

## **Amendments to the Business Corporation Franchise Tax Regulations Relating to the Taxation of Corporate Partners**

On October 17, 2006, the Commissioner of Taxation and Finance adopted amendments to section 1-2.6 and Parts 3 and 4 of the Business Corporation Franchise Tax Regulations (Article 9-A of the Tax Law) relating to the computation of tax for corporations that are partners in partnerships or that are members of limited liability companies that are treated as partnerships. The amendments apply to taxable years beginning on or after January 1, 2007.

A general overview of the amendments follows.

Section 1-2.6 of the regulations has been amended to provide that the term *partnership* includes a limited liability company that has elected to be treated as a partnership for federal income tax purposes.

Numerous amendments have been made to Subpart 3-13, *Corporate Partners*. The regulations now provide that, except for certain foreign corporate limited partners, a taxpayer that is a partner in a partnership shall compute its tax with respect to its interest in the partnership under either the aggregate or entity method. The regulations also discuss each method and set forth the determination of the applicable methodology. Under the aggregate method, a corporate partner takes into account its distributive share of receipts, income, gain, loss or deduction and its proportionate part of assets, liabilities and transactions from the partnership. Under the entity method, a corporate partner is treated as owning an interest in a partnership entity. The interest is considered an intangible asset that constitutes business capital. The regulations make it clear that the aggregate method, which was required under the previous regulations, is the preferred method. A taxpayer must use the aggregate method if it has access to the information necessary to compute its tax using that method. A taxpayer is presumed to have access to the information if any one of the following is met:

- it is conducting a unitary business with the partnership,
- it is a general partner of the partnership or a managing member of a limited liability company which is treated as a partnership for federal income tax purposes,
- it has a 5% or more interest in the partnership,
- it has reported information from this partnership in a prior taxable year using the aggregate method,
- its partnership interest constitutes more than 50% of its total assets,
- its basis in its interest in the partnership pursuant to section 705 of the Internal Revenue Code and 26 CFR § 1.705-1 on the last day of the partnership year that ends within or with the taxpayer's taxable year is more than \$5,000,000, or

- any member of its affiliated group has the information necessary to perform the computation.

A taxpayer may overcome the presumptions and be allowed to use the entity method if it establishes and certifies that the information is not obtainable. In addition, the regulations specify the computation of the tax bases under each method, redefine the term *proportionate part* that was previously contained in section 4-6.5 and provide for the treatment of the gain or loss on the sale of a partnership interest. Various technical and clarifying amendments have also been made within Subpart 3-13 of the regulations.

Several clarifying amendments have been made to section 3-3.2 of the regulations relating to the definition of investment capital. The regulations make it clear that, with respect to a corporate partner using the aggregate method or with respect to a foreign corporate limited partner which has made an election with respect to the partnership pursuant to section 3-13.5 of the regulations, the election to treat cash as business or investment capital is made at the partner level and the partner takes into account its proportionate part of partnership items constituting cash. The regulations also provide that, in the case of these taxpayers, in determining whether a stock, bond, or other security held by the partnership is held for sale to customers in the regular course of business, taxpayers look at the item itself to see if that item is held as inventory by the partnership for sale to the partnership's customers in the regular course of the partnership's business. Lastly, with respect to these taxpayers, the regulations provide that the determination of whether a taxpayer is principally engaged in the lending of funds is made at the partner level and that the partner takes into account its distributive share of gross receipts from the partnership in making this determination.

The regulations change the treatment of stock of a corporation owned by a partnership. Prior to these amendments, stock of a corporation owned by a partnership was taken into account by a corporate partner in determining whether such other corporation was a subsidiary of the corporate partner and, hence, whether the stock of such corporation was considered subsidiary capital. An existing rule contained in section 3-6.2(b) of the regulations, relating to the definition of a subsidiary, requires direct ownership of stock when determining whether a corporation is a subsidiary so that stock owned through a corporate structure consisting of tiers of corporations is not considered. This section has been amended to extend this treatment to include stock owned by a partnership. In addition, section 3-6.3 of the regulations relating to the definition of subsidiary capital has been amended to provide that where a corporate partner using the aggregate method with respect to a partnership directly owns more than 50% of the stock of a corporation, its proportionate part of any stock of such corporation owned by the partnership qualifies as subsidiary capital. Conversely, it provides that where a corporate partner does not directly own more than 50% of the stock of a corporation, any stock of such corporation owned by the partnership does not qualify as subsidiary capital but may qualify as investment capital if it meets the definition of investment capital as set forth in section 3-3.2 of the regulations. A number of other technical and clarifying amendments have also been made in various other sections of Part 3 of the regulations.

The majority of the amendments to Part 4, *Allocation*, of the regulations are contained in section 4-6.5, *Rules relating to allocation by a corporate partner of a partnership or joint venture*. The regulations provide for inter-entity eliminations and exclusions from the property and receipts factors of the business allocation percentage for taxpayers that are partners using the aggregate method. Allocation rules have also been added for taxpayers that are partners that are principally engaged in the conduct of aviation or in the conduct of a railroad or trucking business. In addition, the amendments set forth allocation rules for taxpayers using the entity method. A number of technical and clarifying amendments have also been made.

The full text of the amendments may be obtained at the Tax Department's Web site ([www.nystax.gov](http://www.nystax.gov)).