STATE OF NEW YORK

DEPARTMENT OF TAXATION AND FINANCE

COMMISSIONER OF TAXATION AND FINANCE

ALBANY, NEW YORK

Pursuant to the authority contained in subdivision First of section 171, subsection (a) of section 1096, section 1468, and section 1519 of the Tax Law, the Commissioner of Taxation and Finance hereby makes and adopts the following amendment to the Business Corporation Franchise Tax Regulations, as published in Subchapter A of Chapter I of Title 20 of the Official Compilation of Codes, Rules and Regulations of the State of New York, the Franchise Tax on Banking Corporations Regulations, as published in Subchapter B of Chapter I of such Title, and the Franchise Taxes on Insurance Corporations Regulations as published in Subchapter C of Chapter I of such Title:

Section 1. Subdivision (d) of section 3-2.2 of such regulations is amended to read as follows:

(d) The amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporations is not allowed in computing entire net income. [The exempt foreign trade income of a FSC, which is excluded from gross income for Federal income tax purposes pursuant to section 921 of the Internal Revenue Code, is not a specific exemption or credit for purposes of this subdivision. A "FSC" is a corporation which meets the definition of the term "FSC" contained in section 922 of the Internal Revenue Code and which has made an election to be treated as a FSC under section 922(a)(2) of the Internal Revenue Code or an election to be treated as a FSC under section 922(a)(2) of the Internal Revenue Code or an election to be treated as a small FSC under section 922(b)(1) of the Internal Revenue Code. For the rule regarding inclusion of a FSC in a combined report, see section 6-2.5(b) of this Title.]

Section 2. Subdivisions (c), (d), and (e) of section 3-11.1 of such regulation are relettered to (d), (e), and (f), respectively, and a new subdivision (c) is added to read as follows:

(c) For information relating to the inclusion of a REIT in a combined report, see section 211.4 of the Tax Law.

Section 3. Subdivisions (c), (d), and (e) of section 3-12.1 of such regulations are relettered to (d), (e), and (f), respectively and a new subdivision (c) is added to read as follows:

(c) For information relating to the inclusion of a regulated investment company in a combined report, see section 211.4 of the Tax Law.

Section 4. Paragraph (1) of subdivision (a) of section 3-13.2 of such regulations is amended to read as follows:

(1) it is conducting a unitary business with the partnership within the meaning of section [6-2.2(b)] 6-2.3(e) of this Title;

Section 5. Subparagraph (i) of paragraph (1) of subdivision (a) of section 3-13.5 of such regulations is amended to read as follows:

(i) the limited partnership and corporate group are engaged in a unitary business wherever conducted (see section [6-2.2(b)] 6-2.3(e) of this Title); and

Section 6. The index of Subpart 6-2 of such regulations is amended to read as follows:

SUBPART 6-2

COMBINED REPORTS

Sec.

6-2.1 General

6-2.2 Capital stock [and unitary business requirements] requirement

6-2.3 [Other requirement] Substantial intercorporate transactions requirement and other considerations

6-2.4 [Permission for filing] Filing combined reports

6-2.5 Corporations not required or permitted to file a combined report

6-2.6 Combined reports: [election] other entities

6-2.7 Examples

[6-2.7] 6-2.8 Combined reports: cross - references

Section 7. Subdivision (a) of section 6-2.1 of such regulations is amended to read as follows:

(a) Every corporation is a separate taxable entity and shall file its own report. However, [the Tax Commission, in its discretion, may require a group of corporations to file a combined report or may grant permission to a group of corporations to file] a combined report covering a group of corporations engaged in a unitary business is required in certain circumstances. A combined report covering any taxpayer and another corporation or corporations is required where:

(1) the [requirement of stock ownership or control] capital stock requirement (as described in section [6-2.2(a)] 6-2.2 of this [Part] Subpart) is met; and

(2) [the group of corporations is engaged in a unitary business (as described in section 6-2.2(b) of this Part); and

(3)] the [other requirement] substantial intercorporate transactions requirement set forth in section 6-2.3 [or section 6-2.5(a)] of this [Part, as the case may be,] Subpart has been met.

Section 8. Subdivision (c) of section 6-2.1 of such regulations is REPEALED, subdivision (b) is relettered to be subdivision (c) and a new subdivision (b) is added to read as follows:

(b) Where the capital stock requirement is met and substantial intercorporate transactions are absent, a combined report covering corporations engaged in a unitary business may be required or permitted if the Commissioner deems such a report necessary, because of inter-company transactions or some agreement, understanding, arrangement, or transaction, in order to properly reflect the tax liability under article 9-A of the Tax Law.

Section 9. Section 6-2.2 of such regulations is amended to read as follows:

Section 6-2.2 Capital stock [and unitary business requirements] requirement. (Tax Law, Section 211(4))

(a) [*Capital stock requirement.*] (1) [In deciding whether to permit or require a group of corporations to file a combined report, the Tax Commission will first determine whether] A taxpayer and another corporation meet the capital stock requirement if:

(i) the taxpayer owns or controls, either directly or indirectly, substantially all of the capital stock of [all the other corporations which are to be included in the combined report] another corporation; or

(ii) substantially all of the capital stock of the taxpayer is owned or controlled, either directly or indirectly, by [other corporations which are to be included in the combined report] another corporation; or

(iii) substantially all of the capital stock of the taxpayer and substantially all of the capital stock of [the] one or more other corporations [which are to be included in the combined report] are owned or controlled, either directly or indirectly, by the same interests.

