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EXTERNAL ALERT

New York Legislature Passes Bills Amending State Tax Law

April 3, 2015

Overview

On April 1, 2015, the New York State Legislature delivered to New York's Governor Andrew Cuomo for signature S2009B/A3009B and S2006B/A3006B, referred to generally as "Budget Bills" forming part of the 2015-16 State Budget.[1] This legislation would make technical corrections and other revisions to the New York State tax reform provisions enacted in 2014, and would make changes to certain sales and use tax provisions and other tax laws.[2]

At the time of issuance of this Tax Alert, the official legislative record has not confirmed the enactment date, which could conceivably relate back to March 31, 2015 (*i.e.*, the date by which both the State Senate and Assembly had passed the bills[3]), but is in question due, in part, to the later date of delivery to the Governor. As such, we are still evaluating whether this should be treated as a first or second quarter event for financial statement purposes for calendar year taxpayers.

In this Tax Alert we summarize the more significant New York State tax law changes included in the legislation.[4]

Technical Corrections and Other Revisions to the 2014 New York State Tax Reform

The more significant technical corrections and other revisions to the New York State tax reform provisions enacted in 2014 include the following:

- Redefining the definition of investment capital as investment in stock that meets the following five criteria:
    - Satisfies the definition of a capital asset under Internal Revenue Code ("I.R.C.") § 1221 at all times that the taxpayer owned such stock during the taxable year;
    - Is held by the taxpayer for investment for more than one year (under the original provision, the required holding period was more than six consecutive months);
    - The disposition of such stock is, or would be, treated by the taxpayer as generating long-term capital gains or losses under the I.R.C.;
    - For stock acquired on or after January 1, 2015, at any time after the close of the day in which such stock is acquired, the stock has never been held for sale to customers in the regular course of business; and
    - Before the close of the day on which the stock was acquired, such stock is clearly identified in the taxpayer's records as stock held for investment in the same manner as required under I.R.C. § 1236(a)(1) for the stock of a dealer in securities to be eligible for capital gain treatment (whether or not the taxpayer is a dealer of securities under I.R.C. § 1236); provided, however, that for stock acquired prior to October 1, 2015, that was not subject to I.R.C. § 1236(a)(1), such identification in the taxpayer's records must occur before October 1, 2015.

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[1] See **http://open.nysenate.gov/legislation/bill/A3009B-2015**, regarding delivery of S2009B/A3009B to the Governor on April 1, 2015; and **http://open.nysenate.gov/legislation/bill/S2006B-2015**, regarding delivery of S2006B/A3006B to the Governor on April 1, 2015.

[2] For more on the 2014 New York State tax reforms, see our **Tax Alert dated April 1, 2014**.

[3] See **http://open.nysenate.gov/legislation/bill/A3009B-2015**, which shows that S2009B/A3009B was passed by both the Senate and Assembly on March 30, 2015; and **http://open.nysenate.gov/legislation/bill/S2006B-2015**, which shows that S2006B/A3006B was passed by both the Senate and Assembly on March 31, 2015.

[4] Note that on April 1, 2015, the New York State Legislature also delivered to New York's Governor Andrew Cuomo for signature separate legislation (S461A/A6721A) that, once enactment is confirmed, would adopt broad-based tax reform (generally consistent with the New York State tax reform provisions enacted in 2014) of the New York City corporate tax regime. See, **http://open.nysenate.gov/legislation/bill/S4610A-2015**, regarding passage of S4610A/A6721A on March 31, 2015, by both the Senate and the House and delivery to the Governor on April 1, 2015. We do not address the New York City corporate tax law changes in this Tax Alert but, instead, do so in separate Tax Alert issued on April 3, 2015.

