NEW YORK STATE BUDGET NOTES – MAY 5, 2023

Hodgson Russ State and Local Tax Alert
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With all the noise from the pro hockey and basketball playoffs and the start of the baseball season, you may have missed the dust-up in Albany that delayed the State's budget by almost a month. Some of the issues being debated had (at least to most outside observers) very little to do with determining how much to pay for government services and how to pay for them. But that's how the sausage is made. And as Winston Churchill once observed: "Democracy is the worst form of government, except for all of those other forms that have been tried from time-to-time." In any event, on May 1, the Senate and Assembly passed the Budget, and the Governor signed the revenue portion of the Budget on May 3.

WHAT'S IN:

Here are some highlights from the revenue portion of New York State's Fiscal Year 2023-24 Budget (2023 NY Laws Ch. 59; the "Budget"):

The Department of Taxation and Finance now has the Right to Appeal Certain Tax Appeals Tribunal Decisions: Taxpayers have always had the right to appeal adverse Tribunal decisions; but until now, the Tax Department was not permitted appeal rights. The Budget, under Part V, allows the Tax Department to appeal Tax Appeals Tribunal decisions by petitioning the Appellate Division of the Supreme Court, Third Department. For the Department to appeal a decision, however, the judicial review must be "premised on interpretation of the state or federal constitution, international law, federal law, the law of other states, or other legal matters that are beyond the purview of the state legislature." When the Department petitions for judicial review, however, the accrual of any interest and penalty that would otherwise continue to accrue shall be paused until 15 days after the issuance of a judicial decision that is not appealable. Some have opposed giving the Tax Department appeal rights since it tends to raise the potential cost of a tax controversy to a level beyond that which most taxpayers can afford. It will be interesting to see how the appellate courts deal with the standard of review, since the appeals will technically be between two administrative agencies and the normal standard of review in administrative law cases results in the agency determination being sustained unless it is arbitrary and capricious or not supported by substantial evidence. But what happens when the appeal is agency versus agency?

Attorneys

Paul Baldovin Jr.
Open Weaver Banks
Brandon Bourg
Mario Caito
Richard Campbell
Katherine Cauley
Thomas Collura
Paul Comeau
William Comiskey
Ariele Doolittle
Christopher Doyle
Catherine Eberl
Joseph Endres
Debra Herman
Daniel Kelly
Mark Klein
Joshua Lawrence
Timothy Noonan
Elizabeth Pascal
K. Craig Reilly
Emma Savino
Joseph Tantillo
Michael Van Wagnen
Andrew Wright

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The new law provides that both the Tribunal and the Petitioner are named respondents when the Tax Department appeals a decision. Does that mean that the Tribunal is required to pay half of the respondent's legal fees for the appeal?

Business Income Tax Rate Extension: Part I of the Budget extends through tax year 2026 the temporary 7.25% business income tax rate, for corporate taxpayers with business income bases in excess of $5 million, and the temporary 0.1875% capital base tax rate. The income tax rate increase and the capital base tax were scheduled to sunset at the end of 2023.

Disaster Relief: The Budget gives the Commissioner of the Tax Department the discretion to award disaster relief to taxpayers on multiple fronts. In Part A, the Budget expands the Commissioner's authority to provide relief to taxpayers affected by a presidentially-declared disaster or by a disaster emergency declared by the Governor, allowing the Commissioner to abate any interest that accrued in a period during which taxpayers were unable to meet a tax deadline due to impacts of these disasters, regardless of whether the filing deadline was extended. Prior to the Budget, if the filing deadline was not extended, the Tax Department could only abate penalties in this situation, but not interest. Furthermore, Part E of the Budget allows the Commissioner to abate the penalty for a corporation's underpayment of estimated tax, where the corporation was impacted by casualty, disaster, or other unusual circumstances and "the imposition of such addition to tax would be against equity and good conscience." This provision creates parity in this respect between the corporate and personal income tax underpayment penalties.

Motor Fuel Tax Reporting: Part Q of the Budget requires distributors of motor fuel and Diesel motor fuel to collect, report, and remit taxes to the Tax Department on the sale of any gallon of fuel, including additional gallons resulting from temperature fluctuations that cause the product to expand in volume. Fun fact: X gallons of fuel purchased by a distributor during cold weather turns in to X + Y gallons as the weather gets warmer. So, distributors can end up purchasing less fuel than they sell. In the past, distributors could collect additional tax on the sold fuel due to such temperature fluctuations and subsequent expansions, but were arguably not required to remit additional tax on the expansion gallons.

