This draft provides updates to the proposed rules for special entities that were previously posted in May 2020. In addition to minor editorial changes and consistency edits, the following changes were made:

- Inclusion of a definition of "goods" for purposes of a qualified New York manufacturer.
- Clarifications of what constitutes manufacturing activities.
- Clarification of the BAF computation for corporate partners computing tax under the aggregate method.
- Addition of an example of the tax computation for corporate partners using the entity method.
- Clarification of the sourcing of GILTI for New York S corporations.
- Definitions of real estate investment trust (REIT), non-captive REIT, regulated investment company (RIC), and non-captive RIC are moved to Subpart 1-1, *Definitions.*

The Department is currently reviewing the need for special rules for real estate mortgage investment conduits (REMICs). If it is determined that special rules are needed for these entities, they will be included in an update to this Part.

Given the minimal updates needed for this Part, the Department does not anticipate that many substantive changes will need to be made before the formal promulgation process begins. If there are comments that have not yet been submitted or proposed changes have not been made but you believe are necessary, we strongly encourage such feedback be submitted during this comment period so that the Department may consider them before the formal promulgation process begins.

PART 10 – SPECIAL ENTITIES

SUBPART 10-1

QUALIFIED NEW YORK MANUFACTURERS

Sec.

Section 10-1.1 General Definitions. (Tax Law, section 210(1)(a)(vi) and 210(1)(b)(2))

For purposes of this Subpart, the following terms have the following meaning.

(a) "Adjusted basis" means the adjusted basis determined for federal tax purposes for taxable years beginning before January 1, 2018 and means New York state adjusted basis for taxable years beginning on or after January 1, 2018. "New York state adjusted basis" means the adjusted basis of such property for federal income tax purposes at the close of the taxable year plus the accumulated amount of the federal depreciation deductions disallowed under section 208(9)(b)(17) for such property (including the depreciation deductions for the current taxable year) minus the accumulated amount of the subtractions from federal taxable income allowed under section 208(9)(a)(17) for such property (including the subtractions for the current taxable year).

(b) " Qualified manufacturing property" means tangible personal property and other tangible property, including buildings and structural components of buildings, owned by the corporation and principally used by the corporation or, in the case of combined report,

principally used by the corporation or another member of the combined group, in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing, that (i) are depreciable pursuant to IRC section 167, (ii) have a useful life of four years or more, (iii) are acquired by purchase as defined in IRC section 179(d), and (iv) have a situs in New York State. It does not include tangible personal property and other tangible property qualifying under clauses (B) through (G) of section 210-B(1)(b)(i).

(c) "Goods" mean tangible movable personal property having intrinsic value.

(d) "Qualified manufacturing employees" means employees of the corporation or a member of a combined group who are engaged in manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing in New York.

Section 10-1.2 Definition of qualified New York manufacturer. (Tax Law, section 210(1)(a)(vi) and 210(1)(b)(2))

(a) A corporation or, in the case of a combined report, a combined group, engaged in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing during the taxable year will be a qualified New York manufacturer if the criteria in paragraph (1) or (2) of this subdivision are met.

(1) (i) The corporation or combined group derives more than 50 percent of its gross receipts during the taxable year from its sale of goods produced by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing (hereinafter referred to as the "principally engaged test") and

has qualified manufacturing property that has an adjusted basis of at least one million dollars at the end of the taxable year or has all its real and personal property in New York State for the entire taxable year.

(ii) The corporation's sale of goods requires that title be transferred from the taxpayer to another party, except in instances of contracts covering more than one taxable year for the ultimate sale of goods. Any receipts earned pursuant to such contracts in each taxable year shall be deemed a sale of goods even though transfer of title has not yet occurred. The sale of a good shall not include (a) the licensing of goods, (b) the sale of a warranty, (c) the sale of an insurance contract, (d) or the sale of advertising related to the good.

(iii) To determine whether the corporation or the combined group has satisfied the principally engaged test, the total everywhere receipts of the corporation, or in the case of a combined report, the combined group, shall be multiplied by a fraction. The denominator of the fraction used to compute the principally engaged test is the corporation's or combined group's everywhere receipts, except that any global intangible low-taxed income as defined in IRC section 951A must be excluded. The numerator of the fraction is the portion of such everywhere receipts derived from the sale, by the taxpayer or combined group, of goods produced by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing. Receipts from the foregoing activities are combined when determining the numerator of the fraction for the principally engaged test. Everywhere receipts has the same meaning for this purpose as in subdivision (a) of section 4-1.1 of this Subchapter.

(iv) In the case of a combined report, intercorporate receipts are eliminated in the computation of the principally engaged test.

(2) A corporation or a combined group, in the case of a combined report, that does not satisfy the principally engaged test will be a qualified New York manufacturer if the corporation or combined group employs at least 2,500 qualified manufacturing employees on the last day of the taxable year and has qualified manufacturing property that has an adjusted basis of at least 100 million dollars at the close of the taxable year.

(b) In determining whether goods are produced by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing (hereinafter referred to as manufacturing activities), the following will not be considered manufacturing activities:

(1) A process that makes a good more attractive for sale without substantially altering the good.

(2) A process that does not affect a material change in the good.

(3) Market research, research and development, and design and creation of a prototype.

(4) The manipulation of information.

5) The transmission of information.

(6) The performance of a service.

(7) Cooking, baking and other preparation of food for on-site consumption.

(8) The generation and distribution of electricity, the distribution of natural gas, and the production of steam, ice, or any other good associated with the generation of electricity.

(9) The creation of a digital product.

(10) Heating, cooling, regulating, cleaning, purifying, blending, and distributing activities.

(c) The determination of whether a corporation or a combined group is a qualified New York manufacturer is done on an annual basis.

(d) For purposes of computing the capital base tax, a qualified New York manufacturer includes a corporation that is defined as a qualified emerging technology company under Public Authorities Law Section 3102-e(1)(c) regardless of the $10 million limitations expressed in subparagraph one of that paragraph (c). In the case of a combined report, all members of the combined group must be qualified emerging technology companies for the combined group to be considered a qualified New York manufacturer under this subdivision.

Section 10-1.3 Contract Manufacturing.

(a) For purposes of this section, a corporation that contracts out its production activities is referred to as "the contracting company". The entity to whom the production activities are contracted is referred to as "the production company".

