 1, 2015, Albany and Schenectady counties have been added to the list of upstate counties for which an additional Film Production Credit of 10 percent of certain wages can be generated.[217]

The aggregate amount of Low Income Housing Tax Credits that can be obtained has been immediately increased from $48 million to $56 million. The aggregate amount of credits will be further increased to $64 million, effective April 1, 2015.[218]

For taxable years beginning on or after Jan. 1, 2014, the Youth Works Tax Credit has expanded to provide an additional $1,000 or $500 tax credit, respectively, for each youth retained in full-time or part-time status for an additional year. In addition, the threshold for a part-time position is lowered from 20 to 10 hours per week for full-time high school students.[219] Lastly, the overall allocations for the Youth Works Program have been increased from $6 million to $10 million.[220]

MTA Surcharge

Summary of Current Provisions

To assist in funding the MTA, New York state currently imposes a 17 percent ''MTA Surcharge'' on Articles 9-A and 32 taxpayers based on the amount of their respective franchise taxes that are apportioned to the Metropolitan Commuter Transportation District (''MCTD'').[221] The MCTD encompasses New York City and seven neighboring counties. The MTA Surcharge is imposed on the highest of the Article 9-A tax on entire net income, investment and business capital, minimum taxable income or the fixed minimum tax. Once the highest base is determined, that tax base is recomputed using the following tax rates:

1) 9 percent on entire net income apportioned to New York;

2) 0.178 percent on investment and business capital that is apportioned to New York (with a maximum tax of $350,000);

3) 3.5 percent on minimum taxable income; or

4) the fixed minimum tax at its current rate.[222]

After the tax base is redetermined, it is apportioned to the MCTD based on the average of the ratios that respectively consist of property, payroll and receipts in the MCTD over property, payroll and receipts in New York state.[223] The 17 percent MTA Surcharge is then applied the result.[224]

For Article 32 taxpayers, if the entire net income base is the highest, then it is recomputed as if the tax rate was 9 percent.[225] Article 32 franchise tax is apportioned to the MCTD based on the ratio of the Article 32

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210 *See* the Empire State Development Corporation's website for details on the START_UP New York Program.

211 N.Y. Tax Law §§24-a and 210-B.47, *as added by* Sections 1 and 2 of Part HH, Chapter 59, Laws of 2014.

212 N.Y. §Lab. Law §25-b and N.Y. Tax Law §210-B.48(a), *as added by* Sections 1 and 2 of Part MM, Chapter 59, Laws of 2014.

213 N.Y. Tax Law §210-B.48(b), *as added by* Section 2 of Part MM, Chapter 59, Laws of 2014.

214 Section 5 of Part MM, Chapter 59, Laws of 2014.

215 N.Y. Tax Law §§28(a)(1) and 210.38(a), *as amended by* Sections 1 and 3 of Part O, Chapter 59, Laws of 2014. *See* Banigan, 2200-2nd T.M., *New York State and City Corporation Income Taxes*, §2200.12.B.23 for further discussion of the Empire State Commercial Production Credit.

216 N.Y. Tax Law §28(a)(2)((iii) *as amended by* Section 2 of Part O, Chapter 59, Laws of 2014.

217 N.Y. Tax Law §24, *as amended by* Sections 1 and 3 of Part JJ, Chapter 59, Laws of 2014. *See* Banigan, 2200-2nd T.M., *New York State and City Corporation Income Taxes*, §2200.12.B.22 for further discussion of the Film Production Credit.

218 N.Y. Pub. Hous. Law §22.4, *as amended by* Sections 1 to 3 of Part P, Chapter 59, Laws of 2014.

219 N.Y. Tax Law §§210.44(a) and 210-B.36(a), *as amended or added by* Section 1 of Part U and Section 17 of Part A, Chapter 59, Laws of 2014.

220 N.Y. Lab. Law §25-a(a), *as amended by* Section 3 of Part U, Chapter 59, Laws of 2014.

221 N.Y. Tax Law §§209-B.1 and .6 and 1455-B.1 and .5. The MCTD encompasses the five boroughs (counties) of New York City and seven neighboring counties (Nassau, Suffolk, Dutchess, Orange, Putnam, Rockland and Westchester counties).

222 N.Y. Tax Law §209-B.1.

223 N.Y. Tax Law §209-B.2. Special MCTD formulas applied to corporations engaged in aviation, railroads or trucking. N.Y. Tax Law §§209-B.2-a to 2-b.

224 N.Y. Tax Law §209-B.1.

225 N.Y. Tax Law §1455-B.1.

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taxpayer's gross income within the MCTD to gross income within New York state.[226]

Reforms

Several reforms were enacted with regard to the MTA Surcharge for taxable years beginning on or after Jan. 1, 2015:

- the MTA Surcharge will be imposed using a bright-line statutory nexus threshold[227] in addition to the physical presence standard under current law. The statutory nexus threshold to be applied for purposes of the MTA Surcharge is consistent with that enacted for corporate franchise tax purposes.[228] So, for example, sales of $1 million or more to customers in the MCTD will create an MTA Surcharge liability. See the discussion above regarding the enacted nexus reform provisions.
- the MTA surcharge will be based on franchise tax liability before credits, while under current law, it is imposed on tax liability after credits.[229]
- the MTA Surcharge rate will be increased to 25.6 percent for taxable years beginning on or after Jan. 1, 2015 and before Jan. 1, 2016[230] (and thereafter provides an annual adjustment of the MTA Surcharge rate to be determined by the Department in accordance with the state's financial projections).[231]
- the MTA business allocation percentage will continue to be computed using three factors[232](with the MTA receipts factor reflecting new customer (market) sourcing provisions).

