TSB-M-02(5)C
September 24, 2002

Summary of Corporation Tax Legislative Changes Enacted in 2002

This memorandum contains brief summaries of the legislative changes enacted in 2002, regarding Corporation Tax.

The following legislative changes are summarized in this memo:

- Change in the Interest Rate on Underpayments
- Order of Application of Tax Credits
- Amended Definition of a "New Business" for the Purpose of Determining Refund Eligibility of Certain Tax Credits
- 30% Mandatory First Installment of Estimated Tax for Taxpayers Whose Preceding Year's Tax Exceeds $100,000
- Investment Tax Credit (ITC) for the Financial Services Industry Extended to Include Property Placed in Service Before October 1, 2008
- Investment Tax Credit (ITC) Relief for Property Destroyed as a Direct Result of the Terrorist Attacks of September 11, 2001
- Amendments to Empire Zone (EZ) and Zone Equivalent Area (ZEA) Wage Tax Credit Law
- Qualified Empire Zone Enterprises (QEZE) Technical Corrections
- Low-Income Housing Credit Statewide Limitation Increased
- OTC Derivatives Dealers and the Allocation of Receipts From Principal Transactions by Registered Securities and Commodities Brokers or Dealers
- Changes to Assets Qualifying for the 60% Asset Test Used in Determining Thrift Bad Debt Deduction Eligibility
- A Mobile Telecommunications Service Sourcing Rule is Added for Taxpayers That are Subject to the Section 186-e Excise Tax on Telecommunication Services
- Re-characterization of the Tax for Qualified Gas Transportation Contracts
- Electronic Signatures
- Annual Reports to the State Comptroller

The legislative change summarized in the section titled *Annual Reports to the State Comptroller* is included in Chapter 23 of the Laws of 2002. All of the other legislative changes detailed in this memorandum are found in Chapter 85 of the Laws of 2002.

Some of these provisions are retroactive. For information regarding the filing of amended returns, see the instructions for your return type or Forms CT-8, *Claim for Credit or Refund of Corporation Tax Paid* and CT-9, *Claim for Tentative Refund Based upon Carryback of Net Operating Loss*.

Change in the Interest Rate on Underpayments (Articles 9, 9-A, 32, and 33)

Taxpayers are required to pay interest on tax that is not paid on or before the original due date of the respective return. The interest rate applicable to these underpayments has been increased by two percentage points effective April 1, 2003. The new rate applies to the amount of the underpayment that remains or becomes due on or after that date. The interest rate on overpayments is not affected by this amendment.

The interest rate for underpayments up to and including March 31, 2003, is the sum of the federal short-term rate, as defined in section 1096(e)(3) of the Tax Law, plus three percentage points. When the new rate takes effect on April 1, 2003, the interest rate on underpayments will be the sum of the federal short-term rate plus five percentage points.

The increase in the interest rate for underpayments also affects other computations. For instance, the penalty for understatement of estimated tax under section 1085(c) of the Tax Law is based on the interest rate for underpayments. Additionally, if a recapture of a previously claimed investment tax credit (ITC) is required, the interest rate for underpayments in effect on the last day of the tax year is used to compute the additional recapture amount.

To find the current and previous interest rates on the Department web site at www.tax.state.ny.us, enter *interest rates* in the search engine provided on the site.

(Tax Law Section 1096(e)(2)(B).)

Order of Application of Tax Credits (Articles 9, 9-A, 32, and 33)

The Tax Law has been amended to provide for a new ordering of credits under Articles 9, 9-A, 32 and 33 effective for taxable years beginning on or after January 1, 2000. The amendment to Article 9 establishes an ordering rule. The amendments to Articles 9-A, 32 and 33 modify the existing ordering rules.

Tax credits under **Article 9** must be applied in the following order:

1. Non-carryover credits that are not refundable
2. Carryover credits with limited carryover periods
3. Carryover credits with unlimited carryover periods
4. Refundable credits

Tax credits under **Article 9-A** must be applied in the following order:

1. Non-carryover credits that are not refundable
2. Empire Zone (EZ) and Zone Equivalent Area (ZEA) Wage Tax Credits
3. Carryover credits with limited carryover periods
4. Carryover credits with unlimited carryover periods
5. Refundable credits

Tax credits under **Article 32** must be applied in the following order:

1. Non-carryover credits that are not refundable
2. EZ and ZEA Wage Tax Credits
3. Carryover credits with limited carryover periods
4. Carryover credits with unlimited carryover periods
5. Refundable credits

