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ACCOUNTANTS & ADVISORS

STATE AND LOCAL TAX ADVISOR: HIGHLIGHTING KEY TAX LAW CHANGES ACROSS THE REGION

IMPORTANT NEW YORK STATE CORPORATE INCOME TAX LAW CHANGES GO INTO EFFECT ON JANUARY 1, 2015

In April 2014, Governor Cuomo signed into law the 2014-2015 New York State Budget. This newsletter re-addresses the important New York (NY) corporate income tax law changes contained in the Budget, most of which will be effective for tax years beginning on or after January 1, 2015, unless specified otherwise. Please see below to learn more about the more salient changes.

ECONOMIC NEXUS

Under current law, a business must have a "physical presence" in NY to be subject to the corporate franchise (income) tax. In 2015, businesses that derive receipts sourced to NY totaling $1 million or more in the taxable year are subject to the corporate income tax. Any corporation which is part of a NY unitary combined return that has at least $10,000 of NY sourced receipts and the aggregate of all combined members having at least $10,000 of NY sourced receipts is $1 million or more, then economic nexus exists for such companies. Note, any business that meets the safe harbor for nexus based on Public Law 86-272, will continue to be protected from NY income taxation and not have nexus in NY, despite having NY sourced receipts of $1 million or more. Other states having an economic nexus statute similar to NY's (e.g., Oklahoma and West Virginia) have faced a court challenge arguing that substantial nexus (i.e., physical presence) must exist under the Commerce Clause of the US Constitution.

The new law also eliminates the current exception to corporate income tax nexus for out-of-state businesses that use a NY fulfillment service to hold their inventory in NY and deliver it to NY customers on behalf of these businesses. Note, however, this exception to nexus effective 1/1/15 will still apply for NY sales and use tax purposes.

BANK TAX UNDER ARTICLE 32 REPEALED

Banking corporations and financial service companies will be subject to Article 9-A tax as are most C-Corporations. Such businesses will no longer apportion their income to NY using a 3 factor formula (i.e., deposits, payroll and sales) but will use a single sales apportionment factor.

TAX BASES DRAMATICALLY CHANGED

Under current tax law, a business pays NY corporate franchise tax on the greater of four bases: entire net income, taxable capital, minimum taxable income or fixed dollar minimum. There are also two add-on taxes -- one on subsidiary capital and the other, the MTA surcharge at 17%. The new law will eventually have only 2 bases, business income and fixed dollar minimum. The tax on subsidiary capital will be eliminated as will the alternative minimum tax and the tax on capital will be fully phased out by 2021. Business income will be defined as entire net income minus investment income (Investment income under the new law has been more narrowly defined than under current law) and "other exempt income" (i.e., Subpart F income and unitary dividends). Interest expense attribution rules (i.e., add-back of same to business income) have changed under the new law. There will be a 40% investment income reduction safe harbor election which if chosen, will increase business income for 40% of the business's interest expense. All non-interest expenses will now reduce business income dollar-for-dollar which is a huge change from the current law. Lastly, an alien corporation having US effectively connected income under Internal Revenue Code (IRC) Sec. 882 will be taxed in NY.

NEW TAX RATES

Beginning 1/1/16 (not 2015), the corporate franchise tax rate on business income will be reduced to 6.5% (from 7.1%). Beginning 1/1/15, Qualifying Emerging Technology Companies (QETCs) will be taxed on their business income at a rate of 5.7% and eventually down to 4.875% by 2018 and beyond. Qualified NY manufacturers will have a 0% tax rate.

APPORTIONMENT

The law adopts "market-based sourcing" in determining the single sales receipts factor for, inter alia, the sale of tangible personal property (i.e., current law as well), services, rental of real and personal property in NY, royalties derived from patents, copyrights and similar intangibles and advertising, based on the "location of the customer". Service income under current law is sourced to NY based on "cost of performance".

The "location of the customer" will be determined under a prescribed hierarchy of 3 rules. First is location of primary use; the second is location of where the product is received and the third is use of the product's apportionment percentage from the prior year.

COMBINED REPORTING

Under current law, a business taxable under Article 9-A is required or permitted to file a combined NY corporate franchise tax return if there is 80% or more common ownership (direct or indirect) of companies that are engaged in a unitary business, there are "substantial inter-corporate transactions" between and among the combined companies or if filing separately results in distortion of the NY tax.

Under the new law, the State adopts a full unitary water's-edge method for combined reporting. If corporations in a unitary business are owned directly or indirectly by more than 50% by a NY corporate taxpayer, a combined return is mandatory. There is an exception to this mandatory rule whereby taxpayers may elect to treat more than 50% owned corporations that are **not** part of the unitary group to be included in the combined return. This election is irrevocable for a 7 year period.

A combined report will now include captive Real Estate Investment Trusts (REITs) and captive Regulated Investment Companies (not required to be combined under Article 33) and certain alien corporations which are either treated as a domestic corporation under IRC. Sec. 7701 or have US effectively connected income for the taxable year under IRC Sec.882.

NET OPERATING LOSS DEDUCTION RULES

Currently, taxpayers compute their NY NOL based on their federal NOL which is then applied to reduce pre-apportioned income. Under the new law, the NOL is determined without reference to the federal NOL and is applied on a post-apportionment basis.

As such, there are separate rules for pre-2015 NOLs and for NOLs incurred in 2015 and thereafter. The post-2014 NOLs can be carried back 3 years (but not into a pre-2015 tax year) and carried forward for 20 years. The pre-2015 NOLs, as determined on the last day of 2014, are multiplied by the base year apportionment factor and then divided by 6.5%. This amount can either be deducted 1/10th for each of the next 20 years or claimed 50% in 2015 and 50% in 2016. This pre-2015 NOL must be claimed before the post-2014 NOL is used.

PERMANENT MTA SURCHARGE

This surcharge is calculated as a percentage of the taxpayer's corporate franchise tax and has been increased from 17% to 25.6% and continues to apply a 3 factor apportionment formula. The surcharge has been made permanent as well. The new "economic nexus" standard will apply to determine if the surcharge applies to a taxpayer.

FOR MORE INFORMATION

If you have questions about the information contained in this communication or any state or local tax matter, please contact Steven P. Bryde, JD, Tax Principal, by phone at 212.503.8806 or by email at sbryde@markspaneth.com.