(b) (1) In determining if the contracting company is a qualified New York manufacturer, it may include the assets and employees used in the production activities in that determination only if the contracting company owns the assets being used by the production company in the production activities and only its employees operate or use those assets.

(2) Receipts earned by the contracting company from the sale of goods produced by the production company on behalf of the contracting company are not receipts from the sale of goods produced by manufacturing activities and, thus, would not be included in the numerator of the fraction used in the computation of the principally engaged test.

(c) (1) In determining if a production company is a qualified New York manufacturer, it may include the assets and employees used in the production activities in that determination only

if the production company owns the assets being used and only its employees operate or use those assets.

(2) Receipts paid by the contracting company to the production company for the manufacture of the goods produced by the production company on behalf of the contracting company are not receipts from the sale of goods produced by manufacturing activities unless the production company in fact is selling those goods (that is transferring title to those goods) to the contracting company. The receipts received by the production company from the contracting company would be included in the numerator of the fraction used in the computation of the principally engaged test only if the receipts are from the sale of goods as described in the previous sentence.

Section 10-1.4 Corporate Partners.

(a) A corporation that is a partner in a partnership filing under the aggregate method must combine its distributive share of receipts from the partnership with its own receipts in the computation of the principally engaged test.

(b) A corporation that is a partner in a partnership filing under the aggregate method must combine its proportionate part of the partnership's qualified manufacturing property and qualified manufacturing employees with its own qualified manufacturing property and qualified manufacturing employees to determine if it is a qualified New York manufacturer.

(c) Under the aggregate method, the property, receipts, and employees of the partnership are deemed to be that of the corporate partner. As such, the rules of contract manufacturing do not apply to any partnership/corporate partner agreement regarding manufacturing.

(d) In determining whether a corporation that is a partner in a partnership filing under the entity method is a qualified New York manufacturer, the corporation does not consider any of

the partnership's property or employees in that determination. In addition, it would not include any of the partnership's receipts in the numerator of the fraction used in the computation of the principally engaged test.

SUBPART 10-2

CORPORATE PARTNERS

Sec.

Section 10-2.1 General. (Tax Law section 210(3))

(a) A corporation that is a partner in a partnership must compute its tax with respect to its interest in such partnership under the aggregate method or entity method, whichever applies.

(b) Under the aggregate method, a corporate partner is viewed as having an undivided interest in the partnership's assets, liabilities and items of receipts, income, gain, loss, and deduction. Under the aggregate method, the partner is treated as participating in the partnership's transactions and activities.

(c) Under the entity method, a partnership is treated as a separate entity and a corporate partner is treated as owning an interest in the partnership entity. The partner's interest in the

partnership is an intangible asset.

Section 10-2.2 Determination of applicable methodology.

(a) A corporation must use the aggregate method in determining its tax with respect to its interest in a partnership if the corporation has access to the information necessary to compute its tax using such method. A corporation is presumed to have access to the information if any one of the following is met:

(1) it is conducting a unitary business with the partnership;

(2) it is a general partner of the partnership or is a managing member of a limited liability company that is treated as a partnership for Federal income tax purposes;

(3) it has a five percent or more interest in the partnership determined in the manner provided in section 1-2.2(a)(8)(i)(a) of this Subchapter;

(4) it has reported information from the partnership in a prior taxable year using the aggregate method;

(5) its partnership interest constitutes more than 50 percent of its total assets;

(6) its basis in its interest in the partnership pursuant to IRC section 705 and 26 CFR 1.705-1 on the last day of the partnership year that ends within or with the corporation's taxable year is more than $5,000,000;

(7) any member of its affiliated group or New York combined group has the information necessary to perform such computation; or

(8) it is claiming a tax credit based upon the activities of the partnership or claiming a tax credit computed at the partnership level that flows through from the

partnership to the corporation.

(b) (1) If a corporation does not meet any of the presumptions set forth in subdivision (a) of this section and does not and will not have access to the information necessary to compute its tax using the aggregate method within the time period allowed for filing a report, determined with regard to all available extensions of time to file, and certifies these facts to the Commissioner, the corporation must use the entity method.

(2) If a corporation meets one or more of the presumptions set forth in subdivision (a) of this section but the corporation establishes to the satisfaction of the Commissioner that it, any member of its affiliated group, or any member of its New York combined group does not and will not have access to the information necessary to compute the corporation's tax using the aggregate method within the time period allowed for filing a report, determined with regard to all available extensions of time to file, and certifies these facts to the Commissioner, then the corporation must use the entity method.

(c) If a corporation is a partner in a partnership ("upper tier partnership") and such partnership is a partner in another partnership ("lower tier partnership") and the corporation has the necessary information to use the aggregate method with respect to the items of receipts, income, gain, loss, deduction, assets and liabilities, and activities of the upper tier partnership that are not attributable to the lower tier partnership, but does not have the necessary information to use the aggregate method with respect to such items that are attributable to the lower tier partnership, then such corporation must use the aggregate method with respect to the items of receipts, income, gain, loss, deduction, assets and liabilities, and activities of the upper tier partnership that are not attributable to the lower tier partnership and must use the entity method with respect to such items that are attributable to the lower tier

partnership. If there are additional tiers of partnerships, this methodology must be employed at each tier. The corporation will be presumed to have access to the necessary information with respect to a lower tier partnership and will be subject to the provisions of paragraph (2) of subdivision (b) of this section with respect to a lower tier partnership if one or more of the presumptions set forth in subdivision (a) of this section are met at each tier. If the corporation does not meet any of the presumptions set forth in subdivision (a) of this section and does not have access to the necessary information with respect to a lower tier partnership the provisions of paragraph (1) of subdivision (b) of this section will apply.

(d)(1) For purposes of this section, the term "affiliated group" will have the same meaning as such term has in IRC section 1504, except that the term "common parent corporation" will be deemed to mean any person as defined in IRC section 7701(a)(1). Such section 1504 must be read without regard to the exclusions provided for in section 1504(b).

(2) For purposes of this section, a partnership interest constitutes more than 50 percent of a corporation's total assets if its interest in the partnership is more than 50 percent of the corporation's total assets. In determining its interest in the partnership and its total assets, the corporation may elect to use ending amounts, the average of the beginning and ending amounts as reported on the corporation's balance sheet included in its Federal income tax return, or average amounts determined on a more frequent basis as determined in a manner consistent with the corporation's balance sheet included in its Federal income tax return. Whichever method a corporation elects to use, it must use that method for all of its assets. If the corporation is not required to include a balance sheet in its Federal income tax return, it must use a method that it would have used if it had been required to include a balance sheet in its Federal income tax return. Provided, an alien corporation must use only amounts that are

effectively connected with its United States trade or business.

