New York Tax Reform

A Practical Review

Presented by

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Introduction

- Corporate Tax Reform was signed into law as part of the 2014-15 New York State budget bill on March 31, 2014
- Most provisions effective for tax years beginning after January 1, 2015
- Most significant corporate tax changes since 1987
- NYC has not yet conformed its Code to the new measures

Summary of Topics

- Part 1: Structural and computational reforms
- Part 2: Classification and apportionment
- Part 3: New Combined Reporting rules
  - And a few other changes not previously mentioned

Part 1
Structural and Computational Reforms

Structural/Computational Reforms

- Article 32 (Bank Franchise Tax) merged into Article 9-A (Corporate Franchise Tax)
  - Pre-2015 law
    - Banks used 3-factor (payroll, receipts, deposits) apportionment, deduction of 22.5% interest income attributable to federal/NY obligations, and exclusion of income/expenses from International Banking Facilities
  - A separate Bank Tax seen as unnecessary following Gramm-Leach-Bliley
  - Banks paid a disproportionately large share of corporate taxes under the old rules

Structural/Computational Reforms

- Article 9-A is streamlined
- Pre-2015 law
  - Tax on highest of four bases

ENI, capital, AMTI, fixed dollar minimum + tax on subsidiary capital + MTA surcharge (if applicable) based on a "hold harmless" calculation

Structural/Computational Reforms

- New law
  - AMTI base eliminated
  - Capital stock base remains but phased out by 2021
  - Business income now the primary tax base
  - No separate tax on subsidiary capital
  - MTA surcharge survives but with simplified calculation

Structural/Computational Reforms

- Pre-2015 law
  - Physical presence required with very limited exceptions
    - Credit card companies
    - Foreign corporate part

Structural/Computational Reforms

- New law
  - Economic nexus rules can apply without physical presence
    - Applies to any taxpayer with $1M+ in NY receipts
    - For combined reporting group, threshold is met by aggregating all members of group with $10,000+ NY receipts
    - Does not override PL 86-272
    - Fulfillment service nexus exception eliminated
- Will new rules hold constitutional water?

Alien Corporations

- Pre-2015 law
  - Subject to tax on worldwide income if nexus in NY
- New law
  - Not subject to Article 9-A tax if:
    - Not deemed domestic under IRC (e.g., “stapled stock” entities; or
    - Has no ECI (effectively connected income)
  - If subject to tax, base includes ECI only
  - Cannot be part of combined reporting group if not subject to Article 9-A

Business Income Base Tax Rates

	2014 (tax rate for ENI)	2015	2016	2017	2018 and beyond
Qualified NY Manufacturers	3.25%	0.0%	0.0%	0.0%	0.0%
Qualified Emerging Technology Companies	0.0%	5.7%	5.5%	5.5%	4.875%
Small Businesses	6.5%	6.5%	6.5%	6.5%	6.5%
Remaining Taxpayers	7.1%	7.1%	6.5%	6.5%	6.5%

Examples
Economic Nexus

- A foreign franchisor with no physical presence in NY receives royalties from a NY franchisee in excess of $1M
- A foreign corporation sells digital products to customers headquartered outside of NY (and with no NY physical presence), but where the products will be primarily used by the customers' NY employees (meeting the $1M threshold)

Examples
Alien Corporation

- A Canadian corporation with no PE sends salespeople into NYS
  - Under prior law, it would file a NY income tax return and calculate the tax on each of the 4 bases using worldwide figures
  - Under the new law, it would only be required to file an income tax return in NYS if ECI
  - A NYC GCT return could still be required even if no ECI!

Attendance Validation #1

Please locate your
Attendance Validation Form

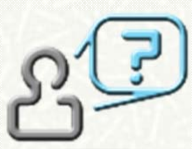
(it should be the 4th page in your Handout Materials)

physical presence

Keep this form handy! We'll have two more attendance validation items for you to write down later in today's webinar.

REMINDER!