Tax credits under **Article 33** must be applied in the following order:

1. EZ Capital Credit
2. EZ and ZEA Wage Tax Credits
3. Non-carryover credits that are not refundable
4. Carryover credits with limited carryover periods
5. Carryover credits with unlimited carryover periods
6. Refundable credits

(Tax Law Sections 187-f, 210.26, 1456(g), 1511(m) and 1511(t))

Amended Definition of a "New Business" for the Purpose of Determining Refund Eligibility of Certain Tax Credits (Articles 9-A, 32 and 33)

The provisions in the Tax Law regarding the investment tax credit (ITC) include a definition of a "new business." In lieu of carrying an unused ITC forward to a future year or years, a taxpayer that qualifies as a new business is entitled to a refund of the ITC.

The Tax Law has been amended to clarify the definition of a new business. The amendment makes it clear that a taxpayer qualifies as a new business during its first five taxable years, excluding short taxable years.

As amended, a "new business" is defined as any corporation, except a corporation:

- of which over fifty percent of the number of shares of voting stock is owned or controlled either directly or indirectly by a corporation subject to taxation under Article 9-A (franchise tax on business corporations), Article 32 (franchise tax on banking corporations), Article 33 (franchise tax on insurance corporations) or sections 183, 184 or 185 of Article 9 (corporation tax); or

- which is substantially similar in operation and in ownership to a business entity or entities taxable or previously taxable under Article 9-A, Article 32, Article 33, sections 183, 184, 185 or 186 of Article 9, Article 22, Article 23, or that would have been subject to the tax under such Article 23 (as that article was in effect on January 1, 1980); or

- which has been subject to tax in New York under Articles 9-A, 32 or 33 for more than five years, excluding short taxable years.

The refund eligibility rules for several other credits also rely on this definition of a new business. Those credits are:

- Investment tax credit for the financial services industry
- EZ Wage tax credit
- ZEA Wage tax credit
- EZ Investment tax credit
- EZ Investment tax credit for the financial services industry

(Tax Law Sections 210.12(j)(3), 1456(i)(8)(C) and 1511(q)(7)(C)).

30% Mandatory First Installment of Estimated Tax Required for Taxpayers Whose Preceding Year's Tax exceeds $100,000 (Articles 9, 9-A, 32, and 33)

All taxpayers whose preceding year's tax, exclusive of the MTA surcharge, exceeds $1,000 are required to pay a mandatory first installment of estimated tax with the tax return required to be filed for the preceding taxable year, or with the application for extension of the time to file that return. All taxpayers subject to the mandatory first installment that are doing business in the Metropolitan Commuter Transportation District (MCTD) are also required to make a mandatory first installment of estimated tax for the metropolitan transportation business tax surcharge (MTA surcharge). The mandatory first installment of estimated tax for the MTA surcharge is paid with the surcharge return required to be filed for the preceding taxable year, or with the application for extension of the time to file that surcharge return. The MCTD includes the counties of New York, Bronx, Kings, Queens, Richmond, Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk and Westchester

The Tax Law has been amended to provide a temporary increase in the mandatory first installment for general business corporations (Article 9-A), banking corporations (Article 32), insurance corporations (Article 33), and entities subject to tax under section 184, 186-a, or 186-e of Article 9, whose preceding year's tax, exclusive of the MTA surcharge, exceeds $100,000. For taxable years beginning on or after January 1, 2003, but before January 1, 2006, those taxpayers are required to pay a first installment equal to 30% of the preceding year's tax. However, for insurance corporations subject to tax under section 1510(b)(1), the mandatory first installment remains at 40% of the preceding year's tax if that preceding year's tax exceeds $1,000. Additionally, taxpayers who are required to pay their first installment at the 30% rate and are subject to the MTA surcharge under section 184-a, 186-c, 209-B, 1455-B, or 1505-a of the Tax Law are also required to calculate their estimated tax for the MTA surcharge at 30% of the preceding year's MTA surcharge. The remaining three estimated tax payments are adjusted so that the total payments do not exceed 100% of the tax estimated to be due. For taxable years beginning on or after January 1, 2006, the mandatory first installment reverts to 25% of the preceding year's tax.

The mandatory first installment of estimated tax and estimated MTA surcharge remains at 25% of the preceding year's tax and MTA surcharge, respectively, for those taxpayers whose preceding year's tax exceeds $1,000, but is less than or equal to $100,000.

