New York Budget Bill: The Sequel

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In this article, the authors review New York's recently passed fiscal 2016 budget, comparing it with the proposed budget as well as to last year's enacted budget. They highlight several noteworthy provisions in this year's law, including a change to the definition of investment capital and the surprising sales and use tax carveout for yacht purchases.

With only days to spare before the April 1 deadline for passing an on-time budget, New York Gov. Andrew Cuomo (D) and the state's legislative leaders announced on March 29 that they had come to an agreement on the fiscal 2016 budget. As in years past, this year's spending plan was first drafted by Cuomo in his 2015-2016 proposed executive budget, which, after weeks of negotiations, tweaks, cuts, and additions, resulted in a final budget bill.

As many readers will recall, New York's 2015 state budget implemented major (and much-applauded) changes to the state's corporate franchise tax regime,[1] so this year's legislation had a tough act to follow. Admittedly, not all sequels disappoint (*The Godfather Part II* and *Indiana Jones and the Temple of Doom* come to mind), but many do. And while we hesitate to equate the New York state budget with a major motion picture (we don't know many people willing to pay $14.50 to read a piece of fiscal legislation), when the plan is seen as a sequel to last year's budget, its comprehensive revisions to New York state's corporation franchise tax make this year's bill more *Jaws 2* than *The Empire Strikes Back*. Nevertheless, there are numerous notable provisions in the new bill, and we've done our best to highlight what made the final cut. With that preview, sit back, grab your popcorn, and allow us to highlight what's in and what's out of this year's state budget.

I. What's In

A. Amendments to Last Year's Corporate Tax Reform

As mentioned above, last year's fiscal 2015 budget legislation included comprehensive revisions to New York state's corporation franchise tax (article 9-A). Those revisions went into effect for tax years beginning on or after January 1, 2015. This year's budget contains several provisions meant to clarify last year's legislation. Perhaps not surprisingly, many of those "clarifications" seek to limit some of the tax benefits in last year's reform legislation.

1. Changes to the Definition of Investment Capital

The 2014-2015 budget bill exempted from article 9-A taxation income from investment capital but limited the types of assets that qualify as such. Investment capital was limited to certain investments in the stock of non-unitary, noncombined corporations but only if the stock was held for at least six consecutive months.[2] Stock "held for sale to customers in the regular course of business" does not qualify as investment capital.

The new budget bill adds additional limitations to the definition of investment capital. First, the stock must now be held for more than one year to qualify as investment capital, and the stock must qualify as a capital asset under IRC section 1221.[3] Moreover, for stocks acquired on or after October 1, 2015, taxpayers must clearly identify the stock in their records as stock held for investment. This recording must occur before the close of the day on which the stock was acquired. In other words, businesses will be unable to sit back and relax after a stock purchase. Instead, they'll have a new administrative burden to worry about. And for stocks acquired on or after January 1, 2015, the stock must never (as in ever) have been held for sale to customers in the regular course of the taxpayer's business.[4]

[1]Christopher L. Doyle, Timothy P. Noonan, and Elizabeth Pascal, "New York Budget Bill Proposes Many Corporate Tax Changes," *State Tax Notes*, Mar. 3, 2014, p. 525.

[2]Tax Law section 208.5 (current).
[3]Tax Law section 208.5(a) (as revised).
[4]Tax Law section 208.5(a) (as revised).

Finally, investment income (that is, income from investment capital) is also now limited to no more than 8 percent of entire net income.[5] While this provision appears reasonable on its face, consider a corporation that has the vast majority of its income as investment income: Before 2015, a very small amount of that investment income would have been taxed due to the application of New York's favorable investment allocation percentage — from January 1 through April 1, 2015, the law proscribed any taxation of that income. Now, however, 92 percent of that income will be taxed in New York, subject to the application of New York's business allocation percentage. We guess Warren Buffett won't be moving Berkshire Hathaway to New York anytime soon.