(2) Corporations that meet the capital stock requirement are "related corporations."

(3) The term *substantially all* means ownership or control of 80 percent or more of the voting power of the issued and outstanding stock. Ownership includes actual or beneficial ownership. To be considered the owner, the stockholder must have the right to vote and the right to receive dividends. The term *control* refers to all cases where the taxpayer controls the stock of [all the other corporations] another corporation or the stock of the taxpayer is controlled by [other corporations] another corporation or the taxpayer and [the] one or more other corporations are controlled by the same interests. The [decision] determination as to whether or not a corporation is controlled by or controls another corporation or is controlled by the same interests will be determined by the facts in each case.

Example 1: The taxpayer, X Corporation, owns 70 percent of the voting stock of Y Corporation. The remaining voting stock is owned by three employees of X Corporation. These employees have agreed in writing to sell their stock to X Corporation when they leave the corporation. As

part of the agreement, the employees have given X Corporation their voting proxy. Thus, X Corporation owns or controls 80 percent or more of the voting stock of Y Corporation.

[(b) *Unitary business requirement.* (1) In deciding whether a corporation is part of a unitary business, the Tax Commission will consider whether the activities in which the corporation engages are related to the activities of the other corporations in the group, such as:

(i) manufacturing or acquiring goods or property or performing services for other corporations in the group; or

(ii) selling goods acquired from other corporations in the group; or

(iii) financing sales of other corporations in the group.

(2) The Tax Commission, in deciding whether a corporation is part of a unitary business, will also consider whether the corporation is engaged in the same or related lines of business as the other corporations in the group, such as:

(i) manufacturing or selling similar products; or

(ii) performing similar services; or

(iii) performing services for the same customers.

(3) *Examples:*

Example 2: A manufacturing corporation organizes an 80 percent or more owned subsidiary and transfers all of its selling activities to the subsidiary. The subsidiary sells only the parent's products for which it receives a commission. The subsidiary has a place of business of its own and its own employees. The corporations are conducting a unitary business.

Example 3: The taxpayer, a manufacturing corporation, forms a holding company which is also subject to tax. The holding company owns all of the manufacturing company's stock. The only activity of the parent-holding company is to receive dividends from the manufacturing corporation. The corporations are not conducting a unitary business.]

Section 10. The title and subdivision (a) of section 6-2.3 of such regulations are amended to read as follows, subdivision (b) is REPEALED, subdivision (c) is relettered to (b) and amended to read as follows:

Section 6-2.3 [Other Requirement] Substantial intercorporate transactions requirement and other considerations. (Tax Law, Sec. 211(4) and (5)).

(a) **[**If the capital stock and unitary business requirements described in section 6-2.2 of this Part have been met, the Tax Commission may permit or require a group of taxpayers to file a combined report if reporting on a separate basis distorts the activities, business, income or capital in New York State of the taxpayers. The activities, business, income or capital of a taxpayer will be presumed to be distorted when the taxpayer reports on a separate basis if there are] In determining whether substantial intercorporate transactions among the related corporations exist, the facts and circumstances of all activities and transactions will be considered regardless of the transfer price for such intercorporate transactions. It is not necessary that there be substantial intercorporate transactions between any one corporation and every other related corporation. However, it is necessary that there be substantial intercorporate transactions between the taxpayer and a related corporation or collectively a group of such related corporations.

[(c)] (b)(1) In determining whether there are substantial intercorporate transactions, the [Tax Commission] Commissioner will consider and evaluate all activities and transactions [directly connected with the business conducted by] of the taxpayer and its related corporations, [such as] including but not limited to:

[(1)] (i) manufacturing or acquiring goods or property or performing services for [other corporations in the group] related corporations;

[(2)] (ii) selling goods acquired from [other corporations in the group] related corporations;

[(3)] (iii) financing sales of [other corporations in the group; or] related corporations;

[(4)] (iv) performing related customer services using common facilities and employees for related corporations;

(v) incurring expenses that benefit, directly or indirectly, one or more related corporations; and

(vi) transferring assets, including assets such as accounts receivable, patents, or trademarks from one or more related corporations.

(2) For purposes of determining whether substantial intercorporate transactions exist, dividends are not considered in the measure of intercorporate receipts, total receipts, intercorporate expenditures, or total expenditures described in subparagraph (i) of paragraph (3) of this subdivision. Interest paid and received on loans between related corporations is considered in determining if there are substantial intercorporate transactions, including interest on loans that constitute subsidiary capital pursuant to section 3-6.3 of this Title and section 208.4 of the Tax Law. Taxes paid or reimbursed will not be considered in determining if there are substantial intercorporate transactions. Similar transactions must be treated in a consistent manner from taxable year to taxable year. Service functions will not be considered when they are incidental to the business of the corporation providing such service and expenditures for service functions are not considered expenditures benefiting a related corporation or a group of related corporations described in subclause “(3)” of clause “(a)” of subparagraph (i) of paragraph (3) of this subdivision. Service functions include, but are not limited to, accounting, legal, payroll processing, and personnel services. Where a corporation makes expenditures that benefit a related corporation or a group of related corporations and allocates these costs to the related corporation or a group of related corporations, the intercorporate cost allocations are not considered receipts or expenditures described in subparagraph (i) of paragraph (3) of this subdivision; the expenditures benefiting the

related corporation or group of related corporations are included in such expenditures described in subclause "(3)" of clause "(a)" of such subparagraph (i).