Section 10-2.3 Computation of tax under the aggregate method.

(a)(1) Under the aggregate method, the corporation's distributive share (see IRC section 704) of each partnership item of receipts, income, gain, loss, and deduction and the corporation's proportionate part of each partnership asset and liability and each partnership activity are included in the computation of the corporation's business income base, capital base, and the fixed dollar minimum tax and will have the same source and character in the hands of the corporate partner for article 9-A purposes as such item has in the hands of the partnership for Federal income tax purposes. Where an item, amount or activity of the partnership is not characterized for Federal income tax purposes or is not required to be taken into account for Federal income tax purposes, the source and character of each item, amount or activity of the partnership will be determined as if such item, amount or activity realized, incurred or experienced by the partnership were realized, incurred or experienced directly by the corporate partner.

(2) A corporation's proportionate part of the partnership's assets and liabilities and activities is determined in accordance with the corporation's capital interest in the partnership. If using a corporation's capital interest in a partnership to determine the corporation's share of partnership items constituting business capital and investment capital does not properly reflect the corporation's share of partnership items constituting business income, investment income, and other exempt income, then the corporation's proportionate part of the partnership's assets and liabilities and activities is determined using the percentage resulting from the manner in which the partners divide the partnership's profits in a profit year and losses in a loss year.

Example: Corporations A and B are partners in Partnership P. A will perform services for a 40% interest in the profits and losses of Partnership P and B will contribute $1,000 for a 60% interest in the profits and losses of Partnership P. B's capital interest is 100% and A's capital interest is zero. Partnership P's only asset is $500 of stock, which pays dividends of $30 during the taxable year.

Based on capital interests, A's proportionate part of P's stock is zero ($500 x 0%) and B's proportionate part of P's stock is $500 ($500 x 100%). In this case, using capital interests does not properly reflect A's share of P's stock. This is because A receives 40% of P's dividends and using capital interests attributes none of P's stock to A. Likewise, B receives 60% of P's dividends and using capital interests attributes all of P's stock to B.

In this case, both A and B must determine their proportionate part of P's assets and liabilities in accordance with their profits and loss interest (40% and 60%, respectively) in P. As a result, A's distributive share of the dividends is $12 ($30 multiplied by 40%) and B's distributive share is $18 ($30 multiplied by 60%).

(3)(i) An allocation of an item, amount or activity, even if recognized for Federal income tax purposes, will not be recognized where it has as a principal purpose the avoidance or evasion of any tax imposed on the corporation, or the combined group of which the

corporation is a member, by New York State or any of its political subdivisions. Where an allocation is not recognized, the corporation's distributive share will be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances).

(ii) The determination of whether a principal purpose of an allocation of an item, amount or activity is the avoidance or evasion of any tax imposed on the corporation, or the combined group of which the corporation is a member, by New York State or any of its political subdivisions depends on all the surrounding facts and circumstances. Among the relevant circumstances to be considered are the following:

(a) whether the allocation has substantial economic effect;

(b) whether the related items of partnership income, gain, loss, and deduction from the same source are subject to the same allocation;

(c) whether the allocation was made without recognition of normal business factors and only after the amount of the allocated item could reasonably be estimated;

(d) the duration of the allocation; and

(e) the overall tax consequences of the allocation.

(iii) A special allocation to a corporate partner of a New York tax credit that is computed at the partnership level may be allowed only if the following conditions are satisfied:

(a) the sole component in the calculation of the tax credit is a partnership expenditure;

(b) the tax credit is allocated in the same way as that expenditure is allocated among the partners;

(c) the allocation of the tax credit does not have as a principal purpose the avoidance or evasion of any tax imposed on the corporation, or the combined group of which the corporation is a member; and

(d) the allocation of the expenditure has substantial economic effect.

(4) Where a corporation is a partner in an upper tier partnership that is a partner in a lower tier partnership, the source and character of such corporation's distributive share or proportionate part, as the case may be, of each partnership item of receipts, income, gain, loss, deduction, asset, liability, and activity of the upper tier partnership that is attributable to the lower tier partnership retains the source and character determined at the level of the lower tier partnership. Such source and character are not changed by reason of the fact that such item flows through the upper tier partnership to such partner.

(b) Business income base. The corporation's distributive share of each partnership item of income, gain, loss, and deduction must be taken into account in the computation of entire net income and the business income base. These amounts must be taken into account in determining the corporation's business income, investment income, and other exempt income.

(c) Capital base. The corporation's proportionate part of each asset and liability of the partnership must be taken into account in the computation of the capital base. These amounts must be taken into account when determining business capital and investment capital. The capital base does not include any amount with respect to the corporation's interest in the partnership itself.

(d) Fixed dollar minimum. In determining the tax measured by the fixed dollar minimum, the corporation must use its New York receipts determined in subdivision (f) of this section.

(e) Small business taxpayer. For purposes of the reduced rate of tax provided in section 210(1)(a) or the exemption from the tax measured by the capital base provided in section 210(1-c) for a small business taxpayer, a corporation must meet the definition of a small business taxpayer in section 210(1)(f). In determining whether the corporation qualifies, it must take into account its distributive share or proportionate part, as the case may be, of partnership amounts of items described in section 210(1)(f).

(f) Business Apportionment Factor. (1) A corporation must include its distributive share of the partnership's business receipts when computing its business apportionment factor. Its distributive share of the partnership's business receipts during the applicable partnership year should be combined with the corporation's own receipts for the taxable year. The corporation must apportion such combined amounts using the rules specified in section 210-A and Part 4 of this Subchapter. To the extent an apportionment rule uses a fraction to determine the amount of New York receipts, a corporation must include the distributive share or proportionate parts of any partnership amounts with the corporation's own amounts in such fraction. In addition, netting of gains and losses must be computed on the combined corporation and partnership amounts.

(2) Where a corporation has receipts from sales to a partnership in which it is a partner, the corporation must reduce its receipts from its sales to the partnership by its distributive share of such purchases by the partnership. Where a partnership has receipts from sales to a corporation that is a partner in the partnership, the corporation does not include its distributive share of the partnership receipts from sales to the corporation in its business apportionment factor.