You can e-mail your questions during today's seminar to be passed along to our presenter for response during the Q&A session -



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Part 2
Classification and Apportionment

Classification

Pre-2015 Law

- Corporations calculate ENI from federal taxable income (or worldwide income) with modifications
- Separate apportionment of business income and investment income
- Exclusion of income, gain, losses from subsidiary capital and expenses directly or indirectly attributable to subsidiary capital

Classification

<u>New Law - Primary Base is Business Tax Base</u>

- Tax = Rate x BAP x (ENI – investment income – other exempt income)
- Eliminates exemption for income from subsidiary capital and for 50% of dividends received from non-subsidiaries
- No add back of foreign taxes paid
- Alien corporations with ECI disregard treaty benefits

Classification
Investment Income

Under Pre-2015 Law

- Includes all income from "investment capital"
- Taxpayer could elect to treat cash as investment or business income
- Apportioned using issuer's allocation percentages
- Litigation involving categorization
  - See *Xerox v. NY*

Classification
Investment Income

Under New Law

- Not subject to tax
- Now a much narrower category
  - Only includes income from stocks of non-unitary corporations held for more than 6 consecutive months (measured across tax years)
- Income from subsidiary capital is not investment income
- No election to treat cash as investment income
- Exception for income from other securities/debt obligations that cannot be constitutionally apportioned to NY

Classification
Other Exempt Income

- CFC income
- Dividends from a unitary corporation not part of the combined group
  - e.g., dividends from Article 9 or Article 33 corporation

Classification
Expense Deductions

- Under Pre-2015 Law
  - Expenses allocated to business, investment or subsidiary income
- Under New Law
  - No deduction for interest or other expenses attributable to non-taxable income
    - i.e., investment and other exempt income
  - Election to reduce non-taxable income by 40% (thereby increasing taxable income) in lieu of attributing expenses

Classification
Royalty Add Back

- See attached article in Handouts
- 2013-14 budget eliminated the royalties received deduction and required NY taxpayers to add back royalties paid from a related member unless one of four exceptions applied
  1. The conduit exception
  2. The subject-to-tax exception
  3. The treaty exception
  4. An exception based on an agreed-to alternative methodology

Treaty Exception

- Executive budget proposed to eliminate the treaty exception but final bill kept 2013 law intact

Attendance Validation #2

Time to record our second attendance check item on your Attendance Validation Form

subsidiary capital

Keep this form handy! We'll have one more attendance validation item for you to write down later in today's webinar.

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Take a Break!

Return in 5 Minutes

The program will resume promptly after 5 minutes.

Apportionment

- Still receipts only
  - Now applies to banks
- Market-based sourcing for all receipts
  - No longer based on where services are performed
  - Eliminates much of the controversy for "other business receipts" in the e-commerce realm?
- More specific framework/process for determining source
- May elect to apportion 8% of all QFI income in lieu of sourcing

Apportionment

Hierarchy for Sourcing Digital Products

1. Location of primary use
2. Location where product is received by the customer
3. Prior year's apportionment factor for the digital product
4. Current year's apportionment factor for other digital products that can be sourced using the hierarchy

Examples

Classification of Income

A financial services company with its sole offices in NYS and customers primarily outside of NY sells securities held for 4 months and an interest in a non-unitary partnership

Examples
Apportionment

An accounting PC operating as a C corporation earns fees from clients across the country for work performed by its employees in its sole office in NYC. Only 10% of its revenue is from New York clients

- Apportionment under the pre-2015 law?
- Apportionment under the new law?
- Apportionment under the NYC general corporation tax?

Part 3
Combined Reporting and Other Miscellaneous Changes

Combined Reporting
Pre-2015 Law

Combined reporting mandatory for non-alien general business corporations that

- Are engaged in a unitary business
- Meet an 80% ownership requirement
- Engage in substantial inter-corporate transactions or have a distortive relationship (maybe)

Combined Reporting
New Law

- Unitary water's edge combined reporting
- Test is unitary business + 50% stock ownership

Say goodbye to substantial inter-corporate transactions test

The end of decombination audits?

The beginning of unitary business audits?