(Tax Law Sections 197-b(1)(a); 213-b(a); 1461(a); and 1514(a)(1).)

Investment Tax Credit (ITC) for the Financial Services Industry Extended to Include Property Placed in Service Before October 1, 2008 (Articles 9-A, 32, and 33)

In 1998, the provisions in the Tax Law for the investment tax credit (ITC) available to general business corporations under Article 9-A were expanded to include qualified property placed in service before October 1, 2003 and used in the financial services industry. Additionally, a new ITC was added to Article 32 for qualified property placed in service before October 1, 2003 and used by banking corporations providing qualifying financial services. For additional information on these provisions see TSB-M-98(7)C.

In 2000, a new ITC was added to Article 33 for qualified property placed in service on or after January 1, 2002 and before October 1, 2003 that is used by insurance corporations providing qualified financial services. For additional information on these provisions see TSB-M-00(5)C.

The Tax Law has been amended to extend the qualifying period of the ITC for the financial services industry under Articles 9-A, 32 and 33. Qualified property placed in service before October 1, 2008 is now eligible for the ITC for the financial services industry.

(Tax Law Sections 210.12; 1456(i); 1511(q).)

Investment Tax Credit (ITC) Relief for Property Destroyed as a Direct Result of the Terrorist Attacks of September 11, 2001 (Articles 9-A , 32 and 33)

Generally, if property on which an investment tax credit (ITC) has been allowed is disposed of or ceases to be in qualified use prior to the end of its useful life, a portion of the credit must be recaptured and added to the tax due in the year of disposition or disqualification. The amount required to be recaptured (the recapture amount) is the difference between the original credit allowed and the credit for actual use. The recapture amount is augmented with interest computed at a rate equal to the underpayment rate in effect on the last day of the tax year in which the recapture occurs. Additionally, the investment credit base used in computing the ITC for any replacement property is the cost or other federal basis of the replacement property. Such cost or other federal basis, in the instance of an involuntary conversion, includes any basis reduction required by Internal Revenue Code (IRC) section 1033.

The Tax Law has been amended to provide the following ITC relief for property that was destroyed or ceased to be in qualified use as a direct result of the terrorist attacks of September 11, 2001. Qualifying Article 9-A or Article 32 taxpayers may make one of the following elections:

- Taxpayers may defer ITC recapture to the next taxable year. The amount required to be recaptured in the next succeeding year will be augmented with interest computed at a rate equal to two times the underpayment rate on the last day of the tax year in which the recapture occurs. However, qualifying taxpayers that elect the deferment and retain a significant percentage of employees in New York State are

not required to recapture any ITC with respect to the qualifying property. The Department of Taxation and Finance has interpreted the term *significant percentage* to be at least 75 percent. Also, if 50 percent or more of a taxpayer's employees died as a direct result of the attacks, the taxpayer may elect to utilize this provision and will not be required to recapture any ITC with respect to the qualifying property, whether or not the taxpayer meets the employment test.

- Taxpayers may elect not to defer the ITC recapture. Instead, these taxpayers may elect to follow the normal recapture rules and elect not to reduce the basis of any replacement property as required by IRC section 1033 in computing the ITC on replacement property. For purposes of this election, it does not matter when the destroyed property was placed in service, or whether an ITC was claimed on the destroyed property.

Although the investment tax credit was not available to insurance corporations (Article 33) for property placed in service prior to January 1, 2002, an insurance corporation that acquires qualifying replacement property which is similar or related in service or use to the property destroyed as a direct result of the attacks may compute the investment credit base of the replacement property without regard to any basis reduction required by IRC section 1033.

(Tax Law Sections 210.12, 1456(i), and 1511(q))

Amendments to Empire Zone (EZ) and Zone Equivalent Area (ZEA) Wage Tax Credit (Articles 9-A, 32 and 33)

The Empire Zone (EZ) wage tax credit and the Zone Equivalent Area (ZEA) wage tax credit are allowed to taxpayers certified under Article 18-B of the General Municipal Law that meet certain increased employment levels in New York State and in the EZ or ZEA during the taxable year and are subject to the franchise tax on business corporations, the franchise tax on banking corporations, or the franchise tax on insurance corporations.

The Tax Law was amended with respect to several provisions of the EZ and ZEA Wage Tax Credit.