(3) Examples. In the following examples, Partnership P has two partners, Corporation A and Corporation B. Corporation A has a 20 percent interest in the partnership and Corporation B has an 80 percent interest. There are no allocations of an item, amount or activity.

Example 1: Corporation A's sales are $20,000,000 for the year, $5,000,000 of which are made to Partnership P. Partnership P makes sales of $10,000,000 during the same year, none of which are to A or other partners. Corporation A determines its everywhere receipts of $21,000,000 as follows:

Sales by Corporation A to other entities		$15,000,000
Sales by Corporation A to Partnership P	$5,000,000	
Less its distributive share of Partnership P's purchases from Corporation A (20% x $5,000,000)	($1,000,000)	
Corporation A's total sales to Partnership P ($5,000,000 - $1,000,000)		$4,000,000
Corporation A's distributive share of Partnership P's total sales (20%*$10,000,000)		$2,000,000
Corporation A's everywhere receipts		$21,000,000

Example 2: The sales made by Corporation A, Corporation B, and Partnership P are as follows:

Corporation A		$20,000,000
Corporation B		$80,000,000
Partnership P sales to Corporation A	$3,000,000	
Partnership P sales to Corporation B	$6,000,000	
Partnership P sales to unrelated Corporation X	$1,000,000	
Partnership P's total sales		$10,000,000

Corporation A determines its everywhere receipts of $21,400,000 as follows:

Sales by Corporation A		$20,000,000
Corporation A's distributive share of Partnership P's total sales (20%*$10,000,000)	$2,000,000	
Less Corporation A's distributive share of Partnership P's sales to Corporation A (20% * $3,000,000)	$600,000	
Corporation A's distributive share of Partnership P's sales		$1,400,000
Corporation A's everywhere receipts		$21,400,000

Corporation B determines its everywhere receipts of $83,200,000 as follows:

Sales by Corporation B		$80,000,000
Corporation B's distributive share of Partnership P's total sales (80%*$10,000,000)	$8,000,000	
Less Corporation B's distributive share of Partnership P's sales to Corporation B (80% * $6,000,000)	$4,800,000	
Corporation B's distributive share of Partnership P's sales		$3,200,000
Corporation B's everywhere receipts		$83,200,000

(4) In instances where an apportionment rule requires the use of a fraction to compute New York receipts, the corporation must use the sum of its own amounts for the taxable year and its distributive share or proportionate part, as the case may be, of partnership amounts during the applicable partnership year when computing such fractions.

(g) Metropolitan Transportation Business Tax Surcharge. (1) The corporation takes into account its distributive share of the partnership's receipts and payroll within the Metropolitan Commuter Transportation District (MCTD) and New York State and its distributive share or proportionate part, as the case may be, of the partnership's property within the MCTD and New York State in computing its MCTD apportionment percentage as required by section 209-B(2). For purposes of section 209-B (2), a corporation that is a partner in a

partnership computes its MCTD apportionment percentage by computing the property, receipts and payroll factors as follows:

(i) The average value of the corporation's real and tangible personal property, owned or rented, within the MCTD plus the average value of the corporation's distributive share or proportionate part, as the case may be, of the partnership's real and tangible personal property, owned or rented, within the MCTD during the applicable partnership year is divided by the average value of the corporation's real and tangible personal property, owned or rented, within New York State plus the average value of its distributive share or proportionate part, as the case may be, of the partnership's real and tangible personal property, owned or rented, within New York State during the applicable partnership year. Where a corporation has leased or rented real or tangible personal property to a partnership in which it is a partner, the corporation includes only the average value of such property in its property factor. The corporation does not include eight times its distributive share of the partnership's rental expense because the average value of the property is included by the corporate partner as the owner of the property. Where a corporation has leased or rented real or tangible personal property from a partnership in which it is a partner, the corporation includes both its proportionate part of the average value of such property and eight times the amount of rental expense that is deemed to have been paid to the other partners with respect to such property. The amount of rental expense deemed paid to other partners is the corporation's total rental expense paid to the partnership less the corporation's distributive share of the partnership's rental income from such property.

(ii) The corporation's business receipts within the MCTD plus the taxpayer's distributive share of the partnership's business receipts within the MCTD during the applicable partnership

year (MCTD receipts) is divided by the corporation's New York receipts determined in subdivision (f) of this section. The MCTD receipts are determined using the rules in subdivision (f) of this section but substituting MCTD for New York State.

(iii) The wages, salaries and other personal service compensation of the corporation's employees, except general executive officers, within the MCTD plus the corporation's distributive share of the wages, salaries and other personal service compensation paid by the partnership to its employees, except employees of the partnership having partnership-wide authority or having responsibility for an entire division of the partnership, within the MCTD during the applicable partnership year is divided by the wages, salaries and other personal service compensation of the corporation's employees, except general executive officers, within New York State plus the corporation's distributive share of the wages, salaries and other personal service compensation paid by the partnership to its employees, except employees of the partnership having partnership-wide authority or having responsibility for an entire division of the partnership, within New York State during the applicable partnership year.

(2) Examples. In the following examples regarding the computation of the property factor of the MCTD apportionment percentage, Partnership P has two partners, Corporation A and Corporation B. Corporation A has a 20 percent interest in the partnership and Corporation B has an 80 percent interest. There are no allocations of an item, amount or activity.

Example 1: Partnership P rents a building in the MCTD owned by corporate partner A (average value of $100,000) for $12,000 per year.

Corporation A must include the average value of $100,000 for the building in both the numerator and denominator of its property factor. No portion

of the property's rental value is included in Corporation A's property factor.

Corporation B must include $76,800 in the numerator and denominator of its property factor, which is its distributive share of the average value of the property rented in the MCTD by Partnership P (80% x $12,000 x 8)

Example 2: Partnership P owns a building in the MCTD and rents it to Corporation A for $12,000 per year. Corporation A must include its proportionate part of the average value of the building, $20,000 (20% X $100,000), in the numerator and denominator of its property factor. In addition, Corporation A must include eight times the amount of rental expense that is deemed to have been paid to Corporation B with respect to such property in the numerator and denominator of its property factor. Such expense of $9,600 is computed by reducing Corporation A's rental expense of $12,000 paid to Partnership P by its distributive share of the partnership's rental income of $2,400 (20% x $12,000). Thus, the value of the building to be used in the numerator and denominator of Corporation A's property factor is $96,800 ($20,000 + (8 X $9,600)). Corporation B must include its proportionate part of the average value of the building, $80,000 (80% X $100,000) in the numerator and denominator of Corporation B's property factor.