REITs: The Budget, pursuant to Part U, extends reduced rates for conveyances to real estate investment trusts under the New York State real estate transfer tax and the New York City real property transfer tax until September 1, 2026.

False Claims Act: Part DD of the Budget amends the New York False Claims Act (the "NYFCA") to permit actions in cases where the taxpayer is alleged to have "knowingly concealed or knowingly and improperly avoided an obligation to pay taxes to the state or local government." The expansion of the NYFCA takes effect immediately and in "any pending case" applies to any tax obligations knowingly concealed or knowingly avoided on or after the effective date. For actions filed after the effective date, this act only applies to such tax obligations knowingly concealed or avoided on or after May 1, 2020. This provision is intended to close a perceived loophole that arguably avoided whistleblower complaints when no tax return was filed by the taxpayer and there was thus no "false statement" by the taxpayer upon which a whistleblower complaint might be premised.

MTA Corporate Tax Surcharge: At Part GG, the Budget establishes the rate of the Metropolitan Transportation Authority ("MTA") surcharge on corporate franchise tax liability 30% of the state tax paid on income corporations earn within the metropolitan commuter transportation district (the "MCTD").

MTA Mobility Tax Applicability: The MCTMT has been a tax imposed on certain employers and self-employed individuals engaging in business within the MCTD, a transportation district that includes the counties of New York, Bronx, Kings, Queens, Richmond, Rockland, Nassau, Suffolk, Orange, Putnam, Dutchess, and Westchester. Prior to the Budget, the MCTMT applied to employers paying wages to employees working in the MCTD and to self-employed individuals (including non-limited partners) with net earnings from self-employment within the MCTD that exceed $50,000.

In Part B, the Budget amends the definition of "net earnings from self-employment" in the Tax Law so that limited partners who are actively engaged in the operations of their partnerships are now deemed to have net earnings from self-employment subject to the MCTMT. Prior to the Budget, the definition of net earnings from self-employment relied on the Internal Revenue Code ("IRC") definition, which excluded amounts earned by limited partners. The language of the Budget's amendment states, "an individual shall not be considered a limited partner if the individual, directly or indirectly, takes part in the control, or participates in the management or operations of the partnership such that the individual is not a passive investor, regardless of the individual's title or characterization in a partnership or operating agreement." This change takes effect immediately, which raises the specter of retroactive application. But inasmuch as the provision is a change in pre-existing law, the retroactive application of it would be considered by many as a Due Process violation.

MTA Mobility Tax Rate: A Budget-related enactment (2023 NY Laws Ch. 58, Part Q) increased the top MCTMT rate from 0.34% to 0.60% for employers with quarterly payrolls over $437,500 in the counties of Bronx, Kings, New York, Queens, and Richmond (effective July 1, 2023). For taxpayers with MCTD-source earnings from self-employment, the MCTMT rate increased from 0.34% to 0.47% for the 2023 tax year, and to 0.60% for the 2024 tax year, for MCTD income attributable to the counties of Bronx, Kings, New York, Queens, and Richmond. So, now there are different rates of tax depending on where in the MCTD your business is located. One expects that this would not be hard to administer for an employer, but for self-employed individuals that have multiple offices with one in, for example, Manhattan and another within White Plains, the calculation will be complicated.

Pass-Through Entity Tax: The Budget, in Part J, amends the State Pass-Through Entity Tax (PTET) and the City PTET. The definitions of "pass-through entity taxable income" and "city pass-through entity taxable income" in Tax Law §§ 860 (h) and 867(b) are amended to require entities to exclude deductions for PTET taxes paid when computing their state and city pass-through entity taxable incomes. This change corrects an unintended "circular" mathematical computation requiring entities to deduct PTET taxes from their pass-through entity taxable income that forms the basis for the PTET tax being deducted. In addition, the Budget amends the definition of "city taxpayer" to correct the unintentional omission of city resident trusts and estates from participating in the NYC PTET. Part J also clarifies when an entity must elect into/revoke their election into the PTET and NYC PTET.