Combined Reporting

- Mandatory combination for certain alien corps, captive REITs or RICs not combinable under Article 33, and combinable captive insurance corps that meet the test
- 7-year irrevocable election for permissive combined reporting group including non-unitary corporations
  - Renewed unless revoked
  - Must include all corporations that meet the stock ownership test and are combinable under the law

Net Operating Losses
Pre-2015 Law

- Based on federal NOLs
- Computation of NOLs is pre-apportionment
- Resulted in “double tracking” of NOLs

Net Operating Losses
New Law

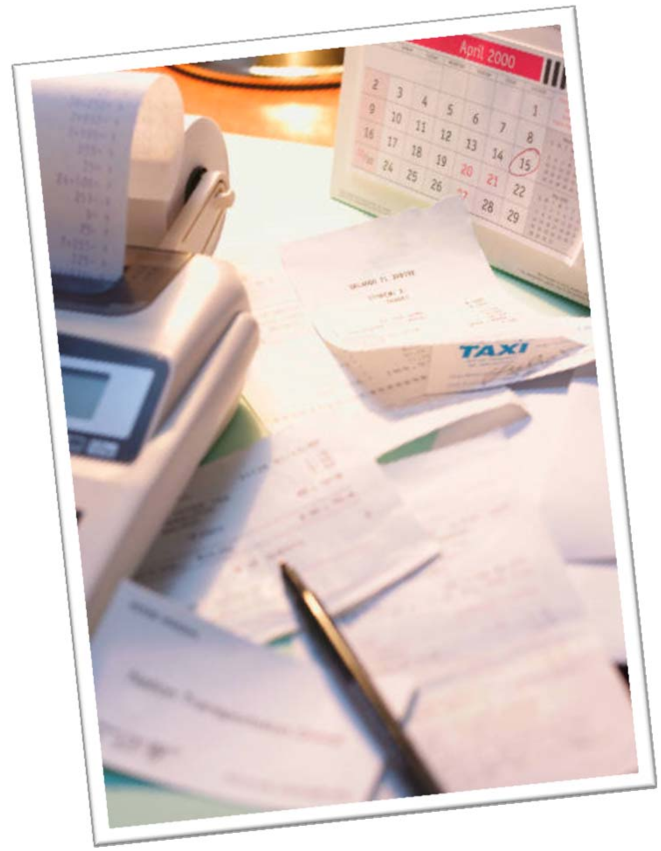
- NOLs incurred beginning on or after 2015
  - Post-apportionment computation
  - 3-year carryback
    - But not before 2015
  - 20-year carryforward
  - Deduction not limited by federal source year or amount

Net Operating Losses

- Prior Net Operating Loss Conversion (PNOLC) Subtraction
  - All unabsorbed NOLs incurred before 2015
  - PNOLC Subtraction Pool = [(2014 BAP) x (2014 tax rate) x (unabsorbed NOLs)] /6.5
    - Use 1/10 of pool per year over 20 years; OR
    - Use ½ of pool in 2015 and ½ in 2016

Miscellaneous
MTA Surcharge

- Base is current year NYS tax before credits
- $1M in-district receipts threshold
- 3-factor formula to apportion to MTA
- 2015 rate increased to 25.6% (to be adjusted annually)



Examples
Combination

- Which of the following related corporations would be combined with an existing Article 9-A taxpayer ("A") under the new rules?
  - Corporation "B" which is engaged in a unitary business with "A" but does not meet the common ownership requirements with "A"
  - "B" however, is related to "C" which is engaged in a unitary business with both "A" and "B"
  - An overcapitalized captive insurance company
  - A related holding company

Examples
NOLs

- A taxpayer has $10M in unabsorbed NOLs as of the end of 2014
- How is the PNOLC calculated?

Attendance Validation #3

Here is the 3rd and FINAL attendance validation for today's webinar.

treaty exception

Question and Answer Session

You can e-mail your questions to

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Please limit your questions to only topics discussed during today's presentation.

CONCLUSION

Thank you for attending today's program

Featured Upcoming Program

Athletes and Entertainers -
Multistate Tax Issues

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Thursday, June 26, 2014