(h) The term "applicable partnership year" means any taxable year of the partnership

ending within or with the taxable year of the partner.

Section 10-2.4 Computation of tax under the entity method.

(a) Under the entity method, for purposes of determining the taxes measured by the business income base, capital base, and the fixed dollar minimum, a corporate partner is treated as owning an interest in the partnership entity. The partner's interest in the partnership is an intangible asset that is business capital.

(b) Business income base. (1) To the extent a corporation's entire net income includes its distributive share of partnership items of income, gain, loss and deduction, such items will be treated as business income. The corporation's distributive share of such partnership items must be apportioned as provided in subdivision (e) of this section and included in the corporation's apportioned business income.

(2) While a corporation may have the information concerning one or more of the modifications set forth in section 208(9), such as state bond interest, a corporation using the entity method does not have all the information necessary to properly compute its article 9-A tax using the aggregate method. Therefore, no modifications should be made with respect to any partnership items.

(c) Capital base. The corporation's interest in a partnership is business capital and is apportioned as provided in subdivision (e) of this section. The corporation's interest in the partnership is the value shown on its books and records kept in accordance with generally accepted accounting principles. If the interest is a marketable security, it is valued at fair market value. The capital base does not include any other amounts that the corporation may have included on its balance sheet with respect to its interest in the partnership.

(d) Fixed dollar minimum. The corporation does not take into account any partnership

items in determining its fixed dollar minimum tax.

(e) A corporation must apportion its distributive share of partnership items of income, gain, loss and deduction included in its business income and its interest in the partnership included in its business capital by its business apportionment factor determined under Part 4 of this Subchapter, computed without regard to its distributive share of any partnership items of income, gain, loss or deduction.

(f) Because the corporation is treated as owning an intangible asset, it is not entitled to claim any portion of any tax credit that would be computed at the partnership level.

(g) Example. Corporation X is a partner in Partnership P. For state tax purposes, the only information Corporate Partner X receives from Partnership P is a statement that lists its proportionate share of New York State income (loss), as well as state source income for other states in which Partnership P operates. The statement does not specify how the state source amounts were computed nor does it confirm that the New York article 9-A rules were used to compute the New York amount. Therefore, Corporate Partner X does not have the necessary information to properly compute its article 9-A tax using the aggregate method, and it must compute its tax using the entity method. As such, the specific information provided by Partnership P about New York State income (loss) must be disregarded. To compute its tax under article 9-A, Corporate Partner X must include its total distributive share of income, gain, loss and deduction from Partnership P as business income. The amount of such amounts from Partnership P are then multiplied by a BAF computed without regard to the amounts from Partnership P.

Section 10-2.5 Treatment of gain or loss from the sale of a partnership interest. Where a corporation is a partner in a partnership, any gain or loss that is recognized from the sale of

the corporation's interest in such partnership and included in entire net income is business income or loss.

SUBPART 10-3

NEW YORK S CORPORATIONS

Sec.

Section 10-3.1 Apportionment rules for New York S corporations. (Tax Law, section 210-A)

A New York S corporation as defined in section 208(1-A) determines the amount of business receipts included in New York receipts or everywhere receipts using the rules in section 210-A and Part 4 of this Subchapter, except as provided in this Subpart.

(a) The term" business receipts for a New York S corporation" means all receipts, net income (not less than zero), net gains (not less than zero), and other items described in section 210-A and the applicable regulations that are included in the New York S corporation's nonseparately computed income and loss or in the New York S corporation's separately stated items of income and loss, determined pursuant to subdivision (a) of IRC section 1366. Business receipts for New York S corporations include amounts that otherwise would have been characterized as investment income from investment capital or other exempt income for New York C corporations.

(b) Because a New York S corporation does not have any investment capital or other exempt income, stock that otherwise would have been investment capital or could generate other exempt income for a New York C corporation as defined in section 208(1-A) may be a qualified financial instrument for a New York S corporation. For purposes of applying the rules in section 4-2.4 of this Subchapter, the term qualified financial instrument shall have the same meaning as in section 4-2.4, except that the instruments excluded from qualified financial instruments in the case of New York S corporations shall be limited to the following:

(1) loans secured by real property;

(2) loans not secured by real property, if the only loans the taxpayer has marked to market are loans secured by real property; and

(3) partnership interests that do not meet the definition of security in IRC section 475(c).

(c) Global intangible low-taxed income (GILTI) is included in everywhere receipts only in instances where the GILTI inclusion amount is computed at the entity level under IRC section 951A. GILTI is not included in New York receipts.

Section 10-3.2 Nonresident and part-year resident shareholders of New York S Corporations. (Tax Law, sections 631 and 632)

(a) To determine the amounts derived from New York sources for purposes of article 22, a nonresident shareholder of a New York S corporation multiplies its pro-rata share of the New York S corporation's items of income, gain, loss, and deduction (and any related section 612 modifications) that are included in the nonresident shareholder's New York adjusted gross income by a fraction, the numerator of which is the New York S corporation's New York receipts and the denominator of which is the New York S corporation's everywhere receipts. Such fraction is hereinafter referred to as the apportionment factor.

(b) For part-year resident shareholders, the rule in subdivision (a) applies only to the New York S corporation's items received during the nonresident period of the taxable year (and any related section 612 modifications) that are included in the part-year resident's New York adjusted gross income.

Section 10-3.3 Examples.

Example 1: Corporation A is a New York S corporation that has the following types of receipts:

- dividends from stock of unitary corporations (that would have been characterized as other exempt income for a New York C corporation);
- dividends from stock of non-unitary corporations (that would have been characterized as investment income for a New York C corporation);
- net gains from sales of stock of non-unitary corporations (that would have been characterized as investment income for a New York C corporation);
- interest from loans secured by real property;
- interest from corporate bonds; and
- net gains from sales of corporate bonds.

Corporation A marks to market stock of non-unitary corporations only. No other assets are marked to market.

