

# REPORT ON EXECUTIVE BUDGET

*State and Local Tax Alert*  
April 10, 2018

On March 30<sup>th</sup>, Governor Cuomo announced that New York lawmakers passed the \$168.3 billion FY 2019 Budget (the “Final Bill”). The Final Bill (S. 7509-C/ A. 9509-C) is available here. We have been following the evolution of the budget since Governor Cuomo released his proposal in January and the “30-day amendments” in mid-February, which we covered here. The highlights of the Final Bill, including those aimed at combating the negative effects of federal tax reform on New Yorkers, along with differences from the Governor’s original proposals, are summarized below.

## **FY 2019 Budget:**

### ***Income Tax Provisions:***

- **Creation of a New Employer Compensation Expense Tax System (Part MM).** Under the Employer Compensation Expense Tax (“ECET”) system (which will be in new Article 24 of the Tax Law), employers may opt-in, for employees making more than \$40,000, and pay the ECET. The ECET is intended to shift a portion of employees’ New York income tax burdens to employers. The tax will be phased in over three years beginning on January 1, 2019. The ECET will be imposed at a 1.5 percent rate in the first year, a 3 percent rate in the 2020, and a 5 percent rate in 2021 and thereafter. Employees will receive a tax credit related to the ECET paid by their employers, in accordance with the following formula: (the employee’s wages for the year in excess of \$40,000) x (1.5% for 2019, 3% for 2020 and 5% thereafter) x (1-[personal tax imposed on the employee, before credits/the employee’s taxable NYS income]). The employer’s election to opt-in to the ECET must be made by December 1 of the prior calendar year.
- **Increasing Options for Charitable Deductions (Part LL).** For tax years beginning on or after January 1, 2019, individual taxpayers will be allowed an income tax credit equal to 85% of any donation made to certain state-operated charitable funds for the tax year following the year in which the donation is made. The charitable funds include the State University of New York Impact Foundation, the Research Foundation of the City University of New York, and Health Research, Inc. The Final Bill also grants political subdivisions—such as school districts, counties, towns, cities, and villages—the authority to create similar funds for education, health care, and other charitable purposes. Donations to these local charitable funds would result in a local credit, reducing local property taxes equal to 95 percent of the donation, or a lower percentage as established by the political subdivision.

## **Attorneys**

Paul Comeau  
Christopher Doyle  
Joseph Endres  
Debra Herman  
Joshua Lawrence  
Timothy Noonan  
Elizabeth Pascal