Effect of subsequent Article 18-B certifications. The Department's existing policy regarding a subsequent Article 18-B certification was added to the Tax Law. The policy is that if a taxpayer becomes certified in more than one Empire Zone or Zone Equivalent Area, the five-year period in which the taxpayer is eligible to claim the EZ or ZEA wage tax credit begins in the first tax year in which the taxpayer first meets all eligibility requirements. Subsequent certifications by a taxpayer in a different EZ or ZEA under Article 18-B do not extend the five-year period for claiming the wage tax credit.

(See Tax Law, Sections 210.19(c), 1456(e)(3), 1511(g)(3))

Calculation of average number of employees. The Tax Law was amended to add the requirement that for purposes of calculating the amount of the EZ or ZEA wage tax credit, an individual employed by a related person (as related person is defined in Internal Revenue Code (IRC) section 465(b)(3)(c)), in an empire zone within the immediately preceding sixty months is not included in the calculation of average number of employees unless the related person was never allowed a wage tax credit for that employee. This provision applies to taxable years beginning on or after January 1, 2002.

(Tax Law Sections 210.19(d),1456(e)(4), 1511(g)(4))

Qualified Empire Zone Enterprise (QEZE) Technical Amendments (Articles 9-A, 32, and 33)

For tax years beginning on or after January 1, 2001, the Empire Zones Program Act provides tax credits for a Qualified Empire Zone Enterprise (QEZE) - the QEZE credit for real property taxes, and the QEZE tax reduction credit. A QEZE is a business enterprise which is certified as an Empire Zone business under Article 18-B of the General Municipal Law prior to July 1, 2005, and which annually meets an employment test.

The Tax Law has been amended to reflect technical changes with regard to the QEZE credits.

***For purposes of the QEZE tax credits, the benefit period is renamed the "business tax benefit period" and redefined as follows*:**

- The business tax benefit period for a QEZE with a test date occurring on or before December 31, 2001, is the first fifteen tax years beginning on or after January 1, 2001.

- The business tax benefit period for a QEZE with a test date occurring on or after January 1, 2002, is the first fifteen tax years following the test year.

Previously, the benefit period was defined as the fifteen next taxable years following the test year.

This provision is effective for taxable years beginning on or after January 1, 2001.

For purposes of the QEZE tax credits, the term "employment test" is redefined and certain provisions of the test are modified as follows:

- The definition of the term "employment test" was amended to eliminate the requirement that in determining the number of employees within the empire zone, a QEZE could include only those employees working in empire zones in which the QEZE is certified under Article 18-B of the General Municipal Law. As amended,

if a QEZE is certified in at least one empire zone, all qualified employees working in any empire zone will be considered employees within those empire zones for purposes of the employment test, regardless of whether the QEZE is certified in all of the empire zones.

- For QEZEs that have a base period of zero years and an employment number in empire zones greater than zero, the employment test will be met only if the QEZE meets the following new business test:

    - A new business shall be any corporation except a corporation that is substantially similar in ownership and operation to a business entity (or entities) that is:

        - taxable, or previously taxable under sections 183, 184, 185, or 186 of Article 9;
        - taxable, or previously taxable under Articles 9-A, 23, 32, or 33;
        - would have been taxable under Article 23 as that Article was in effect on January 1, 1980; or
        - had income or losses that are (or were) included in computing the personal income tax under Article 22.

  This new business test applies to taxpayers who are certified under Article 18-B of the General Municipal Law on or after August 1, 2002.

- For a taxpayer located in an empire zone as a result of a boundary revision or in a newly designated empire zone, the employment test will be calculated as if the taxpayer was always in that location and as if that location was always included in that empire zone. In computing the number of employees in the empire zone for the current year, base period and test year, the taxpayer will include as empire zone employees all qualified employees that were employed at that empire zone location during those years.

- When a business enterprise relocates to an empire zone from a business incubator facility, the employment test will be calculated as if the business enterprise was located in the empire zone during its base period. The employees of the business who worked at the business incubator facility during the base period shall be "empire zone employees" for that period.

With certain exceptions noted above, these provisions are effective for taxable years beginning on or after January 1, 2001.

For purposes of the QEZE tax credits, the following terms are redefined, effective for taxable years beginning on or after January 1, 2001, unless otherwise noted:

The term "***test year***" is redefined as the last taxable year of the business enterprise ending before the test date. Previously, the test year was defined as the last taxable year ending *on or before* the test date. The term was further clarified for business enterprises that were not subject to tax in New York State in the year(s) prior to their year of certification. For these taxpayers, the test year is the last calendar year ending on or before the test date, or in the case of a fiscal year filer, the last fiscal year ending on or before the test date, regardless of whether the business had a tax year prior to the year it was certified under Article 18-B.