(3) [The] (i)"(a)" Subject to clause "(b)" of this subparagraph, the substantial intercorporate [transaction] transactions requirement [may be met] based on a corporation's receipts or expenditures is met where [as little as 50 percent of a corporation's receipts or expenses are from one or more qualified activities described in this subdivision. It is not necessary that there be substantial intercorporate transactions between any one member with every other member of the group. It is, however, essential that each corporation have substantial intercorporate transactions with one other corporation or with a combined or combinable group of corporations. For example, Corporation Z sells 30 percent of its product to Corporation X and 40 percent of its product to Corporation Y. If Corporations X and Y constitute a combined or combinable group, there are substantial intercorporate transactions between Corporation Z and such a combined group because 70 percent of Corporation Z's sales are to such combined group. If Corporations X and Y do not constitute a combined or combinable group, there are not substantial intercorporate transactions between Corporation Z and Corporations X and Y.]:

"(1)" during the taxable year, 50 percent or more of a corporation's receipts includable in the computation of entire net income (excluding nonrecurring receipts) are from a related corporation or a group of related corporations;

"(2)" during the taxable year, 50 percent or more of a corporation's expenditures includable in the computation of entire net income, including expenditures for inventory but excluding nonrecurring expenditures, are to a related corporation or a group of related corporations; or

"(3)" during the taxable year, "(i)" 50 percent of more of a corporation's expenditures includable in the computation of entire net income (excluding nonrecurring expenditures) directly or indirectly benefit a related corporation or a group of related corporations or "(ii)" a corporation's expenditures includable in the

computation of entire net income (excluding nonrecurring expenditures) directly or indirectly benefiting a related corporation or a group of related corporations are equal to 50 percent or more of the sum of such expenditures and the expenditures (excluding nonrecurring expenditures) of the beneficiary corporation or corporations.

"(b)" If, in a particular taxable year, a corporation's intercorporate receipts or expenditures described in subclauses "(1)", "(2)", or "(3)" of clause "(a)" of this subparagraph, are between 45 percent and 55 percent of the total of the corporation's receipts or expenditures, as the case may be, then the test will be satisfied only if the corporation's receipts or expenditures, as the case may be, from one or more related corporations during the taxable year and the prior two taxable years in aggregate equals or exceeds 50 percent of its total receipts or expenditures, as the case may be, during the taxable year and the prior two taxable years in aggregate. If the corporation or one or more of the related corporations involved in the intercorporate transactions did not exist for all of the two prior taxable years, then the 50 percent measure for each corporation will be computed using the number of months that it existed.

(ii) The substantial intercorporate transactions requirement based on a corporation's asset transfers is met where a corporation transfers assets (including through incorporation) to a related corporation and 20 percent or more of the transferee's gross income, including any dividends received, in the taxable year of the transfer or in taxable years subsequent to the year the asset or assets were transferred, is derived directly from the transferred assets. This applies to assets transferred on or after January 1, 2007. For purposes of this test, the following apply:

"(a)" Generally, only assets to the extent that they are transferred in exchange for stock or paid in capital are considered "qualifying assets". Transfers of assets other than in exchange for stock or paid in capital, including transfers of assets through a nonmonetary property dividend, are not considered unless the principal

purpose of the transfer is the avoidance or evasion of the franchise tax imposed on the taxpayer or the combined group by New York State;

"(b)" transfers of cash to a related corporation in exchange for stock or paid in capital are not considered;

"(c)" the term "gross income" means gross income as defined in section 61(a) of the Internal Revenue Code;

"(d)" gross income is derived directly from an asset if the asset or the use of the asset by the transferee produces gross income. Gross income from transferred assets that generate income only when used in combination with other assets is not gross income derived directly from the assets. The gain from a sale of any transferred asset is considered gross income derived directly from the asset. Assets that may directly produce gross income include, but are not limited to, real property, accounts receivable, and intangibles such as patents, copyrights, trademarks, and partnership interests;

"(e)" gross income from the sale of items produced from transferred production equipment would not, by itself, be considered gross income derived directly from the transferred assets. However, gross income from the sale of items produced from transferred assets constituting substantially all of the production process, including associated intangibles, such as might occur in the transfer of an operating division, would constitute gross income derived directly from the transferred assets;

"(f)" gross income received by the transferee as a result of the reinvestment of income attributable to the transferred asset is not gross income derived directly from the transferred asset;

"(g)" the test must be applied for each year of an asset's normal depreciation recovery period under sections 167 or 168(c) of the Internal Revenue Code or amortization period under section 197(a) of the Internal Revenue Code, without regard to any reduction or disallowance of the depreciation or amortization period contained in the Internal Revenue Code. In the case of an asset that is not required to be depreciated or

amortized for Federal income tax purposes, such as accounts receivable, the test must be applied for each year the asset is reflected on the books and records of the transferee under generally accepted accounting principles;

"(h)" if the asset transferred is an interest in another entity including a partnership, an entity treated as a partnership or a disregarded entity, the income distributed or deemed distributed to the transferee by such entity is gross income derived directly from the transferred asset;

"(i)" where more than one asset is transferred, the gross income from all qualifying assets is used in determining whether the test is met;

"(j)" the determination of whether a transaction or series of transactions constitutes an asset transfer is based on the facts and circumstances of the transaction. The form of a transaction will not be respected if the transaction lacks economic substance or if the taxpayer intended a series of actions to be part of a single integrated transaction, or where it has as a principal purpose the avoidance or evasion of the franchise tax imposed on the taxpayer, or the combined group, by New York State; and

"(k)" the following examples illustrate when gross income is or is not derived directly from a transferred asset:

> *Example 1*: If a corporation transfers a patent that is used by the transferee in a production process, income from the sale of the item produced by that process is not gross income derived directly from the patent. However, if the transferee sells the patent, the gain on the sale of the patent is gross income derived directly from the patent.