2. Clarifications to Economic Nexus

As was widely reported, last year's budget legislation expanded the list of activities that cause a corporation to be subject to New York state's franchise tax by adding the activity of "deriving receipts from activity in this state."[6] This economic nexus standard requires corporate taxpayers to file an article 9-A return if the taxpayer has at least $1 million in receipts sourced to New York based on the market-based apportionment provisions included in Tax Law section 210-A. Alternatively, if a taxpayer has at least $10,000 in receipts sourced to New York and the total New York receipts of related corporations that are a part of the taxpayer's combined reporting group are at least $1 million, the taxpayer is considered to be "deriving receipts from activity in" the state and must file an article 9-A return.[7]

The new budget bill clarifies that for purposes of aggregating multiple corporations' receipts, only receipts of corporations in a unitary group (as opposed to a combined reporting group) that meet the ownership requirements contained in the mandatory combined filing provisions under Tax Law section 210-C.2 are aggregated for purposes of the $1 million economic nexus threshold.

3. Qualified New York Manufacturers

Last year's budget established a 0 percent business income tax rate and a capital base cap of $350,000 for "qualified New York manufacturers." Under both the business income and capital bases, there are two ways to meet the definition of a qualified New York manufacturer: (i) the "principally engaged" test, which looks to the taxpayer's in-state receipts and property; and (ii) an alternative test that looks to in-state employment and property.

The property component of the principally engaged test has two requirements. First, the corporation must have property eligible for the investment tax credit (Tax Law section 210-B.1). Second, the corporation must meet one of the following two requirements: either (a) have adjusted basis for federal income tax purposes in qualifying property of at least $1 million, measured on the last day of the tax year, or (b) have all its real and personal property located in New York.[8] The budget bill restricts the type of property that qualifies under the principally engaged test to property described in Tax Law section 210-B.1(b)(i)(A) — that is, to property "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."[9] This is a smaller subset of the broader list of ITC property, which constitutes qualifying property under current law.

B. Sales and Use Tax Carveout for Yachts and Aircraft

One provision sure to make an unexpected splash is the sales and use tax carveout for purchases of yachts. Under a new provision in Tax Law section 1115, any amount above $230,000 spent for the purchase of a "vessel" (that is, a really fancy boat) is exempt from sales tax.[10] New York will also still give taxpayers a credit for sales tax paid on the vessel to another state, but that credit is computed only with regard to the tax due and paid to the other state on the same $230,000 cap. For example, if a taxpayer pays sales tax to Florida on the full purchase price of the yacht, he is entitled to a credit only on the tax paid on the first $230,000 of the purchase price. Senate Republicans and Democrats have supported this provision as a job creation measure.

Another unexpected perk of the new law is that the compensating use tax will not apply to the use of yachts within New York until the vessel is used for 90 consecutive days in the state or is registered in the state.[11] Previously, taxpayers who brought their yachts into New York for even one day could be subject to use tax on the full purchase price of the vessel. But now it looks like there are smoother waters ahead. Ahoy!

Even more surprising-and something that has generated very little fanfare-is a new exemption added under Tax Law section 1115 for general aviation aircraft, which is defined to include all aircraft "used in civil aviation," except for commercial aircraft used to transport persons or property for hire. So apparently that means that the sale or use of recreational aircraft in New York will no longer be taxable at all! Are you kidding me? This is a huge shift in the law, and was basically buried in the section of the bill outlining the yacht changes.

C. Extending the Limitation on Charitable Contributions

The budget also extends the charitable tax deduction limitations for millionaires. Individuals who make between $1 million and $10 million are allowed to take itemized

[5]Tax Law section 208.6(a) (as revised).
[6]Tax Law section 209.1(a) (current).
[7]Tax Law section 209.1(d) (current).
[8]Tax Law section 210.1(a)(vi) (current).
[9]Tax Law section 210.1(a)(vi) (as revised).
[10]Tax Law section 1115(jj) (as revised).
[11]Tax Law section 1118(13) (as revised).

deductions equal to 50 percent of their charitable contributions until 2017.[12] Individuals who make more than $10 million are allowed itemized deductions equal to 25 percent of their charitable contributions until 2018.[13]

D. Beer-Tasting Exemption

First we get special rules for yachts. Now beer? Under current New York law, a wine seller (not to be confused with a wine cellar) generally owes use tax when it takes property out of inventory for its own use. But an exemption is provided for wine or wine product furnished by the official agent of a winery, farm winery, wholesaler, or importer at wine tasting events.[14] This use tax exemption is now extended to products used at other tasting events, including those hosted by licensed breweries and cider producers.[15]