Credits: The Budget offers substantial modifications to various New York tax credits:

Part I of the Budget extends the New York City Musical and Theatrical Production Tax Credit through tax year 2027 and establishes a $350,000 maximum credit amount for each "qualified New York city musical and theatrical production in a level two qualified New York city production facility." The Budget defines a level two qualified New York City production facility to be facilities located in Manhattan that meet certain amenity and income specifications. Relatedly, the Budget amends the Film Production Tax Credit at Part D. Here, the Budget increases the credit rate, extends the credit, increases the aggregate credit amount, allows an additional credit for non-wage production costs, modifies the credit for relocated television series, and provides other minor modifications.

Part C of Budget amends the Investment Tax Credit to make it refundable for eligible farmers, through tax year 2027.

Part J of the Budget and Part HHH of a different enactment (2023 NY Laws Ch. 58) expands the period in which the Brownfield Tax Credit can be claimed for certain projects, based on the location of the project and when the taxpayer purchased the project site.

In Part G, the Budget creates the Child Care Creation and Expansion Tax Credit Program Act for businesses creating or expanding their childcare capacity for the children of their employees, whether directly or via a third party. Businesses that meet the eligibility requirements may claim a credit equal to 20% of the costs of creating or expanding their program's available infant and toddler seats, capped at 25 seats. The aggregate amount of credit that a business may claim is $25 million each year, from 2023 through 2025, to be allocated on a pro rata basis.

Part H of the Budget allows New York City to adopt a biotechnology credit for tax years 2023 through 2026. Governor Hochul's original budget proposal allowed the credit to be claimed under the New York City general corporation tax, unincorporated business tax, and banking corporation tax. The Budget, however, limits the credit to the New York City general corporation tax and the unincorporated business tax.

The Budget, under Part EE, repeals a provision of the Corporate Franchise Tax that previously allowed for the transfer of unused investment tax credits in "qualified transactions" (i.e. IRC §§ 351/355 reorganizations).

Additionally, the Budget extends or slightly modifies the following credits: the COVID-19 Capital Costs Tax Credit Program (Part F); the Rehabilitation of Historic Properties Tax Credit (Part I); the Empire State Commercial Production Tax Credit (Part I); and the No. 6 Heating Oil Conversion Tax Credit (Part I).

NYC Recovery Incentives: In another Budget-related bill (S.4005-C/A.3005-C, Part AA), various property and sales tax incentives in New York City would be extended, including: the Lower Manhattan sales and use tax exemption for furnishing commercial office space, the Energy Cost Savings Program Credit, the Lower Manhattan Energy Program, the Commercial Expansion Program, and the Commercial Revitalization Program (including the Commercial Rent Tax Special Reduction).

WHAT'S NOT IN:

S-Corp Election: Governor Hochul's original budget proposal included an amendment so that all federal S corporations would be automatically treated as S corporations for New York tax purposes, unless the corporation was a qualified New York manufacturer under Tax Law § 210(1)(a)(vi) and elected New York C corporation status on its tax return. However, this provision was omitted from the Budget. In January, we saw a similar bill passed in New Jersey (P.L. 2022, c. 133), which eliminated the requirement for federal S corporations to affirmatively elect New Jersey S corporation status and included an opt-out provision. As of January 1, 2023, unless an S corporation in New Jersey takes affirmative steps to opt out (which requires the consent of 100% of the shareholders), the corporation is automatically treated as a New Jersey S corporation.

No Personal Income Tax Rate Changes: The Senate and Assembly's respective Budget proposals included increased New York personal income tax rates, including a 10.8% tax rate for income levels between $5 million and $25 million and an 11.4% tax rate for income levels over $25 million. But Governor Hochul was vocally opposed to these increased rates, apparently viewing them as likely to accelerate the relocation of wealthy taxpayers from New York to states with more-friendly tax climates. Ultimately, the Governor's logic prevailed.

Sales Tax on Digital Products: The Assembly's budget proposal (A.3009-B, Part EE) included a new sales tax on streaming entertainment and digital products, to fund MTA transportation systems. The proposal, if included in the Budget, would have imposed a 4% state tax and 4% local tax on digital products, including popular streaming services, as well as certain apps, games, music, podcasts, and audiobooks. The Assembly's proposal, however, was omitted from the final Budget. Concerns were raised over the proposal's constitutionality and its conformity with the Internet Tax Freedom Act. A court challenge of Maryland's version of the digital products tax is ongoing, and to date, the taxpayers are prevailing.

For more information on this alert, contact Christopher L. Doyle, Brandon J. Bourg, or Mario T. Caito.