> *Example 2*: A corporation transfers production equipment to another corporation. The income from selling products made by the production equipment is not considered to be gross income derived directly from the equipment. If the transferee sells the production equipment, any gain on such sale is considered gross income derived directly from the transferred asset. In addition,

gross income from the sale of items produced from transferred assets constituting substantially all of the production process, including associated intangibles, such as might occur in the transfer of an operating division, would constitute gross income derived directly from the transferred assets.

Example 3: Rental income derived from a transferred asset is considered gross income derived directly from a transferred asset. However, if the rental income is deposited in a bank account, interest earned on the bank account is not gross income derived directly from the asset.

(iii) In determining whether the substantial intercorporate transactions requirement has been met, the Department will consider the materiality of the transactions and whether the transactions have economic substance, including the extent to which the motivation of the taxpayer in undertaking the transactions was to affect the membership of the combined group.

Section 11. A new subdivision (c) is added to section 6-2.3 of the regulations to read as follows:

(c) The following steps should be used to determine whether a combined report is required and, if so, which corporations are included in that combined report:

(1) Every taxpayer must identify all of the corporations to which it is related. Where one or more of the related corporations are taxpayers, identify all of the corporations related to these taxpayers. Do this until all related corporations have been identified. If a taxpayer has no related corporations, it must file on a separate basis. This constitutes the Step 1 group of related corporations.

(2) Identify all of the related corporations that have substantial intercorporate transactions with a taxpayer identified in Step 1. These related corporations and the taxpayer with which they have substantial intercorporate transactions constitute the Step 2 tentative combined group.

(3) Add to the Step 2 tentative combined group every related corporation that has substantial intercorporate transactions with any corporation identified in Step 2. This constitutes the Step 3 tentative combined group.

(4) Add to the Step 3 tentative combined group every related corporation that has substantial intercorporate transactions with any corporation identified in Step 3. Repeat this process until it adds no more corporations to the group. This constitutes the Step 4 tentative combined group.

(5) Identify each related corporation not in the Step 4 tentative combined group that has substantial intercorporate transactions with another related corporation not in the Step 4 tentative combined group. Compare all such groups and combine into one group those with common members ("unattached related group"). There may be more than one unattached related group.

(6) If there are substantial intercorporate transactions between any one corporation in an unattached related group and the Step 4 tentative combined group, then all corporations in that unattached related group are included in the combined group. Do this for each unattached related group. As unattached related groups are included in the combined group, do this analysis between the expanded group and each unattached related group. The resulting group is the Step 6 tentative combined group.

(7) If there are substantial intercorporate transactions between any one corporation in the Step 6 tentative combined group and an unattached related group, then all corporations in the unattached related group are included in the combined group. Do this for each unattached related group. As unattached related groups are included in the combined group, do this analysis between the expanded group and each unattached related group. The resulting group is the Step 7 tentative combined group.

(8) Add to the Step 7 tentative combined group each related corporation that has substantial intercorporate transactions with the Step 7 tentative combined group.

(9) Repeat the processes set forth in Steps 4, 6, 7, and 8 until no more corporations can be added to the tentative combined group.

(10) Eliminate from the tentative combined group those corporations that are formed under the laws of another country (alien corporations), that are taxable under another franchise tax imposed by the Tax Law (or would be taxable under another franchise tax if subject to tax), and corporations that compute their business allocation percentage using a statutory method that is different from the taxpayer's (e.g., aviation corporations and trucking corporations compute their business allocation percentage using a different business allocation percentage than manufacturing corporations), New York S corporations defined in section 208(1-A) of the Tax Law, and foreign corporations not subject to tax that have an election in effect under subchapter S of chapter one of the Internal Revenue Code. Also eliminate any captive REIT or captive RIC as defined in subdivisions 9 and 10 of section 2 of the Tax Law, respectively, that is required to be included in a combined return under section 1462(f) or 1515(f) of the Tax Law. If two or more corporations are eliminated, it is possible that they will constitute a combined group if they have substantial intercorporate transactions. For example, one group could consist of trucking corporations and another group could consist of manufacturing corporations. However, section 211.4(a)(5) of the Tax Law provides that alien corporations are not to be included in a combined group (also see section 6-2.5 of this Subpart – Corporations not required or permitted to file a combined report).

Section 12. Subdivisions (d), (e) and (f) of section 6-2.3 of the regulations are REPEALED and new subdivisions (d) and (e) are added to read as follows:

(d) If the capital stock requirement described in section 6-2.2 of this Subpart has been met, but substantial intercorporate transactions are absent, a combined report may be required or permitted if the Commissioner deems such a report necessary because of inter-company transactions or some agreement, understanding, arrangement, or transaction in order to properly reflect the tax liability under article 9-A.