## **Practices & Industries**

State & Local Tax

## REPORT ON EXECUTIVE BUDGET

- **Decoupling from Federal Changes (Part JJ).** Previously, New York law allowed state residents to itemize deductions on their personal income tax returns only if they also itemized on their federal returns, and deductions and limitations followed federal rules. So, absent a law change, the new federal laws limiting certain itemized deductions, including the new \$10,000 SALT deduction limit, would have flowed through to state personal income tax returns. The Final Bill decouples from the federal tax law to allow itemized deductions for New York State and City purposes even if the taxpayer takes the standard deduction on their federal income tax return. The Final Bill also decouples the New York Tax Law and the New York City Administrative Code from the federal Internal Revenue Code in certain other respects, allowing taxpayers to continue to deduct alimony (regardless of when the divorce became final) and moving expenses for New York tax purposes. This provision is largely unchanged from what the Governor originally proposed in his 30-day amendments.
- **Statute of Limitations Extension for Assessing Additional Tax on Amended Returns (Part H).** Except as otherwise provided by New York Tax Law and the New York City Administrative Code, the Final Bill provides that, if a taxpayer files an amended return, the Department of Taxation and Finance (“DTF”) may assess additional tax, under Articles 9, 9-A, 22, and 33 and New York City Personal Income Tax, including recovery of a previously paid refund, which is attributable to a change or correction on the amended return, within one year. This provision is effective immediately and applies to all amended returns filed on or after the effective date. Prior to the bill, DTF generally had three years from the original filing date of the original tax return to audit and assess additional tax, and an amended return did not extend the statute of limitations except with respect to determining reductions or offsets to refunds or credits claimed on the amended returns. The Governor’s proposal originally provided for an extension of the statute of limitations to three years.
- **Employee Wage Reporting Change (Part I).** On a quarterly basis, employers and other entities responsible for the collection, remittance, and reporting of withholding taxes are required to file a Form NYS-45, which is used by both the Department of Labor (“DOL”) and DTF. Currently, these entities provide employee-level details to DOL on a quarterly basis and to DTF on an annual basis. The bill amends the Tax Law to require quarterly reporting to DTF.
- **Simplification of Resale Exemption for Prepared Food (Part J).** Prior to the Final Bill, Tax Law § 1105(d) imposed sales tax, with no resale exclusion, on any purchase of restaurant-type food to be sold in establishments such as restaurants, cafeterias, or taverns, or by caterers. Such entities were, however, permitted a credit for the taxes paid on food purchases. The Final Bill amends the Tax Law to allow restaurants, cafeterias, taverns, caterers, and other vendors to purchase food exempt from sales tax when such purchases are for resale. This provision applies to sales made on or after June 1, 2018.
- **Clarification of Statutory Residency Requirements (Part O).** In 2015, an Administrative Law Judge ruled, in a case that was successfully argued by our Hodgson Russ State and Local tax team, that in part-year domicile cases, only the portion of the year the taxpayer is not domiciled in New York should be considered when determining whether the “more than 183 days” test of statutory residency is met. We wrote about this case here. The Final Bill, however, codifies DTF’s pre-existing policy of counting days an individual is present in New York for the entire year to determine statutory residency, regardless of whether or not an individual was a part-year domiciliary. This provision will become effective beginning January 1, 2019. Props to the Legislature for deciding to forego the retroactive effective date sought in the Governor’s original proposal.
- **Maintains 2017 Empire State Child Tax Credit Benefits at Current Levels (Part P).** The Empire State Child Tax Credit amount is calculated as a percentage of the Federal child tax credit. The Federal child tax credit was increased by

## REPORT ON EXECUTIVE BUDGET

the Federal tax reform legislation (Public Law 115-97). To avoid a coincidental increase in the New York credit, the Final Bill ties the New York credit to Federal law existing immediately prior to the Federal reform.

### *Sales Tax Provisions:*

- **Changes the Veterinary Sales Tax Credit to an Exemption (Part W).** Previously, a veterinarian could apply for a credit or refund for sales tax paid on purchases of drugs or medicine used by the veterinarian in treating livestock and poultry used in farm production. The Final Bill creates an outright exemption for such purchases for both veterinarians and farmers, and eliminates the prior existing credit, effective June 1, 2018.
- **Responsible Person Sales Tax Relief for Minority LLC Owners (Part X).** Responsible persons – certain owners, officers, directors, employees, and managers – of a business are jointly and severally liable, along with the business entity or any other responsible person of the business, for sales tax liabilities owed. Under previous law, all LLC members and partners in a partnership were considered responsible persons. However, the Final Bill provides that certain members of an LLC and limited partners in a limited partnership are liable only for their pro-rata share of the business's original liability, if they show that: (i) they were not under a duty to act for the LLC or limited partnership in complying with the requirements of the sales tax; and (ii) their ownership interest and the percentage of their distributive share of the profits and losses of the LLC or limited partnership are each less than 50%. This provision is effective immediately and largely codifies the DTF's pre-existing policy reflected in TSB-M-11(17)S.
- **Technical Changes to Local Sales Tax Statutes (Part Z).** Chapter 61 of the Laws of 2017 sought to extend the revenue distribution provisions for additional rates of sales and use taxes for all counties that currently impose them to November 30, 2020. However, the revenue distribution provisions for Genesee, Monroe, Onondaga, and Orange Counties were inadvertently extended only until November 30, 2019. The Final Bill extends extend such provisions in those four counties through November 30, 2020.