- Removing the provision stating that for purposes of determining the requisite holding period of a security to qualify as investment capital, the Commissioner of the New York Department of Taxation and Finance would take into account offsetting positions the taxpayer takes in such security or similar securities.
- Conforming the related statute addressing the investment capital holding period requirement to provide that if a taxpayer acquires stock that is a capital asset under I.R.C. § 1221 during the taxable year and owns that stock on the last day of the taxable year, it will be presumed, solely for purposes of determining whether that stock should be classified as investment capital after it is acquired, that the taxpayer held that stock for more than one year.
    - Adding that if the taxpayer does not in fact own the stock at the time it actually files its original report for the taxable year in which it acquired such stock, then the presumption in the preceding sentence does not apply and the actual period of ownership would be used to determine whether the stock should be classified as investment capital after it is acquired.
- Removing the subtraction of hedging losses and expenses from the computation of nontaxable investment income (the original provision essentially would have disallowed those expenses).
- Adding a limitation on investment income such that if the taxpayer's investment income determined without regard to attributed interest deductions comprises more than 8% of the taxpayer's entire net income, investment income determined without regard to such interest deductions cannot exceed 8% of the taxpayer's entire net income (determined on a combined group basis where applicable).
    - Adding that the election to reduce investment income by 40% in lieu of interest attribution is revocable (which revocation must be consistent with a revocation of such election in computing exempt CFC income and exempt unitary corporation dividends) and is determined after applying the 8% limitation noted above.
- Deleting a provision that permitted the exclusion from entire net income of a New York City refund or credit relating to the New York State stock transfer tax.
- Clarifying that, for purposes of computing the residential and small business loan subtraction modification for certain community banks and small thrifts, the $8 billion asset qualifying test for a combined group applies if the taxpayer is included in a combined report and the assets of the combined group do not exceed $8 billion and clarifying generally that the modifications for certain community banks and small thrifts do not reduce the numerator and denominator of the apportionment fraction.
- Clarifying that only unitary group members that meet the ownership test under Article 9-A (more than 50% voting power ownership) are considered in applying the aggregate bright-line economic nexus tests. In other words, only the New York receipts of $10,000 or more of unitary group members would be aggregated to determine whether the $1 million or more bright-line nexus threshold is met.
    - Excludes from the application of the bright-line economic nexus test corporations that are not permitted to be included in a combined report under Article 9-A that otherwise could be considered unitary (*e.g.*, corporations taxed under Article 9 or Article 33).
- Clarifying that a non-U.S. corporation qualifying for New York's self-trading exemption would not be deemed to be subject to the bright-line economic nexus rules if its activities are limited to self-trading.
- Clarifying that for purposes of qualifying as a "qualified New York manufacturer" (for a 0% tax rate on the business income base), a combined group filing a combined report would be required to meet the "principally engaged" test on a combined basis.
- Limiting the type of New York property required in order to qualify as a qualified New York manufacturer (for income tax, capital tax, and fixed dollar minimum tax purposes) to New York ITC property that is "principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing," whereas the New York property requirement previously had been satisfied with any New York ITC property (such as research and development property).
- Establishing a capital base rate of 0.132% for tax years beginning in 2015 for qualified New York manufacturers and Qualified Emerging Technology Companies ("QETCs"); adding new fixed dollar minimum tables for S corporations that are qualified New York manufacturers or QETCs; adding that with respect to qualified New York manufacturers, the fixed dollar minimum tables apply in the case of a combined report only if the combined group satisfies the requirements to be a qualified New York manufacturer.
- Clarifying that the deduction related to pre-2015 net operating losses (the Prior Net Operating Loss Conversion, "PNOLC," subtraction) can be claimed only until the calculated pool of pre-2015 net operating

losses is exhausted, and, except where the taxpayer elects to use its entire pool of pre-2015 net operating losses in 2015 and 2016 (as elected on its first return for the 2015 tax year), the taxpayer may carry forward the PNOLC subtraction pool for no longer than 20 taxable years or until the 2035 tax year, whichever comes first.

- Clarifying that an NOL must be carried back to the earliest year first; and providing that a taxpayer may make an irrevocable election (which would apply to all members of a combined group) on an original timely filed return determined with regard to extensions (a separate election for each loss year) to waive the entire carryback period.