(e)(1) For purposes of this Subpart, in determining whether a corporation is part of a unitary business, the Commissioner will consider whether the activities in which the corporation engages are related to the activities of the other corporations in the group, such as:

(i) manufacturing or acquiring goods or property or performing services for other corporations in the group; or

(ii) selling goods acquired from other corporations in the group; or

(iii) financing sales of other corporations in the group.

(2) In determining whether a corporation is part of a unitary business, the Commissioner will also consider whether the corporation is engaged in the same or related lines of business as the other corporations in the group, such as:

(i) manufacturing or selling similar products; or

(ii) performing similar services; or

(iii) performing services for the same customers.

(3) *Examples*:

Example 1: A manufacturing corporation organizes an 80 percent or more owned subsidiary and transfers all of its selling activities to the subsidiary. The subsidiary sells only the parent's products for which it receives a commission. The subsidiary has a place of business of its own and its own employees. The corporations are conducting a unitary business.

Example 2: The taxpayer, a manufacturing corporation, forms a holding company. The holding company owns all of the manufacturing company's stock. The only activity of the parent-holding company is to receive dividends from the manufacturing corporation. The corporations are not conducting a unitary business.

Section 13. The title and subdivision (a) of section 6-2.4, of such regulations are amended to read as follows:

Section 6-2.4 [Permission for filing] Filing combined reports. (Tax Law, Sec. 211(4)).

(a)(1) [A] As provided in this Subpart a group of related corporations [meeting the requirements set forth in section 6-2.2 and 6-2.3 of this Subpart does not need to request prior permission] may be required or permitted to file on a combined basis. To file on a combined basis the group must file a completed combined report. The first year the group files on a combined basis, and each year thereafter in which the composition of the group changes, the group must include the following information[, either on] with the report [or attached thereto]:

(i) the exact name, address, employer identification number and the state of incorporation of each corporation included in the combined report;

(ii) information showing that each of the corporations meets the capital stock requirement of section [6-2.2(a)] 6-2.2 of this Subpart for the taxable year; and

(iii) the exact name, address, employer identification number and the state of incorporation of all corporations (except alien corporations) [which] that meet the capital stock requirement of section [6-2.2(a)] 6-2.2 of this Subpart for the taxable year, [which] but are not included in the combined report.

(2) In addition, the following information may be required to be submitted for the taxable year at another time, such as in conjunction with an audit:

(i) a statement providing details as to why a combined report which includes only the corporations listed in subparagraph (1)(i) of this subdivision [equitably reflects the New York State activities of the corporations which] that meet the capital stock requirement of section [6-2.2(a)] 6-2.2 of this Subpart and the details as to why the corporations listed pursuant to subparagraph (1)(iii) of this subdivision [should be] are excluded; and

(ii) information establishing that[, for the taxable year,] each corporation included [on] in the report meets the [unitary business requirement of section 6-2.2(b) of this Subpart, as well as the] requirements of section 6-2.3 of this Subpart.

Section 14. Section 6-2.5 of such regulations is amended to read as follows:

Section 6-2.5 Corporations not required or permitted to file a combined report. (Tax Law, Sec. 211(4)).

(a) [A foreign corporation not subject to tax will not be required to be included in a combined report unless the requirements described in section 6-2.2 of this Subpart have been met and the Tax Commission determines that inclusion is necessary to properly reflect the tax liability of one or more taxpayers included in the group because of:

(1) substantial intercorporate transactions (see section 6-2.3(c) of this Subpart); or

(2) some agreement, understanding, arrangement or transaction whereby the activity, business, income or capital of any taxpayer is improperly or inaccurately reflected.

> *Example 1:* A parent corporation, a taxpayer, is the sole owner of a finance subsidiary which is a foreign corporation not subject to tax The parent manufactures furniture which it sells to independent retail dealers. The parent has an agreement with its finance subsidiary that the subsidiary will directly finance the purchase of the parent's furniture when it is purchased by customers of the independent retail dealers. The subsidiary's income is predominantly derived from financing retail sales of its parent's products. The independent retail dealer arranges the financing for the customer with the subsidiary. The parent and finance subsidiary will be required to file a combined report because of this agreement.

(b) An alien corporation (see section 3-8.3 of this Title --Alien corporations)] A corporation organized under the laws of a country other than the United States (see Tax Law section 211.4(a)(5)) may not be included in a combined report. [Provided, however, that all FSCs, including those that are alien corporations, may be

included in a combined report. For a special rule regarding the computation of the entire net income of a FSC, see section 3-2.2(d) of this Title.]

[*Example 2:* A taxpayer has several 80 percent or more owned alien subsidiaries, none of which is a FSC. It organizes an 80 percent or more owned domestic subsidiary to provide financing for the alien subsidiaries. Assume the parent, the domestic subsidiary and the alien subsidiaries are conducting a unitary business. The parent and the domestic subsidiary will be permitted or required to file a combined report if they meet the requirement set forth in section 6-2.3 of this Subpart. However, in no event will the alien subsidiaries be allowed in a combined report.