### *Miscellaneous Tax Provisions:*

- **Clarification of Corporate Tax Provisions (Part KK).** Under both the New York Tax Law and the New York City Administrative Code, the Final Bill includes provisions to clarify that amounts included in federal gross income under Internal Revenue Code ("IRC") § 965 as "transition" income should be treated as "exempt CFC income," if received (or deemed received) from a non-US corporation that is not included in a combined Article 9-A report with the taxpayer. The Final Bill also requires corporations to add-back to the income reported on their New York Article 9-A return any deduction on their 2017 federal return claimed under IRC § 965(c). Permitting both the exemption for the income and the deduction would have given corporate taxpayers an unintended double benefit.
- **New York City Congestion Surcharge (Part NNN).** New Tax Law Article 29-C, "Congestion Surcharge," is included in the Final Bill, which enacts a surcharge on for-hire vehicles below 96<sup>th</sup> Street in Manhattan. The surcharge is \$2.75 for for-hire vehicles, \$2.50 for yellow cabs, and \$0.75 for pooled trips. This provision is effective January 1, 2019. Some provisions of the Governor's January 2018 proposals were ultimately **omitted** from the Final Bill. Some of the noteworthy omissions are discussed below:
- **Changes to Treatment of Carried Interests.** Currently, federal law allows hedge fund managers and private equity investors to treat carried interest income as capital gains, rather than ordinary income. New York is unable to tax such

## REPORT ON EXECUTIVE BUDGET

capital gain income when earned in New York by a non-resident. The Governor proposed to require all income from investment management services to be treated, for New York purposes, as income earned from a trade or business and would have subjected the gain to an additional 17% carried interest “fairness” fee. If passed, this provision would have taken effect only if Connecticut, New Jersey, Massachusetts, and Pennsylvania enacted legislation having a substantially similar effect. The Governor’s proposal was excluded from the Final Bill.

- **Right to Appeal Tax Tribunal Decisions for the Department of Taxation and Finance.** Under current law, only a taxpayer may seek judicial review of an adverse decision from the Tax Appeals Tribunal; DTF may not appeal a Tribunal decision. The Governor’s proposal would have granted DTF the right to appeal adverse Tax Appeals Tribunal decisions. The Governor’s proposal was excluded from the Final Bill.
- **Deferment of Business Related Tax Credit Claims.** For taxable years beginning on or after January 1, 2018, and before January 1, 2021, the Governor’s original proposal would have required business taxpayers to defer the use and application of certain business-related tax credits for three years if, in the aggregate, they exceed \$2 million. Had this provision been included in the Final Bill, the tax credits that would have been affected were the special additional mortgage recording tax credit, the credit for servicing certain mortgages, and the low income housing credit. The Governor’s proposal was excluded from the Final Bill.
- **Imposition of Internet Marketplace Collection/Reporting Requirement.** Without extending the rules concerning sales tax nexus, the Governor proposed to impose an “internet fairness conformity tax” by requiring marketplace providers with annual sales in excess of \$100 million to collect sales tax on taxable sales of tangible personal property by third-party vendors. Additionally, if passed, the provision would have required sellers and marketplaces that do not collect New York sales taxes to file information returns regarding sales of tangible personal property in New York. The Governor’s proposal was excluded from the Final Bill.
- **Change in Real Estate Transfer Tax Refund and Liability Provisions.** The bill would have extended the statute of limitations under Tax Law § 1412(a) from two years to three years for filing an application for refund of real estate transfer tax paid erroneously and Tax Law § 1402-a(b) would have been amended to provide joint liability between the grantor and grantee for payment of the mansion tax. The Governor’s proposal was excluded from the Final Bill.
- **Elimination of Energy Services Sales Tax Exemption.** Under the law, Tax Law §§ 1101(b) and 1105(b) the Governor proposed to impose sales tax on all transportation, transmission, and delivery of gas or electricity; however, Tax Law § 1105-C reduces the rate of tax to zero when the transportation, transmission, or delivery of gas or electricity is sold separately from the commodity. The bill would have eliminated the § 1105-C exemption. The Governor’s proposal was excluded from the Final Bill.
- **Vending Machine Sales Tax Exemption Increase.** The bill would have maintained an exemption for food or drink purchases costing \$1.50 or less from any vending machine accepting only coin or cash; however, it would have increased the exemption to \$2.00 for any vending machines that are capable of accepting payment in a form other than coin or cash, regardless of whether those machines also accept coin or cash. The Governor’s proposal was excluded from the Final Bill.