E. Excelsior Jobs Tax Credit Program Opened to Entertainment and Music Companies

The budget bill amends the Excelsior Jobs Program to allow some entertainment and music companies to participate in the tax credit program.[16] The Excelsior Jobs Program provides job creation and investment incentives to companies in targeted industries to create and maintain new jobs in the state. A company that has been accepted to participate in the Excelsior Jobs Program may qualify for fully refundable tax credits claimed over 10 years. Now, entertainment companies and businesses engaged in music production are eligible for the credit. The term "entertainment company" includes entities "principally engaged in the production or post production" of motion pictures, televised commercial advertisements, animated films or cartoons, music videos, television programs, and radio programs.[17] Music production is "the process of creating sound recordings of at least eight minutes, recorded in professional sound studios, intended for commercial release." The term does not include "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."[18]

F. Employee Training Incentive Program

The budget also adds a new article 22 to the Economic Development Law, creating an employee training incentive program. To receive credits under the program, training must "upgrade, retrain or improve the productivity of employees."[19] Training that results in the issuance of a license or certification is not eligible. Internship credits are available only for internships in "advanced technologies" and are capped at $1 million.

G. Extended Warrantless Wage Garnishment

Tax Law section 174-c, enacted into law as part of the 2013-2014 budget, allows the commissioner to serve income executions on individual tax debtors and their employers without having to docket a public tax warrant (that is, a lien) with the appropriate county clerk's office and the Department of State. This warrantless income execution provision was set to expire on April 1, 2015, but will now remain in effect until April 1, 2017.

II. What's Out

As mentioned above, the final budget bill was a byproduct of Cuomo's fiscal 2016 proposed executive budget. The governor's proposal contained several noteworthy provisions that (in many cases, thankfully) did not make it into the final bill.

A. No Expansion of Sales Tax Collection Requirements to Marketplace Providers

Under current state law, the responsibility to collect and remit sales taxes on taxable in-state sales is limited to vendors.[20] A vendor is generally defined as a person "making sales" that has a sufficient connection to New York to require it to collect and remit sales tax on sales to customers in the state.[21] In some circumstances, an agent of the vendor can be treated as a co-vendor, who will have joint responsibility for collecting and remitting the tax.[22]

Because vendors are defined as the persons actually making sales, a party that merely facilitates a sale between a seller and a buyer through a physical or online marketplace is not a vendor and does not have tax collection responsibilities. The proposed executive budget sought to change this structure, but Cuomo's suggestion failed to receive the support of lawmakers. The proposed changes would have placed the burden of collecting tax on sales facilitated through an online or physical marketplace on the marketplace provider. Stay tuned on this issue, though. New York has long been a leader in taxing online transactions.[23] And in the past, controversial provisions have been floated as test balloons to gauge public or commercial reaction. It's possible some version of this provision could show up in a subsequent budget.

B. Alleged Sales and Use Tax Avoidance Strategies

The proposed budget also sought to eliminate various perceived sales and use tax avoidance strategies. Those proposals would have primarily affected transactions between

[12]Tax Law section 615(g)(1) (as revised).
[13]Tax Law section 615(g)(2) (as revised).
[14]Tax Law section 1115(a)(33) (current).
[15]Tax Law section 1115(a)(33) (as revised).
[16]Economic Development Law section 353.1(i)-(j) (as revised).
[17]Economic Development Law section 352.7 (as revised).
[18]Economic Development Law section 352.11 (as revised).
[19]Economic Development Law sections 441-446 (as revised); Tax Law section 210-B.50 (as revised).

[20]Tax Law sections 1131(1), 1132(a)(1) (current).
[21]Tax Law section 1101(b)(8) (current).
[22]Tax Law section 1101(b)(8)(ii)(A) (current).
[23]Noonan, Doyle, and Daniel P. Kelly, "The *Amazon* Decision: A New Nexus Standard for the Internet Age?" *State Tax Notes*, Apr. 22, 2013, p. 289.

related parties. For example, the proposal sought to treat single-member limited liability companies (SMLLC) and their single members as one person for sales tax purposes, regardless of whether the SMLLC was disregarded for income tax purposes. This change would have forced SMLLCs to remit sales tax in situations in which they purchase property or services for resale to their single members.