All of these receipts are considered business receipts for Corporation A. The amount of such receipts included in Corporation A's New York receipts or everywhere receipts is determined in accordance with section 4-3.1 of this Subchapter.

Corporation A did not make the fixed percentage election. Therefore, dividends and net gains from stock are not included in its New York receipts or everywhere receipts pursuant to section 210-A.5(a)(2)(G) and the amount of interest from loans secured by real property, interest from corporate bonds, and net gains from the sale of corporate bonds included in New York receipts or everywhere receipts is determined in accordance with section 210-A.5(a)(2) and Part 4 of this Subchapter.

To determine the amounts derived from New York sources for purposes of article 22, nonresident shareholder X of Corporation A must multiply its pro-rata share of Corporation A's items of income, gain, loss, and deduction that are included in shareholder X's New York adjusted gross income, including all income, gain, and loss from Corporation A's stocks, loans, and corporate bonds by Corporation A's apportionment factor.

Example 2: Same facts as Example 1 except that Corporation A makes the fixed percentage election. Since one stock has been marked to market, all stock are qualified financial instruments. The result is that eight percent of the dividends and net gains (not less than zero) from stocks are included in

Corporation A's New York receipts and one hundred percent of dividends and net gains (not less than zero) from stock are included in everywhere receipts. The loans and corporate bonds are not qualified financial instruments as none of these assets have been marked to market. The amount of interest from the loans secured by real property, interest from corporate bonds, and net gains from the sales of corporate bonds included in New York receipts or everywhere receipts is determined in accordance with section 210-A and the applicable regulations.

To determine the amounts derived from New York sources for purposes of article 22, nonresident shareholder X of Corporation A must multiply its pro-rata share of Corporation A's items of income, gain, loss, and deduction that are included in shareholder X's New York adjusted gross income, including all income, gain, and loss from Corporation A's stock, loans, and corporate bonds by Corporation A's apportionment factor.

SUBPART 10-4

REAL ESTATE INVESTMENT TRUSTS (REITs) AND REGULATED INVESTMENT COMPANIES (RICs)

Sec.

10-4.3 Qualified financial instrument apportionment rules for non-captive REITs and non-captive RICs.

10-4.4 Combination rules for REITs and RICs.

Section 10-4.1. General treatment of REITs and RICs. (Tax Law, sections 209(4), (5) and (7), 210, 210-C, 1515(f)(4))

(a)(1) For any taxable year in which a REIT is subject to tax for Federal income tax purposes under IRC section 857, the REIT will be subject to tax under article 9-A unless it is a captive REIT required to be included in a combined report under article 33.

(2) For any taxable year in which a RIC is subject to tax for Federal income tax purposes under IRC section 852, the RIC will be subject to tax under article 9-A, unless it is a captive RIC required to be included in a combined report under article 33.

(b) For purposes of article 9-A, REITs and RICs, other than REITs and RICs required to be included in a combined report, are subject to tax computed on either the business income base or the fixed dollar minimum tax, whichever is greater.

(c) In the event that a REIT pays dividends after the close of a taxable year, pursuant to IRC section 858, and such dividends were declared before the date its federal report for such year must be filed (including extensions), such REIT may treat the dividends as having been paid during the taxable year.

(d) For any taxable year during which a REIT does not qualify for taxation under IRC section 857, or a RIC does not qualify for taxation under IRC section 852, such REIT or such RIC will be treated in the same manner as any other taxpayer subject to tax under article 9-A.

Section 10-4.2 Computation of income. (Tax Law, sections 209(5) and (7))

(a)(1) In the case of a REIT, "federal taxable income" means real estate investment trust taxable income as defined in IRC section 857(b)(2), as modified by IRC section 858 and, where applicable, by IRC section 965(m)(1)(B).

(2) If a REIT is subject to IRC section 965(m) and makes the election provided for by IRC section 965(m)(1)(B), the amount of any federal deduction allowed pursuant to IRC section 965(c) will be determined with reference to IRC section 965(m)(2)(B)(i), for purposes of the adjustments required by sections 208(9)(b)(23) and 1503(b)(2)(W).

(b)(1) In the case of a RIC, "federal taxable income" means investment company taxable income as defined in IRC section 852(b)(2), as modified by IRC section 855, plus any amount taxable under IRC section 852(b)(3).

(2)(i) A RIC that has received or accrued interest from federal, state, municipal or other obligations must add back the amount of such interest in computing its entire net income, to the extent such interest is exempt from federal income tax and is not included in federal taxable income. The amount to be added back may be reduced by any expenses attributable to such interest that are denied deductibility under IRC section 265, as well as any related amortizable bond premium that is denied deductibility under IRC section 171(a)(2).

(ii) Any amount added back pursuant to this paragraph must not be subtracted in computing entire net income.

Section 10-4.3. Qualified financial instrument apportionment rules for non-captive REITs and non-captive RICs. (Tax Law, section 210-A)

When computing the business apportionment factor, non-captive REITs and non-captive RICs must use the following rules regarding qualified financial instruments in lieu of the rules specified in section 4-2.4 of this Subchapter.

(a) For purposes of this section, a "qualified financial instrument" means a financial instrument, other than a financial instrument listed in subdivision (b) of this section, that is of a type described in one of the following clauses of section 210-A(5)(a)(2): clause (A)—loans; clause (B)—federal, state, and municipal debt; clause (C)—asset backed securities and other government agency debt; clause (D)—corporate bonds; clause (G)—dividends and net gains from sales of stock or partnership interests; clause (H)—other financial instruments; clause (I)—commodities.

(b) The following financial instruments are not qualified financial instruments, even if they are of a type described in subdivision (a) of this section:

(1) a loan secured by real property;

(2) a financial instrument that is investment capital; and

(3) stock that generates other exempt income.

(c) Except as provided in subdivision (d) of this section, the amount of receipts, net income (not less than zero) and net gains (not less than zero) from qualified financial instruments included in New York receipts or everywhere receipts is determined using the customer sourcing method contained in section 210-A(5)(a)(2), and further described in this section.

(d)(1) Non-captive REITs and non-captive RICs may elect the fixed percentage method to include eight percent of net income (not less than zero) from qualified financial instruments in New York receipts and one hundred percent of net income (not less than zero) from qualified financial instruments in everywhere receipts. The election may be made whether or not such net

income would otherwise be included in New York receipts or everywhere receipts pursuant to the provisions of section 210-A(5)(a)(2).