- Amending the apportionment provisions:
  - Clarifying that a qualified financial instrument ("QFI") means a specified type of financial instrument that has been marked to market in the taxable year by the taxpayer under I.R.C. §§ 475 or 1256; provided that, if the taxpayer has in the taxable year marked to market such a specified financial instrument, then any financial instrument within that type that has not been marked to market by the taxpayer under I.R.C. §§ 475 or 1256 is a QFI in the taxable year. If a corporation is included in a combined report, QFI status would be determined on a combined basis.
    - Providing that stock that is investment capital is not a qualified financial instrument.
    - Clarifying that a loan "secured by real property" (where 50% or more of the collateral used to secure the loan based on fair market value at inception consists of real property) is not a QFI and if the only loans that are marked to market by the taxpayer under I.R.C. §§ 475 or 1256 are loans secured by real property, then no loans are QFIs.
  - Clarifying that the fixed percentage method for determining the inclusion of receipts and net gains from qualified financial instruments shall be elected on an original timely filed return determined with regard to extensions.
  - Deleting "the location of the treasury function of the business entity" as the first level in the hierarchy for purposes of determining commercial domicile in sourcing receipts from financial transactions, so that now the first level in the hierarchy is the seat of management and control of the business entity.
  - Adding apportionment provisions for marked-to-market net gains of certain financial instruments, receipts from the operation of vessels, and receipts from qualified air freight forwarders.
- Eliminating the requirement that the designated agent of a combined group, a taxpayer which acts on behalf of the members of the group relating to the combined report, must be the parent corporation.
- Clarifying that the commonly owned group election (permitting qualifying nonunitary groups to file a combined return) is made on a timely filed return of the combined group, determined with regard to extensions.

These changes contained in the legislation would be effective as if originally enacted as part of the 2014 Tax Reform, which generally would be for tax years beginning on or after January 1, 2015.

Changes to Sales and Use Tax Provisions

The more significant pending New York State sales and use tax changes include the following:

- Expanding the sales and use tax exemption for residential and commercial solar equipment to include electricity that is purchased from a seller primarily engaged in the sale of solar energy systems equipment and/or electricity generated by such equipment if the electricity is sold under a written agreement and is generated by equipment that is: (1) owned by a person other than the purchaser of the electricity; (2) installed at the purchaser's residence or non-residential premises; and (3) used to provide heating, cooling, hot water or electricity.
  - This provision additionally amends existing local option provisions to include the expanded exemption and would take effect on December 1, 2015.
- Adding "prepaid mobile calling services" to the definition of "prepaid telephone calling service" in order to clarify that retailers must apply the same rules that they apply to prepaid telephone calling services in determining the incidence of the sales tax.
  - The rule that the sale is sourced to the location of the retailer where the customer bought the service, whether the customer is initiating the account or recharging an existing account there, would generally apply.
  - This provision would take effect immediately.

- Exempting from New York use tax beer, cider and liquor used at tastings held in conformity with the Alcoholic Beverage Control Law, as well as several types of items used to package such beverages.
    - This provision would take effect June 1, 2015, and would apply in accordance with the transition provisions in §§ 1106 and 1217 of the New York Tax Law.
    - Clarifying that, in addition to wine and wine product, certain types of items used to package such wine or wine product furnished to customers for a wine tasting held in accordance with the Alcoholic Beverage Control Law are exempt from sales tax. This provision would take effect immediately.
- Exempting from sales and use tax receipts in excess of $230,000 from the sale of a "vessel." The term "vessel" has the same meaning as defined in New York Vehicle and Traffic Law § 2250 and includes an outboard motor or trailer as defined in New York Vehicle and Traffic Law § 156, when sold in conjunction with such vessel. This provision would take effect June 1, 2015.
- Exempting from the sales and use tax general aviation aircraft and machinery or equipment to be installed on such aircraft. General aviation aircraft is defined as aircraft that is used in general aviation and that is not commercial aircraft as defined in Tax Law § 1101(b)(17). This provision would take effect September 1, 2015.
- Exempting from sales and use tax the sale of tangible personal property and the sale of services (that are otherwise taxable) to a related person when: (1) (i) the vendor and the purchaser are referenced as either a "covered company" or a "material entity" as described in the code of federal regulations in a resolution plan that has been submitted to a U.S. agency for the purpose of satisfying the Dodd-Frank Wall Street Reform and Consumer Protection Act, or (ii) the vendor and the purchaser are separate legal entities pursuant to a divestiture directed pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act; (2) the sale would not have occurred between such related entities if not for the resolution plan or divestiture; and (3) in acquiring such property or services, the vendor did not claim an exemption from the tax. This provision would take effect on the first day of a sales tax quarterly period, next commencing at least 90 days after the date of enactment.