The executive budget also targeted related-party leases by seeking to require that sales tax be paid at the inception of related-party leases in which the lease term is more than one year. Under current law, except in the cases of some motor vehicles, vessels, and airplanes, sales tax is due each time a lease payment is made by the related-party lessee.

Finally, the governor's proposal sought to impose sales and use tax on most intercompany transfers of tangible personal property between related parties. Under current law, New York excludes from sales and use tax most transfers or contributions of property to either a corporation or partnership solely in exchange for shares of stock or a partnership interest.

C. Additional Enforcement Measures

The executive budget also proposed a number of changes affecting the ability of the tax department to enforce compliance with the Tax Law. Specifically, the governor's provisions would have provided the department with new or modified tools to enforce the collection of past-due tax liabilities. This would have included lowering the threshold for driver's license suspensions for past-due tax liabilities from $10,000 to $5,000[24] and creating a new professional and business license tax clearance system, whereby applicants for professional licenses would be required to pay their past-due tax liabilities before such licenses are issued or renewed. Neither of these provisions were enacted in the final bill.

III. New York City Corporate Tax Reform

Cuomo's proposed executive budget also sought to substantially conform New York City's corporate tax regime to the state's. Although these conforming provisions were notably absent from the budget bill, the Legislature passed a separate bill on March 31, 2015, to reform New York City's tax system and to incorporate many of the corporate tax changes enacted in the state's 2014-2015 budget bill.[25]

The city's new corporate tax provisions are contained in a new subchapter 3-A of chapter 6 of title 11 of the city's administrative code.[26] The new laws apply generally for all tax years beginning on or after January 1, 2015. As mentioned above, the city's corporate tax scheme now largely conforms to the state's. The most significant conforming changes include a merger of the bank tax into the general corporation tax; the modification of the classifications of income (business, investment, and other exempt income); the elimination of the tax on subsidiary capital; the addition of an exemption from tax for investment income and other exempt income; new treatment for net operating losses; the adoption of combined reporting for unitary corporations that meet a more than 50 percent stock ownership test (with an election for non-unitary corporations to file a combined return if they meet the ownership test); and customer-based sourcing.

The new law does not, however, fully conform New York City corporate taxes to those at the state level. New York City continues to disregard federal and New York state S corporation elections, thereby subjecting federal and state S corporations to the historic general corporation and bank taxes at the entity level (the changes above apply to all corporations and banks that are not S corporations under IRC subchapter S. Similarly, unincorporated businesses will continue to be subject to New York City's unincorporated business tax (UBT). According to the New York City Department of Finance, S corporation and UBT will be studied in 2015.[27] And unlike New York state, which has adopted an economic nexus standard, New York City will continue to apply its historical nexus standards for corporate tax purposes.

The city will also now apply an increased business income tax rate for major financial institutions — an increased tax rate of 9 percent will apply to financial corporations with more than $100 billion in assets, as compared with the 8.85 percent tax rate that now applies to most other corporations. And although the city reduced its tax rates for qualified manufacturing corporations with New York City business income, the city did not adopt the 0 percent rate that now applies at the state level. There are still differences between city and state taxes that professionals and taxpayers will have to consider, but this legislation goes a long way to eliminating what was previously a troubling disconnect.

Conclusion

While this year's budget is unlikely to generate the fanfare of last year's budget bill, every budget (and every less-than-stellar sequel, for that matter) has its moments, and we've highlighted a few of the most noteworthy scenes above. As with all budgets, there are likely to be growing pains, which will be addressed through litigation and future technical changes. For now, though, it's recommended that tax professionals familiarize themselves with these changes. The next installment is only 12 months away. ☆

[24]Noonan and Lance E. Rothenberg, "Tax Collector in Mirror Is Closer Than It Appears: New York Acts to Suspend Taxpayers' Driver's Licenses," *State Tax Notes*, Nov. 4, 2013, p. 311.

[25]Chapter 59, Part A, N.Y. Laws of 2014. *See also supra* note 1.

[26]NYC Admin. Code sections 11-651-11-660 (as revised).

[27]New York City Department of Finance, "Summary of the New York City Corporate Tax Reform Legislation," *available at* http://www1.nyc.gov/assets/finance/downloads/pdf/15pdf/corporate-tax-reform.pdf.