(2) Net income from qualified financial instruments is the sum of (i) net gains (not less than zero) from each type of qualified financial instrument that would be subject to the same customer sourcing method in section 210-A(5)(a)(2), and the applicable regulations, if not for the fixed percentage method; (ii) net income (not less than zero) from each type of qualified financial instrument that would be subject to the same customer sourcing method in section 210-A(5)(a)(2), and the applicable regulations, if not for the fixed percentage method; and (iii) receipts from each type of qualified financial instrument.

(3) The fixed percentage method election must be made annually and must be made on an original, timely filed report, determined with regard to extensions for time for filing. Any fixed percentage method election made on a report that is filed late will be invalid and ineffective.

(4) Once the fixed percentage method election has been made in the manner required in paragraph (3) of this subdivision for a taxable year, it is binding on the taxpayer and the Department for such taxable year and cannot be revoked or overridden.

(e) Example: Corporation X is a non-captive RIC. It elects to use the fixed percentage method in the manner required by paragraph (3) of subdivision (d) of this section to determine the amount of its net income (not less than zero) from qualified financial instruments to include in New York receipts and everywhere receipts. Its income does not qualify as other exempt income or income from investment capital.

Corporation X has $1,000 in dividends from Stock A; ($200) loss from the sale of Stock B; $750 gain from the sale of corporate bond C, which was sold through a licensed exchange; $25,000 gain from the sale of corporate bond D, which was not sold through a registered securities broker or dealer or through a licensed exchange; $5,000 gain from the sale of debt obligation E, which was issued by Country Y; ($2,000) loss from the sale of debt obligation F, which was issued by Country Z; and $2,000 of interest from deposit accounts.

Corporation X has $31,750 of net income (not less than zero) from qualified financial instruments included in everywhere receipts broken down as follows:

- $1,000 of dividends from stock;
- $0 of gains from sales of stock (as the loss is limited to zero);
- $750 of gains from sales of bonds sold through a licensed exchange or registered securities broker or dealer;
- $25,000 of gains from sales of bonds not sold through a licensed exchange or registered securities broker or dealer;
- $3,000 of gains from one type of other financial instrument (debt obligations issued by a country, or political subdivision thereof, other than the United States); and
- $2,000 of interest from one type of other financial instrument (deposit accounts).

Corporation X includes $2,540 (8 percent multiplied by $31,750) from qualified financial instruments in its New York receipts. Since Corporation X only has receipts and net gains (not less than zero) from qualified financial instruments, the result is a business apportionment factor of eight percent.

Section 10-4.4. Combination rules for REITs and RICs.

(a) Captive REITs and captive RICs will always be included in a combined report under article 9-A, unless they are required to be included in a combined report under article 33.

(1)(i) For purposes of determining under which article of the Tax Law a captive REIT or a captive RIC is to be combined, the rules in section 1515 will be applied first. If such captive REIT or such captive RIC is not required to be included in a combined report under article 33, then it will be included in a combined report pursuant to the rules included in section 210-C, and further described in Subpart 6-2 of this Subchapter.

(ii) A captive REIT or captive RIC is required to be included in a combined return under article 33 in either of these circumstances:

(A) When the corporation that directly owns or controls more than fifty percent of the voting power of the capital stock of the captive REIT or captive RIC is a life insurance corporation subject to tax or required to be included in a combined return under article 33; or, if this condition in this clause is not satisfied, then

(B) When the closest controlling stockholder of the captive REIT or captive RIC is a life insurance corporation subject to tax or required to be included in a combined return under article 33.

(C) The term "closest controlling stockholder" means the corporation that indirectly owns or controls over fifty percent of the voting power of the capital stock of a captive REIT or captive RIC, is subject to tax under section 1501 or article 9-A or is required to be included in a combined return under article 33 or a combined report under article 9-A, and is the fewest tiers of corporations away in the ownership structure from the captive REIT or captive RIC.

(D) Examples.

Example 1: Insurance Company X, which is licensed as a life insurance company in New York State and subject to tax under section 1501, owns 100 percent of the voting power of the capital stock of Corporation Y, a general business corporation subject to tax under article 9-A. Corporation Y owns 75 percent of the voting stock of a captive REIT. Because over 50 percent of the voting power of the capital stock of the captive REIT is not directly owned or controlled by a life insurance corporation subject to tax or required to be included in a combined return under article 33 and the closest controlling stockholder of the captive REIT is a life insurance company, the captive REIT must be included in a combined return with Insurance Company X.

Example 2: Insurance Company X, which is licensed as a life insurance company in New York and subject to tax under section 1501, owns 100 percent of the voting power of the capital stock of Corporation Y, a general business corporation subject to tax under article 9-A. Corporation Y owns 100

percent of the voting power of the capital stock of Corporation Z, also a general business corporation subject to tax under article 9-A. Corporations Y and Z are engaged in a unitary business. Corporation Z owns 100 percent of the voting power of the capital stock in a captive RIC. Corporation Y is the closest controlling stockholder in the captive RIC. Because over 50 percent of the voting power of the capital stock of the captive RIC is not directly owned or controlled by Insurance Company X, and the closest controlling stockholder in the captive RIC is not a life insurance corporation subject to tax under article 33, the captive RIC is required to be included in a combined report under article 9-A with Corporations Y and Z.

Example 3: Same facts as in Example 2 except that Corporations Y and Z are not engaged in a unitary business. In this case, the captive RIC is required to be included in a combined report with Corporation Z.

(2) If a captive REIT owns the stock of a qualified REIT subsidiary (QRS), as defined in IRC section 856(i)(2), then the QRS must be included in any combined report required to be made by such REIT.

(b) A non-captive REIT must be included in a combined report under article 9-A with its qualified REIT subsidiary. All other non-captive REITs are prohibited from being included in a combined report under article 9-A.

(c) In the case of a combined report including a captive REIT, or a captive RIC:

(1) such captive REIT or such captive RIC must be included in the computation of the combined capital base;

(2) intercompany dividends paid by such captive REIT to another member of the combined group are not eliminated in the computation of combined federal taxable income if the combined group is utilizing the subtraction for small thrifts and qualified community banks that maintain a captive REIT under section 208(9)(t);

(3) the adjustments required by section 1503 will not include the deduction for dividends paid by such captive RIC to any member of the affiliated group that includes the corporation that directly or indirectly owns over 50 percent of such RIC's voting stock; and

(4) federal taxable income shall be computed without regard to the deduction for dividends paid by such captive REIT or such captive RIC to any member of the affiliated group that includes the corporation that directly or indirectly owns over 50 percent of such captive REIT's or such captive RIC's voting stock.