The term "***test date***" means the later of July 1, 2000, or the date prior to July 1, 2005, on which the business enterprise was first certified under Article 18-B of the General Municipal Law. Subsequent certifications under Article 18-B will not change the test date for the business enterprise.

The term "***employment number***" was modified to exclude any individual who was employed in the preceding sixty months by a related person to the QEZE (as related person is defined in IRC section 465(b)(3)(c)). This provision is effective for taxable years beginning on or after January 1, 2002.

The term "***eligible real property taxes***" was amended to add the requirement that the real property taxes on property owned by the QEZE for which a QEZE real property tax credit is claimed, become a lien on the real property in a year in which the business enterprise is both certified and qualifies as a QEZE. The term was also amended to codify Department policy that the term *eligible real property taxes* includes certain payments in lieu of taxes (PILOT payments). However, the amendment includes a requirement that the PILOT payments be made pursuant to a written agreement approved by both the New York State Department of Economic Development and Office of Real Property Services as satisfying generally accepted and recognized standards of real property tax appraisals.

A limitation on the amount of QEZE Real Property Tax Credit which may be claimed in a tax year was added for taxpayers that are certified under Article 18-B of the General Municipal Law on or after August 1, 2002.

The credit shall be limited to the greater of the following amounts:

- The *employment increase limitation*, calculated by multiplying the increase in the employment number in the empire zones in which the QEZE is certified by $10,000; **or**

- The *capital investment limitation*, calculated at 10% of the *cost or other basis* of real property, owned by the QEZE and located in an empire zone in which the QEZE is certified, multiplied by the greater of:

  - the sum of the percentage of physical occupation of the real property by the QEZE and the percentage of physical occupancy of the real property by a

related person to the QEZE, as *related person* is defined in IRC section 465(b)(3)(c); **or**

- the percentage of the cost or other basis attributable to the construction, expansion or rehabilitation of the real property (as opposed to the acquisition). If 50 percent or more of the cost or other basis is attributable to the construction, expansion or rehabilitation of the real property (as opposed to the acquisition), then the percentage of physical occupation by the QEZE shall be deemed to be 100 percent.

The *cost or other basis* is the greater of:

- the cost or other basis for federal income tax purposes on the later of January 1, 2001, or on the effective date of certification under Article 18-B of the General Municipal Law; **or**
- the cost or other basis for federal income tax purposes on the last day of the tax year.

Any business enterprise certified under Article 18-B of the General Municipal Law before August 1, 2002 is not subject to this limitation in any year of the business tax benefit period.

A recapture requirement has been added for the QEZE Real Property Tax Credit.

For taxable years beginning on or after January 1, 2001, a portion of the QEZE real property tax credit must be recaptured if the amount of the real property taxes on which the credit was calculated is subsequently reduced by a final order in any proceeding under Article 7 of the Real Property Tax Law. The recapture amount is equal to the amount of the credit originally taken, less the amount of credit recalculated using the reduced property taxes.

The QEZE Tax Reduction Credit has been amended to codify the computation of the tax factor for corporate partners of a QEZE and combined filers.

To compute the tax factor, corporate partners and combined filers must first determine the larger of the applicable tax in (1) through (3) below:

(1) Article 9-A: The larger of the tax on the entire net income base or the minimum taxable income base.

(2) Article 32: The larger of the tax on entire net income or alternative entire net income.

(3) Article 33: The larger of the tax on entire net income or entire net income plus compensation.

The tax factor for corporate partners (and corporate members of LLCs which have elected to be taxed as a partnership) is the larger of the applicable tax determined in (1) through (3) above, multiplied by a ratio, the numerator of which is the *partner's (or member's) income from the QEZE partnership (or LLC)* allocated within New York State and the denominator of which is the *partner's (or member's) entire income* allocated within New York State. In no event may the ratio exceed one. The term *partner's (or member's) income from the QEZE partnership (or LLC)* means partnership (or LLC) items of income, gain, loss, deduction and New York modifications entering into entire net income, minimum taxable income, alternative entire net income, or entire net income plus compensation, as the case may be. The term *partner's (or member's) entire income* means entire net income, minimum taxable income, alternative entire net income, or entire net income plus compensation, as the case may be. The commissioner of the Department of Taxation and Finance may prescribe other methods which reasonably reflect the portion of tax attributable to the QEZE.