Changes to Tax Credits

The more significant pending changes to tax credits include the following:

- Changing the name of the New York Youth Works Tax Credit Program to the Urban Youth Jobs Tax Credit Program and decreasing the allocation of tax credits under each of programs three, four and five from ten million dollars each to twenty million dollars collectively. This change would be effective immediately.
- Modifying the Brownfield Clean-up Program, generally effective July 1, 2015, or on the date published in the state register, including:
    - Amending the definition of Brownfield site to mean real property where a contaminant is present at levels exceeding certain soil clean-up and health-based or environmental standards;
    - Creating new credit terminology that may affect eligibility and to be further defined by regulation including: "upside down," "underutilized," and "affordable housing projects;"
    - Excluding from eligibility amounts paid to related parties except that related-party service fees may be allowed in the calculation of the tangible property credit component;
    - Adding the BCP-EZ program, which will provide for the expedited investigation and/or remediation of contamination at Brownfield sites and eligibility to receive a certificate of completion, but such certificate will not entitle the holder to tax credits; and
    - Making tax credits under the program available to projects that are accepted into the Brownfield Clean-up program by December 31, 2022, and requiring that certificates of completion be received by March 31, 2026.
- Providing that the investment tax credit applicable to certain financial institutions may not be taken for property first placed in service on or after October 1, 2015, and restoring to the statute providing such credit, language permitting the aggregation of use by certain affiliates to meet the statutory use requirement. This change would be effective immediately.
- Amending, effective immediately the Excelsior Jobs Program ("EJP") tax credit to include businesses operating predominantly as "entertainment companies" or in "music production" as new categories of businesses eligible for the program.
    - "Entertainment companies" are defined as entities engaged in the production of motion pictures, televised commercial advertisements, animated films, music videos, television programs, radio

production, and video game production, among others. The term does not include an entity principally engaged in the live performance of events.
    - “Music production” is defined as the process of creating sound recordings of at least eight minutes, recorded in professional sounds studios, intended for commercial release. Music production does not include the recording of live concerts or recordings that are primarily spoken word or wildlife or nature sounds or produced for instructional use or advertising or promotional purposes.
    - An entertainment company must create at least 100 net new jobs, while a music production entity must create at least five net new jobs to be eligible for the program.
- Amending the EJP tax credit to include a new category of regionally significant project for entertainment companies that create or obtain at least 200 net new jobs and make significant capital investment in the state. This change would be effective immediately.
- Amending the EJP tax credit definition of software development to include production or post-production of video games other than those embedded and used exclusively in advertising, promotional website or microsites. This change would be effective immediately.
- Creating the Employee Training Incentive Program, which would convey refundable tax credits for qualified activities equal to 50% of eligible training costs, for a maximum credit of up to $10,000 per eligible employee receiving training. This change would apply to taxable years beginning on or after January 1, 2015, and to eligible training costs incurred on or after the effective date of the legislation.
- Modifying the calculation of the credit for alternative fuel vehicle refueling property and electric vehicle refueling property to exclude costs of grants awarded before January 1, 2015.

Mobile Telecommunication Services

The pending law would levy taxes under New York Tax Law §§ 186-e and 186-c (an excise tax of 2.9% of gross receipts on the sale of mobile telecommunication services provided by home service providers where the mobile telecommunication customer’s place of primary use is in New York and the related Metropolitan Commuter Transportation District surcharge) beginning on or after May 1, 2015.

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