Example 3: A taxpayer has an 80 percent or more owned alien subsidiary which is a FSC. The parent and such alien subsidiary are conducting a unitary business. The parent and such alien subsidiary will be permitted to file a combined report if they meet the requirement set forth in section 6-2.3 of this Subpart or will be required to file a combined report if the Commissioner of Taxation and Finance determines that inclusion of such alien subsidiary in a combined report is necessary pursuant to subdivision (a) of this section. (c)]

(b) A corporation which is taxable under [some other article of] another franchise tax imposed by the Tax Law [(except corporations which are taxable under article 9-A and article 13-A, section 182, 182-a, 182-b or 186-a of article 9)] (or would be taxable under another franchise tax if subject to tax) may not be included in a combined report.

[*Example 4:* A corporation engaged in the manufacture and sale of furniture organizes an 80 percent or more owned subsidiary to which it transfers its delivery department. The subsidiary's only activity is making deliveries of the taxpayer's goods. Even though the activities of the two corporations constitute a unitary business, a combined report will not be required or permitted

since the subsidiary is properly taxable under section 183 and section 184 of article 9 of the Tax Law as a transportation corporation. (d)]

(c) A taxpayer that allocates in accordance with section 210.3(a)(7)(A) of the Tax law (relating to aviation corporations) may not be included in a combined report with any other corporation that does not allocate pursuant to such section 210.3(a)(7)(A), unless such taxpayer or other such corporation is a qualified air freight forwarder as described in section 211.4(a)(2)(ii) of the Tax Law, with respect to such other corporation or taxpayer, respectively, and all corporations included in the combined report elect to have such qualified air freight forwarded so included.

(d) A taxpayer that allocates in accordance with section 210.3(a)(8) of the Tax Law (relating to railroad and trucking corporations) may not be included in a combined report with any [other such] corporation that does not allocate pursuant to such section 210.3(a)(8).

(e) A New York S corporation, as defined in section 208(1-A) of the Tax Law, may not be included in a combined report except with:

(1) one or more New York S corporations (see section [6-2.3(a)] 6-2.3 of this Subpart); and/or

(2) one or more foreign corporations not subject to tax, which have made an election under subchapter S of chapter one of the Internal Revenue Code (see section [6-2.3(b)] 6-2.3(d) of this Subpart [or subdivision (a) of this section)].

Section 15. Section 6-2.6 of such regulations is amended to read as follows:

Section 6-2.6 Combined Reports: [election] Other entities. (Tax Law, Sec. 211(4)).

(a) Any corporation which owns or controls either directly or indirectly substantially all of the capital stock of a taxable DISC, as defined in section 3-9.2 of this Title, will be allowed, at its election, to file a combined report which includes such DISC. [If] However, if the corporation fails to make the election allowed

by this section, the [Tax Commission] Commissioner [may, in its discretion, require] is not prohibited from requiring a combined report covering the corporation and such DISC.

(b) For information relating to the inclusion of a real estate investment trust (REIT) in a combined report, see section 211.4 of the Tax Law.

(c) For information relating to the inclusion of a regulated investment company (RIC) in a combined report, see section 211.4 of the Tax Law.

Section 16. Section 6-2.7 of such regulations is renumbered to be section 6-2.8 and a new section 6-2.7 is added to read as follows:

Section 6-2.7 Examples

Unless otherwise provided, assume the following facts for all examples:

Corporation A owns all of the stock of corporations B, C, D, E, F, G, H, L, M, N, O, P, Q, and R. All of the corporations are calendar year taxpayers for federal income tax purposes. Corporations B and C are taxable under article 9-A of the Tax law and the other corporations would be subject to tax under article 9-A if they had nexus with New York. All of the corporations use (or would use) the business allocation percentage computed pursuant to section 210.3(a)(10) of the Tax Law. None of the corporations is a corporation organized under the laws of a country other than the United States.

Example 1: 90 percent of B's receipts are from D. Therefore, there are substantial intercorporate transactions between B and D. B and D are a tentative combined group and must file a combined report.

Example 2: B's receipts are: 22 percent from A, 20 percent from C, 30 percent from D, 10 percent from E and the rest are from unrelated entities. 40 percent of C's expenses are to B. No other substantial intercorporate transactions occur between the corporations. Since there is no

tentative combined group among the related corporations, corporations B and C file on a separate basis.

Example 3: 90 percent of B's receipts are from D and 100 percent of D's receipts are from E. D is an alien corporation. There are substantial intercorporate transactions between B and D, and D and E. B, D and E are a tentative combined group. However, since D is a corporation organized under the Laws of a country other than the United States, it cannot be included in a combined report (see sections 6-2.3(c)(10) and 6-2.5(b) of this Subpart). Therefore, B and E file a combined report.

Example 4: A is the only taxpayer and 50 percent of A's receipts are from B, with another 4 percent from E. 30 percent of E's expenditures are to A and 20 percent to D. C has no transactions with anyone in the group. 50 percent of D's receipts are from A. 50 percent of F's receipts are from A. 100 percent of H's receipts are from F. 100 percent of R's receipts are from H. 20 percent of B's receipts are from L, 20 percent from M, and 20 percent from N. 100 percent of L's receipts are from M. 100 percent of M's receipts are from N. 40 percent of O's receipts are from R and 30 percent are from D. 60 percent of P's receipts are from O. 80 percent of L's expenditures are to Q. All of these corporations are in the Step 1 group of related corporations described in section 6-2.3(c)(1) of this Subpart because they meet the stock ownership test.