The tax factor for corporations who file a combined report is the amount of combined tax (the larger of the applicable tax determined in (1) through (3) above) multiplied by a ratio, the numerator of which is the amount of income attributable to the QEZE allocated to New York State, and the denominator of which is the income of the combined group. In no event may the ratio exceed one. Combined groups which have one or more members with losses compute the tax factor as described above without including the loss(es) in either the numerator or the denominator. The commissioner of the Department of Taxation and Finance may prescribe other methods which reasonably reflect the portion of tax attributable to the QEZE.

These provisions are a codification of current Tax Department policy and are effective for taxable years beginning on or after January 1, 2001.

The effect on the Empire Zone Program if the effective date of the program is not extended beyond July 31, 2004.

The Tax Law was amended by Chapter 85 of the Laws of 2002 to provide that if the designation of an area as an Empire Zone is no longer in effect because section 969 of the General Municipal Law was not amended to extend the effective date of that designation beyond July 31, 2004, a business enterprise that was certified pursuant to Article 18-B of the General Municipal Law on or before July 31, 2004, will be deemed to continue to be certified for purposes of the QEZE tax benefits. In addition, all references to Empire Zones in the provisions of the Tax Law concerning QEZEs shall be read as meaning areas designated as Empire Zones as of July 31, 2004.

(Tax Law Sections 14, 15, 16, 210.27, 210.28, 1456 and 1511)

Low Income Housing Credit Statewide Limitation Increased (Articles 9-A, 32, and 33)

The New York Low Income Housing Credit Program provides tax credits to developers who invest their own funds in housing for low-income persons and families. The program is administered by the New York State Division of Housing and Community Renewal, with the amount

of the credit for each building determined by the Commissioner of that Division. For additional information on this credit see TSB-M-00(2)C.

The Public Housing Law has been amended to increase the statewide aggregate dollar amount of tax credits which can be allocated to eligible low-income buildings from $2 million to $4 million. This provision takes effect immediately.

(Public Housing Law Section 22)

OTC Derivatives Dealers and the Allocation of Receipts from Principal Transactions to New York State by Registered Securities and Commodities Brokers or Dealers (Article 9-A)

For taxable years beginning on or after January 1, 2003, the definition of the term "registered securities or commodities broker or dealer" has been expanded to include over-the-counter (OTC) derivatives dealers as defined under regulations of the Securities and Exchange Commission (17 CFR 240.3b-12). Under the SEC definition, an OTC derivatives dealer must be affiliated with a registered broker or dealer and must limit its activities to those transactions or activities described by the SEC.

Additionally, for taxable years beginning on or after January 1, 2003, the customer sourcing provisions relating to principal transactions entered into by registered securities or commodities brokers or dealers taxable under Article 9-A have been amended to allow these brokers or dealers to elect to source the gross income from those transactions based on the location of the customer to the principal transaction. A principal transaction is one where the registered broker or dealer is acting as principal for its own account, rather than agent for the customer. If the election is made, gross income from principal transactions is deemed to arise from a service performed in New York to the extent that the gross proceeds from the transactions are generated from sales of securities or commodities to customers within the state based upon the mailing addresses of those customers in the records of the taxpayer. The portion of principal transaction income of these brokers or dealers that is sourced to New York is based on a fraction, the numerator of which is the gross proceeds from principal transactions with New York customers, and the denominator of which is the gross proceeds from all principal transactions. Gross proceeds are determined without deduction for any cost incurred by the taxpayer to acquire the securities or commodities. For purposes of this calculation, the taxpayer must separately calculate gross income from principal transactions by type of security or commodity.

The current sourcing provision for tax years beginning on or after January 1, 2003, which is retained in the law, sources the income from principal transactions based on the location of the broker or dealers's branch, office or employee that is awarded a production credit for the principal transaction. If no election is made, the amount of principal transaction gross income included in the numerator of the receipts factor is determined by using the production credit system.

For further information concerning the allocation of receipts to New York State by registered

securities and commodities dealers, see page six of TSB-M-00(5)C, *Summary of Corporation Tax Legislative Changes Taking Effect in 2001 and After*.

(Tax Law Sections 210.3(a)(9)(B) and 210.3(a)(9)(A)(iii).)