For purposes of this subdivision, "affiliated group" has the same meaning as in IRC section 1504, but without regard to the exceptions provided for in IRC section 1504(b).

SUBPART 10-5

DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

Sec.

Section 10-5.1. General. (Tax Law, sections 208(1) and (9)(i), 209(6))

(a) For purposes of article 9-A, a corporation will be treated as a Domestic International Sales Corporation (hereinafter called a "DISC") if it meets the requirements of IRC section 992(a).

(b) For purposes of article 9-A, a DISC is either a "tax exempt DISC" or a "taxable DISC." For any taxable year during which a corporation does not meet the requirements for treatment as a DISC, it will be treated in the same manner as any other taxpayer subject to tax under article 9-A.

(c) The term "former DISC" refers, with respect to any taxable year, to a corporation that is not a DISC during such year but was (or was treated as) a DISC for a prior taxable year. However, a corporation will not be considered a former DISC for a taxable year unless such corporation has, at the beginning of such taxable year, undistributed previously taxed income or accumulated DISC income.

Section 10-5.2. Taxable DISC. (Tax Law, sections 209(6), 211(1))

A taxable DISC is a DISC that is not a tax exempt DISC. A taxable DISC is subject to tax measured by the capital base or the fixed dollar minimum tax, whichever is greater. A taxable DISC is not subject to tax measured by the business income base. A taxable DISC must file its report on or before the 15th day of the ninth month following the close of its taxable year, and must identify itself as a DISC on such report.

Section 10-5.3. Tax exempt DISC. (Tax Law, sections 208(9)(i), 211(1))

(a) A tax exempt DISC is a DISC that during a taxable year:

(1) receives more than five percent of its gross receipts from the sale of inventory or other property that it purchased from its stockholders; or

(2) receives more than five percent of its gross rentals from the rental of property that it purchased or leased from its stockholders; or

(3) receives more than five percent of its total receipts other than from sales or rentals from its stockholders.

(b) A tax exempt DISC has no filing requirement under article 9-A, although its corporate stockholders may have a filing requirement (see section 10-5.4 of this Subpart).

Section 10-5.4. Corporate stockholders of tax exempt DISC. (Tax Law, section 208(9)(i))

(a) A taxpayer that is subject to tax under article 9-A and is a stockholder of a tax exempt DISC must do the following on its report required to be filed under article 9-A:

(1) adjust its receipts, expenses, assets and liabilities to include its attributable share of the DISC's receipts, expenses, assets and liabilities;

(2) eliminate any deemed or actual distributions received from the DISC to the extent already included in entire net income; and

(3) eliminate intercorporate transactions between the stockholder and the tax exempt DISC.

(b) A taxpayer required to file a report pursuant to this section also must file the affiliated entity information schedule.

Section 10-5.5. Corporate stockholder's treatment of distribution and capital of a DISC. (Tax Law, section 208(8-A))

(a) Since a DISC is not subject to tax on its earnings and profits, no deduction is allowed for the dividends distributed to a corporation owning stock of a DISC.

(b) Deemed distributions from a DISC or a former DISC that are taxable as dividends pursuant to IRC section 995(b) must be treated as business income.

(c) Actual distributions from a DISC or a former DISC must be treated as business income, unless such distributions meet the requirements of subdivision (d) of this section.

(d) Actual distributions from a DISC or a former DISC will be treated as investment income if:

(1) such distributions are treated as being made out of "other earnings and profits" for Federal income tax purposes, under IRC section 996; and

(2) the stock of the DISC meets the definition of investment capital.

(e) Any gain or loss recognized for Federal income tax purposes on the disposition of stock in a DISC or a former DISC must be treated as business income, whether or not the stock of the DISC meets the definition of investment capital.

(f) The corporate stockholder's distributive share of the DISC's investments in the stocks, bonds or other securities or indebtedness from a DISC must be treated as business capital.

Section 10-5.6. Combined reports. (Tax Law, section 210-C)

(a)(1) If both the capital stock requirement and the unitary business requirement are met with respect to a taxpayer that is a stockholder of a taxable DISC and such DISC, the taxpayer is required to make a combined report with the taxable DISC.

(2) If the capital stock requirement is met, but the unitary business requirement is not met, with respect to a taxpayer that is a stockholder of a taxable DISC and such DISC, the taxable DISC will be included in a combined report with the taxpayer only if the taxpayer is part of a combined group that has made the commonly owned group election.

(b) In filing a combined report pursuant to subdivision (a) of this section, intercorporate dividends from a taxable DISC or a taxable former DISC are treated as business income and shall not be eliminated.

Section 10-5.7. Rules for treatment of earnings and profits.

(a) For purposes of article 9-A, the earnings and profits of a DISC or of a former DISC are deemed to be divided into the following three categories:

(1) accumulated DISC income, which includes the earnings and profits of the corporation that have been deferred from taxation, as defined in 26 CFR 1.996-3[b];

(2) previously taxed income, which includes the earnings and profits of the DISC that have been previously taxed by reason of having been deemed distributed, as defined in 26 CFR 1.996-3[c]; and

(3) other earnings and profits, which includes the earnings and profits of the DISC that were derived by the corporation in taxable years when it was not qualified as a DISC, as defined in 26 CFR 1.996-3[d].

(b) Any actual distribution to a stockholder that is made out of the earnings and profits of a DISC or a former DISC shall be treated as made in the following order:

(1) first, out of previously taxed income, as described in paragraph (2) of subdivision (a) of this section;

(2) second, out of accumulated DISC income, as described in paragraph (1) of subdivision (a) of this section; and

(3) third, out of other earnings and profits, as described in paragraph (3) of subdivision (a) of this section.

(c) If for any taxable year a DISC, or a former DISC, incurs a deficit in earnings and profits, such deficit shall be charged in the following order:

(1) first, to other earnings and profits, as described in paragraph (3) of subdivision (a) of this section;

(2) second, to accumulated DISC income, as described in paragraph (1) of subdivision (a) of this section; and

(3) third, to previously taxed income, as described in paragraph (2) of subdivision (a) of this section.