New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Taxpayer Guidance Division

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Summary of Corporation Tax Legislative Changes Enacted in 2007 and Expiring Tax Law Provisions

This memorandum contains brief summaries of the corporation tax legislative changes that are part of the fiscal year 2007-2008 New York State budget bill (Chapter 60 of the Laws of 2007) and other recently enacted corporation tax legislation (Chapters 89, 93, 94, and 96 of the Laws of 2007). The memorandum also contains information relating to corporation Tax Law provisions enacted in prior years that have expired.

Corporation Tax Legislative Changes Enacted in 2007

The following section of this memorandum contains information relating to the Tax Law provisions enacted in 2007.

Single factor business allocation percentage for certain Article 9-A filers (Article 9-A)

The Tax Law has been amended to provide that the business allocation percentage used by most Article 9-A (franchise tax on general business corporations) taxpayers will be computed using only the receipts factor for tax years beginning on or after January 1, 2007. When calculating the tax on the entire net income base, the minimum taxable income base, and the capital base, most Article 9-A taxpayers will allocate their business income, alternative business income, and business capital to New York State using only the receipts factor as the business allocation percentage. Prior to this amendment, the change to the single factor business allocation percentage was to have taken effect for tax years beginning on or after January 1, 2008.

The single factor business allocation percentage does not apply to Article 9-A taxpayers that are (1) principally engaged in the conduct of aviation; (2) air freight forwarders acting as principal and like indirect air carriers; (3) qualified foreign air carriers; or (4) principally engaged in the conduct of a railroad business or trucking business. In addition, the single factor business allocation does not apply to the computation of the Metropolitan Commuter Transportation District (MCTD) allocation percentage, which is used in the computation of the MTA surcharge. The MCTD allocation percentage will continue to be computed by adding a single-weighted property factor, a single weighted receipts factor, and a single weighted payroll factor and dividing the result by three or the number of factors.

(Tax Law section 210.3(a)(10))

Real Estate Investment Trusts (REITs) and Regulated Investment Companies (RICs) (Articles 9-A, 32, and 33)

The Tax Law has been amended concerning the tax treatment of REITs and RICs under Articles 9-A, 32 (franchise tax on banking corporations), and 33 (franchise tax on insurance corporations) of the Tax Law. The provisions described below apply to tax years beginning on or after January 1, 2007.

Article 9-A. Tax Law section 209.5 has been amended to require a REIT, whose capital stock is substantially owned or controlled, directly or indirectly, by one or more corporations that are not REITs but are taxable under Article 9-A (or corporations that are included in a combined report with a corporation that is subject to tax under Article 9-A) to make a report on a combined basis with those corporations. However, a combined report will not be required if all the other corporations are also REITs. Additionally, a REIT is not required to be included in a combined report if over fifty percent of the capital stock of the REIT is owned directly or indirectly by a bank holding company as defined in Tax Law section 1462(f) or a banking corporation subject to tax under Tax Law section 1451.

Tax Law section 209.7 has been amended to require a RIC, whose capital stock is substantially owned or controlled, directly or indirectly, by one or more corporations that are not RICs but are taxable under Article 9-A (or corporations that are included in a combined report with a corporation that is subject to tax under Article 9-A) to make a report on a combined basis with those corporations. However, a combined report will not be required if all the other corporations are also RICs. Additionally, a RIC is not required to be included in a combined report if over fifty percent of the capital stock of the RIC is owned directly or indirectly by a bank holding company as defined in Tax Law section 1462(f) or a banking corporation subject to tax under Tax Law section 1451.

If a REIT or RIC is required to make a report on a combined basis under Tax Law section 209.5 or 209.7, then, when computing combined entire net income (ENI), the deduction available to REITs for dividends paid under section 857(b)(2) (as modified by section 858) of the Internal Revenue Code (IRC), and the deduction for dividends paid available to RICs under section 852(b)(2) (as modified by section 855) of the IRC, are not allowed. In addition, if a REIT or RIC is required to make a report on a combined basis under Tax Law section 209.5 or 209.7, the combined report must include the combined capital of all corporations, including any REIT or RIC included in the report.

Definitions for Articles 32 and 33. The following definitions were added to both Article 32 and Article 33 of the Tax Law:

- *REIT* means a real estate investment trust as defined in IRC section 856.