Changes to Assets Qualifying for the 60% Asset Test Used in Determining Thrift Bad Debt Deduction Eligibility (Article 32)

Bad debt deductions are allowed to banking corporations that qualify as "thrift institutions" under both subparagraphs (A) and (B) of section 1453 (h)(1) of the Tax Law. Subparagraph (B) of section 1453 (h)(1) is referred to as the "asset test." To meet the requirements of this test, at least 60 percent of the assets of the bank must be comprised of the assets listed within this subparagraph. Subparagraph (B) has been amended to modify two of the existing categories, and to add three new categories, of qualifying assets. No changes have been made to the requirements contained in subparagraph (A) of section 1453 (h)(1).

As detailed in the bulleted items below, the legislation modifies existing clauses (vi) and (vii), and adds new clauses (xiii) through (xv) to section 1453(h)(1)(B). The changes apply to taxable years beginning on or after January 1, 2002.

- Clause (vi) was modified to include any regular interest in a Financial Asset Securitization Investment Trust (FASIT), as defined in section 860L of the IRC, but only in the proportion that the assets of the FASIT consist of property described in clauses (i) thru (v) of section 1453(h)(1)(B). However, if 95% or more of the assets of the FASIT are assets described in clauses (i) thru (v), the entire interest in the FASIT qualifies.

- Clause (vii) was modified to place a limitation on the mortgage-backed securities that may be included in the asset test. Clause (vii) was also modified to add to the assets included in the asset test any collateralized mortgage obligation, the security for which consists primarily of mortgage loans, provided that the real property which serves as security for the loans is (or from the proceeds of the loan, will become) residential real property or real property primarily used for church purposes.

- New clause (xiii) adds to the assets included in the asset test, loans for which the taxpayer is the creditor and that are wholly secured by loans secured by residential real property or real property primarily used for church purposes, described in clause (iv) of the same section, but excluding loans for which the taxpayer is the creditor to any banking corporation described in paragraphs one through seven of Tax Law section 1452(a), or a real estate investment trust. Also excluded are loans that are treated by the taxpayer as subsidiary capital for purposes of the deductions provided by Tax Law section 1453(e)(11).

- New clause (xiv) adds to the assets included in the asset test, loans to a small business or small farm located in low-income or moderate-income census tracts or block numbering areas delineated by the US Bureau of the Census in the most recent decennial census.

- New clause (xv) adds to the assets included in the asset test, community development loans or community development investments.

The legislation also provided definitions for the terms "community development loan," "community development investment" and "community development."

Conforming amendments were made to the New York City Administrative Code.

(Tax Law Section 1453(h)(1)(B).)

A Mobile Telecommunications Service Sourcing Rule is Added for Taxpayers that are Subject to the Section 186-e Excise Tax on Telecommunication Services (Article 9)

The excise tax imposed under section 186-e of the Tax Law has been amended to conform to the sourcing rule provisions of the Federal Mobile Telecommunications Sourcing Act (Public Law 106-252) with respect to sales of mobile telecommunications service made on or after August 2, 2002. The section 186-e amendments provide that the excise tax is imposed on gross receipts from mobile telecommunications service provided by a home service provider, if the customer's place of primary use is within New York State. Gross receipts include all charges for mobile telecommunications services made by a home service provider, regardless of where the mobile telecommunications service originates, terminates or passes through. Any charge billed by or for a home service provider is deemed provided by that home service provider. The existing excise tax provisions continue to apply for sales of telecommunications service other than sales of mobile telecommunications service (see TSB-M-95(3)C).

Prior to these amendments, if the total charge made by a home service provider included both taxable and other components, and the other components were not separately stated, the total charge was included in gross receipts and subject to the tax imposed under section 186-e. The section 186-e amendments provide that certain charges now may be excluded from gross receipts subject to the excise tax, even if not separately stated, if the home service provider uses an objective, reasonable, and verifiable standard as set forth in the new law to identify, quantify, and account for each component of the total charge to the customer. If the home service provider separately sells the property or service which may be broken out, then the charge for this property or service is to be based on the price for this property or service as separately sold. If a home service provider does not separately sell the property or service, then the charge for the property or service is to be based on the prevailing retail price of comparable property or service sold separately by other home service providers. In any case, the charge for the property or service must be reasonable and proportionate to the total charge to the mobile telecommunications customer.