To the extent that a provision in the new customer sourcing provisions provides that 8 percent of the receipts specified in such provision should be included in the numerator of the apportionment fraction, 90 percent of such 8 percent amount will be considered within the MCTD and 100 percent of such 8 percent amount will be considered to be within New York State.

Severability Provisions

Should a federal or New York state court of final jurisdiction (the courts) hold that any provision of the enacted corporation tax reforms is invalid, then, under severability provisions included in the tax reform legislation, the remainder of the corporation tax reforms are to be treated as if they were enacted without the provision that was determined to be invalid.[233] In addition, the severability provisions explicitly address the following:

1) if the tax rates for qualified New York manufacturers are found to be invalid by the courts, then such manufacturers are subject to taxation at the same rates imposed upon all other corporate taxpayers under Article 9-A;

2) if any of the tax credits are found to be invalid by the courts, then that credit is deemed repealed and will have no force or effect for any taxpayer; and

3) if the MTA Surcharge is held to be invalid as enacted (with the Department being charged with annually adjusting the MTA Surcharge rate), then the MTA Surcharge is to be applied at the rate of 27.1 percent.[234]

If a tax provision is found invalid, then normally some backward looking relief is to be applied, whether by refunding taxes to the disadvantaged party or retroactively imposing taxes on the advantaged parties.[235] The severability provisions are designed to apply the latter remedy. However, there is a question of what happens when the years in question are considered closed under the New York statute of limitations provisions.[236]

For example, an out-of-state manufacturer that does not meet the criteria for being a ''qualified New York manufacturer'' sells the products it produces in New York. That manufacturer is assessed taxes on its business income apportioned to New York for 2014, 2015 and 2016. That manufacturer litigates the issue of whether New York's zero percent tax rate on the business income of qualified New York manufacturers improperly discriminates against non-New York manufacturers and ultimately the U.S. Supreme Court finds that zero percent rate to be unconstitutional in its decision issued in 2024. While the relevant severability provision would require that qualified New York manufacturers be subject to the general Article 9-A tax rates back through 2014, the New York statute of limitations would seem to bar any retroactive tax assessments against such qualified New York manufacturers with respect to tax years that have expired. Under that circumstance, refunds may be due to the out-of-state manufacturer for the years that the qualified New York manufacturers cannot be assessed taxes as the meaningful backward looking relief due to that out-of-state manufacturer.[237]

New York City Conformity

At the time of this writing, the New York City Administrative Code with respect to the City's Banking Corporation Tax and General Corporation Tax have not been conformed to revised New York state tax law. In fact, New York City's Gramm-Leach-Bliley transition provisions, which freezes the status of certain entities as either banking corporations or general business corporations, has been extended for taxable years beginning

[226] N.Y. Tax Law §1455-B.2 and 20 NYCRR §23-1.3.

[227] N.Y. Tax Law §§209-B.1(A), (B), (C) and (D), *as amended or added by* Section 7 of Part A, Chapter 59, Laws of 2014.

[228] N.Y. Tax Law §§209.1(A), (B), (C) and (D), *as amended or added by* Section 7 of Part A, Chapter 59, Laws of 2014.

[229] N.Y. Tax Law §209-B.2, *as amended by* Section 8 of Part A, Chapter 59, Laws of 2014.

[230] The effective rate of the MTA surcharge in 2015 will be 1.8 percent (25.6 percent MTA rate multiplied by 7.1 percent Article 9-A rate), an increase of approximately 0.3 percent from 2014 when the effective rate of the MTA surcharge is 1.5 percent (17 percent MTA rate multiplied by 9 percent historical Article 9-A rate).

[231] N.Y. Tax Law §§209-B.1(F), *as added by* Section 7 of Part A, Chapter 59, Laws of 2014.

[232] With respect to the MTA Surcharge property factor, property is valued at adjusted basis used for federal income tax purposes. However, taxpayers can make a revocable election on their first tax return due on or after Jan. 1, 2015, to use fair market value in lieu of adjusted basis.

[233] Section 112, Part A, Chapter 59, Laws of 2014.

[234] *Id.*

[235] *McKesson Corporation v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18 (1990).

[236] N.Y. Tax Law §1083.

[237] *See* Memorandum, California Franchise Tax Board, May 17, 2004 for an analogous situation.

before Jan. 1, 2017. This is suggestive that any New York City corporation tax reform may lag that of New York state by a year or two.

Conclusion

The enacted corporate franchise tax reforms will, when effective, eliminate or modify substantially specific aspects of the current franchise tax law that are unique to New York, such as the subsidiary capital and combined reporting rules. In other respects, the reforms follow existing trends in state taxation, such as bright-line statutory nexus and apportionment of receipts based on customer (market) sourcing rules. Overall, the enacted reforms appear to more closely align New York's major corporation tax provisions with that of other states. But as with any major reforms, the full effects will play out over time.

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