

New York City Proposes Corporate Tax Reform

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Overview

On January 12, 2015, New York City Mayor Bill de Blasio proposed major reforms of the New York City corporate tax structure. The proposed reforms were included in Governor Cuomo's 2015-2016 Executive Budget released on January 21, 2015.¹ If enacted into law, the proposed reforms would bring the New York City General Corporation Tax into substantial conformity with the New York State corporate franchise tax reforms enacted in 2014.² However, unlike the State's enacted corporate reform, the New York City reform proposals do not contain an income tax rate reduction for all corporate taxpayers and do not call for the reduction and ultimate elimination of the alternative tax base on capital. Also, the proposals do not modify New York City's unincorporated business tax ("UBT") and do not appear to apply to federal subchapter S corporations or subchapter S subsidiaries, which would continue to be taxed in accordance with the currently-applicable, pre-reform provisions. The reforms, as contained in the proposed draft legislation, are intended to be revenue neutral and, if enacted, are expected to be retroactive to January 1, 2015. In this Tax Alert we summarize the more significant proposed law changes.

Proposed New York City Corporate Tax Reforms³

The more significant proposed reforms to New York City's corporate tax structure include the following:

- Merging the bank tax and corporate franchise tax for large corporations (C-Corporations)
- Adopting a broad-based, bright-line nexus concept such that corporations with sales of \$1 million or more to New York City customers during the tax year would be subject to tax
- Adopting general customer-based (market) sourcing of receipts and specific sourcing rules for digital products and financial service receipts, while maintaining the schedule under current law to phase-in single sales factor apportionment by 2018
- Limiting what constitutes investment capital and investment income (generally, dividends and gains from stock of non-unitary corporations held for more than six months and income that New York City is prohibited from apportioning as business income under U.S. Constitutional principles) and modifying existing expense attribution rules so that only interest expense attributable to non-taxable investment or exempt income would be subject to disallowance (similar rules would apply with respect to attributing liabilities to non-taxable investment capital)
 - Also, the proposed law would create a safe harbor election whereby aggregate non-taxable investment and exempt income would be reduced by a flat 40% amount in lieu of being subject to interest expense attribution (except that certain dividends would not be eligible for the 40% safe harbor)
- Changing the starting point for computing New York City taxable income for alien (non-US) corporations with New York City nexus from world-wide taxable income to federal "effectively connected income" (ECI), determined without regard to tax treaties
- Changing the net operating loss ("NOL") provisions from a pre-apportioned to a post-apportioned computation, ending the requirement that New York City NOL usage be limited to the corresponding amount of federal NOL usage, and providing transition rules for converting NOL deductions from pre-tax reform years for use in subsequent tax years

¹ See Part QQ of the 2015-2016 New York State Executive Budget, Revenue Article VII Legislation, which can be accessed at: <https://www.budget.ny.gov/pubs/executive/eBudget1516/fy1516artVIIbills/REVENUEArticleVII.pdf> . The 2015-2016 Executive Budget also includes technical changes to New York State corporate franchise tax reforms enacted into law in 2014. A separate Tax Alert will address those proposed changes.

² Our April 1, 2014 Tax Alert, *Sweeping New York State Tax Reforms Enacted*, is available [here](#).

³ The listed reforms are based on proposed draft legislation that is subject to change and final enactment.

- Providing a three-year carryback for NOLs incurred in post-reform taxable years, provided that no NOL can be carried back to a taxable year beginning before January 1, 2015 (the carryforward period would remain at 20 years)
- Adopting full water's-edge unitary combined reporting with a greater than 50% ownership test and an election to permit combined filing for certain commonly owned groups with a seven-year lock-in period
- Reducing the rate from 8.85% to 6.5% for small *non*-manufacturers with less than \$1 million of allocated business income (determined without taking into account pre-2015 NOLs computed using transition rules)
- Reducing the rate from 8.85% to 4.425% for small manufacturers with less than \$10 million of allocated business income (determined without taking into account pre-2015 NOLs computed using transition rules)
 - The proposed law would also provide a smaller rate reduction for manufacturers with allocated business income (determined without taking into account pre-2015 NOLs computed using transition rules) of \$10 million or greater but less than \$20 million
- Retaining the alternative tax base on capital and increasing the tax cap from \$1 million to \$10 million
 - The proposed law would also exclude the first \$10,000 of capital tax base
- Eliminating the additional tax on subsidiary capital and eliminating most exclusions for income from subsidiaries, while retaining an exemption for dividends and "CFC income" (defined by reference to IRC § 951(a)) from unitary subsidiaries
- Eliminating the alternative tax base equal to 8.85% on 15% of the excess of (a) net income plus the amount of salaries or other compensation paid to any person, including an officer, who at any time during the taxable year owned more than five percent of the taxpayer's issued capital stock over (b) a specific exemption amount (\$40,000)
- Increasing the cap on the alternative "fixed dollar" minimum tax to \$200,000 for taxpayers with New York City gross receipts over \$1 billion, with incremental increases of the fixed dollar minimum over the current cap of \$5,000 where New York City gross receipts are over \$50 million and not over \$1 billion
 - Since the tax due on a combined report includes the fixed dollar minimum tax for each taxpayer member of the New York City combined group other than the designated agent, the increased fixed dollar minimum amounts would apply to each taxpayer member of the New York City combined group other than the designated agent
- Permitting New York City to make adjustments to the apportionment of income or capital as originally filed where an assessment is made under the extended statute of limitations applicable in the event of a federal or New York State change to income (or in certain other situations) to the extent based on such federal or New York State change to income and permitting taxpayers to make the corresponding changes to the apportionment factor as originally filed with regard to a claim for refund of such assessment
- Continuing certain significant tax credits including the New York City Relocation and Employment Assistance Program ("REAP") credit, the Lower Manhattan REAP credit, the Industrial Business Zone Tax Credit, and the New York City Biotechnology Credit.

Considerations

If adopted into law, the proposed changes would apply retroactively to January 1, 2015, to align with the New York State changes that were enacted last year. Tax law changes to the New York City Administrative Code must be adopted by the New York State legislature and approved by the New York State Governor.

As noted above, under the proposed changes New York City would not conform the taxation of federal S corporations and the UBT to the New York State Tax Reform changes. In light of this potential nonconformity, taxpayers may wish to consider whether their choice of business entity is the most appropriate for their business and tax circumstances.

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