In addition, the Metropolitan Transportation Business Tax Surcharge (MTA surcharge)

imposed under section 186-c has been amended to conform with these rules. The MTA surcharge is imposed on the gross receipts of a home service provider from charges for mobile telecommunications services, where the customer's place of primary use is within the Metropolitan Commuter Transportation District (MCTD). The MCTD includes the counties of New York, Bronx, Queens, Kings, Richmond, Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester.

For additional information, see TSB-M-02(4)C.

(Tax Law Sections 186-e and 186-c)

Re-characterization of the Tax Allocable to Qualified Gas Transportation Contracts (Article 9-A)

For taxable years beginning on or after January 1, 2000, any tax paid under Article 9-A of the Tax Law allocable to receipts attributable to a qualified gas transportation contract shall be deemed to have been paid under Article 9 of the Tax Law if all of the following conditions are met:

- for taxable years ending prior to January 1, 2000, the taxpayer paid the franchise tax due under section 184 of Article 9;
- for the taxable year at issue, all of the receipts from the pipeline transportation of natural gas attributable to the taxpayer and included in the taxpayer's entire net income are solely from the transportation of natural gas for wholesale customers and commercial retail customers;
- the taxpayer's tax under Article 9-A is determined on the entire net income base and the amount of tax so determined is greater than the amount of tax that the taxpayer would have incurred if the taxpayer's tax were computed under sections 183 and 184 of Article 9 (as those sections existed on December 31, 1999) based on the same taxable year; and
- the taxpayer is a party to a qualified gas transportation contract.

A *qualified gas transportation contract* is an agreement for the transportation of natural gas for an end-user that is a qualified cogeneration facility with a rated capacity of one thousand megawatts or more, and the contract meets all of the following conditions:

- was entered into before January 1, 2000, and was in full force and effect and binding on the parties thereto as of that date,
- as originally executed, was for a term of at least twenty years, and
- the terms of which prohibit the pass-through to that customer of the tax imposed under Article 9-A, while allowing the recovery of the tax imposed under section 184 of Article 9.

A contract does not qualify as a qualified gas transportation contract if, on or after January 1, 2000, there is either:

- any renewal or extension of an otherwise qualified gas transportation contract, or
- any material amendment to, or supplementation of, an otherwise qualified gas transportation contract.

A renewal, extension, or material amendment or supplementation has the same force and effect of terminating the re-characterization of tax as if the qualifying gas transportation contract had expired by its own terms.

These provisions apply only for the taxable years during which a qualified gas transportation contract is in full force and effect. The provisions apply, during the taxable year, only to the receipts of the taxpayer less any expenses of the taxpayer (but not less than zero) to the extent the receipts and expenses are included in entire net income and attributable to a qualified gas transportation contract.

These provisions expire for taxable years beginning on or after January 1, 2015.

(Tax Law Section 208.9(n).)

Electronic Signatures

The Tax Law has been amended to add a new section 171-k that authorizes the Commissioner of Taxation and Finance to provide for the use of electronic signatures on tax returns and reports filed electronically. The law states that electronic signatures must be consistent with the requirements of the State's Electronic Signatures and Records Act (ESRA). However, if the Commissioner determines that electronic signatures used by the Internal Revenue Service (IRS) in tax administration are not consistent with the requirements of ESRA, the Commissioner, after conferring with the Office for Technology, may prescribe the manner and form of electronic signature on any return or report. Such an electronic signature must conform, to the extent practicable, with electronic signatures used by the IRS.

(Tax Law Section 171-k)

Annual Reports to the State Comptroller (Article 9-A)

The Tax Law has been amended to enable the Tax Department to provide annual reports to the State Comptroller containing certain identifying information relating to general business corporations to help the Comptroller administer and enforce the Abandoned Property Law.

The provision requires the Commissioner to enter into an agreement with the State Comptroller to provide a report to the Comptroller upon the Comptroller's request, not more frequently than annually, which would identify corporations or other entities which have filed a Business Corporation Franchise Tax return under Article 9-A of the Tax Law for any taxable year within the ten calendar years preceding the report. The report is only to be used by the Comptroller for the administration and enforcement of the Abandoned Property Law, and may only be redisclosed by the Comptroller for those purposes. Notwithstanding the State's Public Officers Law or any other provision of law, the report furnished to the Comptroller will not be open to the public for inspection. The provision took effect on March 28, 2002, and expires after April 1, 2003.

(Tax Law Section 211(12).)