

New York deadline approaching for identifying stock as investment capital

Overview

New York State and New York City each enacted tax reform effective January 1, 2015, which includes an exemption from tax for income from “investment capital” (subject to limitations). Under the new definition of “investment capital,” which is the same for New York State and New York City purposes,¹ the term means those investments in stocks of non-unitary corporations that satisfy the following five-part test:

- Qualify as a capital asset under § 1221 of the Internal Revenue Code (IRC) at all times the taxpayer owned such stock during the tax year;
- Are held by the taxpayer for investment for more than one year;
- If disposed of, generate (or would generate) long-term capital gains or losses under the IRC;
- For stocks acquired on or after January 1, 2015, have never been held for sale to customers in the regular course of business after the close of the day on which the stock was acquired; and
- Before the close of the day on which the stock was acquired, must be clearly identified in the corporation's records as stock held for investment in the same manner as required under IRC § 1236(a)(1) for the stock of a dealer in securities to be eligible for capital gain treatment (whether or not the corporation is a dealer in securities subject to § 1236).
 - For stock acquired prior to October 1, 2015, that was not subject to IRC §1236(a), the identification requirement must occur before October 1, 2015.

The New York State Department of Taxation and Finance released a technical memorandum, TSB-M-15(4)C, (5)I (July 7, 2015),² describing the identification procedures required to satisfy the fifth bullet set forth above. **As applied to stock acquired prior to October 1, 2015, the deadline for complying with these procedures is September 30, 2015. If stock is not clearly identified as investment capital in the required manner, that stock will not qualify as investment capital, and thus income from such stock would not be exempt.**

This Tax Alert summarizes the identification procedures.

Summary of identification procedures

For corporations that are not dealers subject to IRC § 1236, in order to satisfy the investment capital identification requirement, stock acquired before October 1, 2015, must be clearly identified in the corporation's records as stock held for investment before October 1, 2015. For dealers subject to IRC § 1236, in order to satisfy the investment capital identification requirement, stock acquired before and after October 1, 2015, must be clearly identified in the corporation's records as stock held for investment under IRC § 1236(a)(1). A separate New York identification is not permitted since the federal identification under IRC § 1236 is determinative. Identifying stock as held for investment for purposes of IRC § 475 is not sufficient.

The investment capital identification procedures for corporations that are not dealers subject to IRC § 1236 are met as follows:

- The stock must be recorded in an account maintained for investment capital purposes only—separate from any account maintained for stock held for sale to customers.
 - The account may be an account maintained in the taxpayer's books of account for recordkeeping purposes only; or
 - It may be a separate depository account maintained by a clearing company as nominee for the corporation.
- The investment capital account must disclose:
 - Name of the stock;
 - CUSIP number of the stock (or CINS number for international securities);
 - Date of purchase;
 - Number of shares purchased; and

¹ N.Y. Tax Law § 208.5(a); N.Y. City Admin. Code § 11-652.4(a).

² A copy of TSB-M-15(4)C, (5)I (Jul. 7, 2015) can be accessed [here](#).

- Purchase price of the stock.
- If the stock is sold, the investment capital account also must disclose:
 - Date of sale;
 - Number of shares sold; and
 - Sales price for that stock.

The investment capital account must be set up in a manner that readily identifies the length of time the stock was owned by the corporation.

Identification rules for combined groups

In a combined report, each included corporation must follow the identification procedures described above for investments in stock owned by that corporation. Thus, each corporation included in the combined report that is not a dealer must maintain its own investment capital account and follow the identification procedures described above.

Identification rules for stock purchased pursuant to an option

If stock is purchased by a corporation pursuant to an option, the stock may be identified as investment capital only if before the close of the day on which the option was acquired the corporation clearly identified the option in its records as held for investment. For corporations that are not dealers for purposes of IRC § 1236, any stock purchased on or after October 1, 2015, pursuant to an option acquired by the corporation prior to October 1, 2015, may not be identified as investment capital unless the corporation clearly identified the option in its records as held for investment prior to October 1, 2015.

Identification rules for corporate partners

If the corporation is a partner in a partnership and uses the aggregate method to compute its tax, if the statutory requirements for investment capital are satisfied at the partnership level, the corporation's proportional part of the stock owned by the partnership may qualify as investment capital. In particular, the partnership must follow the identification procedures specified above for the stock to qualify as investment capital. Specifically:

- If a partnership is a dealer for purposes of IRC § 1236, stock acquired before and after October 1, 2015, must be clearly identified by the partnership as held for investment under § 1236(a)(1) in order to satisfy the investment capital identification requirement; and
- If a partnership is not a dealer subject to IRC § 1236, stock acquired before October 1, 2015, satisfies the investment capital identification requirement if the partnership makes the identification before October 1, 2015, in accordance with the identification procedures described above for corporations that are not dealers.

Note: If, on or after October 1, 2015, a corporation becomes a partner in a non-dealer partnership and prior to the date the corporation becomes a partner, the partnership had not identified any stock as investment capital using the procedures described above, only stock acquired by the partnership on and after the date the corporation became a partner may potentially qualify as investment capital. Investment partnerships may not be aware that these new rules exist (e.g., those partnerships that do not file New York returns) and, therefore, from the corporate partners perspective, income that previously would have qualified as investment income may be business income allocated to New York at a much higher allocation percentage if the proper identification requirements are not adopted by the partnership.

Considerations

As applied to stock acquired prior to October 1, 2015, the foregoing identification requirements must be implemented by September 30, 2015. If stock is not clearly identified as investment capital in the required manner, that stock will not qualify as investment capital as defined in N.Y. Tax Law § 208.5(a), and thus income from such stock would not be exempt. However, even if the stock is identified as required, it will not qualify as investment capital unless all the other requirements of N.Y. Tax Law § 208.5(a)(i)-(iv) are satisfied. Per TSB-M-15(4)C, (5)I (July 7, 2015), identification of stock as investment capital in the manner described above will also satisfy the investment capital identification requirements of the New York City Corporate Tax of 2015.³

³ N.Y. City Admin. Code § 11-652.4(a)(v).

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