The Step 2 tentative combined group as described in section 6-2.3(c)(2) of this Subpart consists of A, B, D, and F. As a result of Step 3 (see section 6-2.3(c)(3) of this Subpart), H is added to

the tentative combined group. As a result of Step 4 (see section 6-2.3(c)(4) of this Subpart), R is added to the tentative combined group.

As described in Step 5 (see section 6-2.3(c)(5) of this Subpart), L, M, N and Q is an unattached related group and O and P is an unattached related group.

Corporations O and P are added to the tentative group pursuant to Step 6 (see section 6-2.3(c)(6) of this Subpart) because 70 percent of O's receipts are from R and D. The Step 6 tentative combined group is A, B, D, F, H, R, O and P.

The corporations in the unattached unrelated group of L, M, N and Q are all added to the tentative combined group pursuant to Step 7 (see section 6-2.3(c)(7) of this Subpart) because B has substantial intercorporate transactions with the unattached related group of L, M, N and Q. The Step 7 tentative combined group is A, B, D, F, H, R, O, P, L, M, N and Q.

Pursuant to Step 8 (see section 6-2.3(c)(8) of this Subpart), E is added to the Step 7 tentative combined group because 30% of its expenditures are from A and 20% are from D. The Step 9 (see section 6-2.3(c)(9) of this Subpart) tentative combined group is the same as the Step 8 tentative combined group. Since no corporations will be excluded from the Step 9 tentative combined group pursuant to Step 10 (see sections 6-2.3(c)(10) and 6-2.5 of this Subpart), the group of corporations that must file a combined report are A, B, D, F, H, R, O, P, L, M, N, Q and E.

Example 5: Same facts as Example 4 except that A, B, D, and F have filed on a combined basis for several years. In the current year, A realizes that it would reduce its New York State tax liability if it included C in the combined report. A creates K by contributing $10,000 of cash to it in exchange for all of K's stock. (In the alternative, A lends $10,000 to K, an existing dormant corporation). K enters into a contract with C to provide it with all of its office supplies (pens, paper, paper clips, etc.). K buys all of its office supplies from A and then sells them at a slight mark-up to C. In addition, K has a very small amount of interest income from a bank account.

The creation of K (or, in the alternative, making K an active corporation) and the transactions of A with K and K with C are not substantial intercorporate transactions because they lack economic substance.

Example 6: A is a bakery in NY and E is a bakery in Florida. Each year, A sells E a few pieces of equipment but the transactions are not substantial from either A's or E's point of view. In a particular year, A realizes it would reduce its New York State tax liability if it included E in a combined report with it. A creates K by contributing $10,000 to it in exchange for all of K's stock. A sells the equipment to K and K sells the equipment to E.

The creation of K and the transactions of A with K and K with E are not substantial intercorporate transactions because they lack economic substance.

Example 7: A's only activity is to receive dividends from its wholly owned subsidiaries. B sells stocks, C sells municipal bonds and D sells corporate bonds. B, C and D each have their own

employees. However, the employees of one corporation are authorized to and do sell extensively the securities sold by the other corporations. 80 percent of the receipts of B, 70 percent of the receipts of C and 60 percent of the receipts of D are generated by sales made by the common pool of employees of B, C, and D. All three corporations carry on their activities at or using common facilities. Because there are substantial intercorporate transactions using common facilities and employees among B, C and D, they are a combined group and must file a combined report. A is not included in the combined group because it has no substantial intercorporate transactions with a related corporation.

Section 17. Section 6-2.8 as renumbered by section 16 of this proposal is amended to read as follows:

Section 6-2.8 Combined reports: cross-references.

The following is a list of cross-references to other sections of this Subchapter which pertain to combined reports:

(a) Combined corporations ceasing to exercise franchise or to be subject to tax under article 9-A, see section 2-3.1(d) of this Title.

(b) [Computing] Computation of tax on a combined [reports] report, see section 3-1.3 of this Title.

[(c) Definition of entire net income, see section 3-2.2 of this Title.]

[(d)] (c) Computing entire net income on a combined [reports] report, see section 3-2.10 of this Title.

[(e)] (d) Computing business capital and investment capital on a combined [reports] report, see section 3-3.8 of this Title.

[(f)] (e) Computing minimum taxable income on a combined [reports] report, see section 3-4.5 of this Title.

[(g)] (f) Fixed dollar minimum on a combined [reports] report, see section 3-5.3 of this Title (for New York S corporations, see section [3-1.3[d]] 3-1.3(d) of this Title).

[(h)] (g) Computing subsidiary capital on a combined [reports] report, see section 3-6.6 of this Title.

(h) Net operating loss deduction – combined reports, see section 3-8.7 of this Title.

(i) Combined reports (DISC), see section 3-9.6 of this Title.

(j) Combined reports (Real Estate Investment Trusts), see section 3-11.1(c) of this Title.

(k) Combined reports (Regulated Investment Companies), see section 3-12.1(c) of this Title.

[(i)] (l) Allocation on combined reports, see section 4-1.2 of this Title.

[(j)] (m) Rented real and tangible personal property, see section 4-3.2(c)(1) of this Title.

[(k)] (n) Receipts factor on combined reports, see section 4-4.8 of this Title.

[(l)] (o) Form of reports on combined basis, see section 6-3.2 of this Part.

[(m)] (p) A corporation reporting on a combined basis ceasing to be subject to tax, or ceasing to exercise its franchise but remaining subject to tax, see section 6-4.3(c) of this Part.

[(n) Payment of tax on combined reports, see Subpart 7-1 of this Title.

(o)] (q) Assessment of tax on combined reports, see section 8-1.3 of this Title.

Section 18. Subdivisions (a) and (b) of section 6-3.2 of such regulations are amended to read as follows:

(a) In all cases where a combined report is required or permitted (see Subpart 6-2 of this Part) a combined franchise tax report must be submitted by the [corporation] taxpayer designated as the parent responsible for paying the combined tax on form CT-3-A. In addition, each related corporation in the combined group must submit such other reports and other information which the Commissioner [of Taxation and Finance] may require.

(b) [All] It is not necessary that all corporations in the combined group [must use] have the same accounting period. (See Subpart 2-1 for information relating to accounting periods). Where a corporation's taxable year is different from that of the taxpayer designated as the parent, the applicable taxable year of such corporation to be included in the combined group is the taxable year that ends within the taxable year of the

taxpayer designated as the parent. The Commissioner may permit or require a taxpayer to use a different accounting period where appropriate.

Section 19. Subdivisions (b) and (d) section 21-2.1 of such regulations are to read as follows:

(b) [Each] Generally, each of the corporations to be included in the combined return must be a banking corporation or a bank holding company. (See section 1462(f)(2)(v)(B) of the Tax Law for information relating to the inclusion of captive REIT and captive RIC in a combined return.)

(d) [Each] It is not necessary that all [corporation] corporations included in a combined return [must use] have the same accounting period. (See section 21-3.2 of this Part – Form of combined returns.).

Section 20. Section 21-3.2 of such regulations is amended to read as follows:

(a) In all cases where a combined return is permitted or required (see Subpart 21-2 of this Part Combined Returns), a combined franchise tax return must be submitted by the [corporation] taxpayer designated as the parent responsible for paying the combined tax on form CT-32-A. In addition, each corporation in the combined group must submit such other reports and other information which the Commissioner [of Taxation and Finance] may require.

(b) [All] It is not necessary that all corporations in the combined group [must use] have the same accounting period. (See Subpart 17-1 for information relating to accounting periods). Where a corporation's taxable year is different from that of the taxpayer designated as the parent, the applicable taxable year of such corporation to be included in the combined group is the taxable year that ends within the taxable year of the taxpayer designated as the parent. The Commissioner may permit or require a taxpayer to use a different accounting period where appropriate.

Section 21. Subchapter C of Chapter I of such regulations is amended by adding a new Part 33 to read as follows:

PART 33

COMBINED RETURNS

(Statutory authority: Tax Law, Section 171, 1096(a), 1519)

Section 33.1 Combined returns. [Tax Law, Section 1515(f)] (a) Section 1515(f) of the Tax Law requires certain taxpayers that are subject to tax under Article 33 to file on a combined basis with related corporations where there are substantial intercorporate transactions among the related corporations. The provisions of Subpart 6-2 of this Title relating to combined reports under Article 9-A of the Tax Law are applicable to combined returns filed under section 1515(f) of the Tax Law except where otherwise provided by the Tax Law or this Part.

(b) In determining whether there are substantial intercorporate transactions, the Commissioner will consider and evaluate all activities and transactions of the taxpayer and its related corporations, including but not limited to;

(1) manufacturing, acquiring goods or property, or performing services for related corporations,

(2) selling goods acquired from related corporations,

(3) financing sales of related corporations,

(4) performing related customer services using common facilities and employees for related corporations,

(5) selling policies or contracts of insurance for related corporations,

(6) reinsuring risks for related corporations,

(7) collecting premiums or other consideration for any policy or contract of insurance for related corporations,

(8) incurring expenses that benefit, directly or indirectly, one or more related corporations, and

(9) transferring assets, including assets such as accounts receivable, patents, or trademarks from one or more related corporations.

(c) For purposes of determining whether the substantial intercorporate transactions requirement based on a corporation's asset transfers is met, the term "gross income" means life insurance gross income or gross income as defined by section 803 or 832 of the Internal Revenue code, whichever is applicable; and

(d) In following the steps set forth in section 6-2.3(c) of this Title that are used in determining whether a combined report is required and, if so, which corporations are included in the combined report, at the last step (see 6-2.3(c)(10)), any corporations that are formed under the laws of another country (alien corporations), that are taxable under another franchise tax imposed by the Tax Law (or would be taxable under another franchise tax if subject to tax), or that are subject to the tax imposed by section 1502-a of the Tax Law (e.g., authorized non-life insurance corporations) or section1502-b of the Tax Law (e.g., authorized captive insurance companies) must be eliminated from the tentative combined group. Also eliminate any captive REIT or captive RIC as defined in subdivisions 9 and 10 of section 2 of the Tax Law, respectively, that is required to be included in a combined report under section 211.4(a)(6) or a combined return under section 1462(f) of the Tax Law. (Also see section 6-2.5 of this Title – Corporations not required or permitted to file a combined report.)

Section 22. These amendments shall take effect on the date the Notice of Adoption is published in the State Register and apply to taxable years beginning on or after January 1, 2013.

Dated: Albany, New York
December 17, 2012

Thomas H. Mattox
Commissioner of Taxation and Finance