- *RIC* means a regulated investment company as defined in IRC section 851.

- *REIT holding company* means a corporation that (1) owns, directly or indirectly, over 50% of the capital stock of a REIT, or (2) in connection with one or more other corporations in its affiliated group (as defined in IRC section 1504 without regard to the exclusion provided for in IRC section 1504(b)), owns over 50% of the capital stock of a REIT.

- *RIC holding company* means a corporation that (1) owns, directly or indirectly, over 50% of the capital stock of a RIC, or (2) in connection with one or more other corporations in its affiliated group (as defined in IRC section 1504 without regard to the exclusion provided for in IRC section 1504(b)), owns over 50% of the capital stock of a RIC.

Article 32. Tax Law sections 1453(e)(11)(ii) and (iii) allowed banking corporations, in computing ENI, a deduction for 60% of the dividend income from subsidiary capital and 60% of the net gains from subsidiary capital. These sections have been amended to limit these deductions as follows:

- For tax years beginning on or after January 1, 2007, and before January 1, 2009, 50% of disallowed investment proceeds from a REIT or RIC (or a REIT holding company or RIC holding company) will be excluded from the deduction.

- For tax years beginning on or after January 1, 2009, and before January 1, 2011, 75% of disallowed investment proceeds from a REIT or RIC (or a REIT holding company or RIC holding company) will be excluded from the deduction.

- For tax years beginning on or after January 1, 2011, 100% of the disallowed investment proceeds from a REIT or RIC (or a REIT holding company or RIC holding company) will be excluded from the deduction.

For purposes of the deduction of dividend income from subsidiary capital under Tax Law section 1453(e)(11)(ii), *disallowed investment proceeds* is defined as dividends from a REIT or RIC, or dividends from a REIT holding company or a RIC holding company, to the extent that the dividends are attributable to such holding company's ownership interest in a REIT or RIC. Disallowed investment proceeds do not include dividends from or attributable to a REIT or RIC included in a combined report under Article 9-A Tax Law section 209.5 or 209.7 to the extent such dividends were included in the computation of combined ENI.

For purposes of the deduction of gains in excess of losses under Tax Law section 1453(e)(11)(iii), *disallowed investment proceeds* is defined as gain or loss from the disposition of an ownership interest in a REIT or RIC, and the gain or loss from the disposition from a REIT holding company or RIC holding company, to the extent that the gain or loss is attributable to such holding company's interest in a REIT or RIC.

Note: Tax Law section 1453(u)(5)(B) provides that a banking corporation (or group of banking corporations properly included in a combined return) with taxable assets (or combined taxable assets in the case of a combined return) for the taxable year of eight billion dollars or less will not have any disallowed investment proceeds.

Article 33. Tax Law section 1503(b)(1)(A) allowed insurance companies subject to tax under Article 33, in computing ENI, a deduction for 100% of income, gains, and losses from subsidiary capital. This section has been amended to limit this deduction as follows:

- For tax years beginning on or after January 1, 2007, and before January 1, 2009, 50% of disallowed investment proceeds from a REIT or RIC (or a REIT or RIC holding company) will be excluded from the deduction.

- For tax years beginning on or after January 1, 2009, and before January 1, 2011, 75% of disallowed investment proceeds from a REIT or RIC (or a REIT or RIC holding company) will be excluded from the deduction.

- For tax years beginning on or after January 1, 2011, 100% of disallowed investment proceeds from a REIT or RIC (or a REIT or RIC holding company) will be excluded from the deduction.

For purposes of section 1503(b)(1)(A), *disallowed investment proceeds* is defined as a distribution from, or gain or loss from, the disposition of an ownership interest in a REIT or RIC, or a distribution from, or gain or loss from, a REIT or RIC holding company to the extent the distribution, gain or loss is attributable to such holding company's interest in a REIT or RIC.

Tax Law section 1503(b)(1)(B) allowed insurance companies subject to tax under Article 33, in computing ENI, a deduction for 50% of dividends other than from subsidiaries. This section has been amended to limit this deduction as follows:

- For tax years beginning on or after January 1, 2007, and before January 1, 2009, 50% of disallowed investment proceeds from a REIT or RIC (or a REIT or RIC holding company) will be excluded from the deduction.

- For tax years beginning on or after January 1, 2009, and before January 1, 2011, 75% of disallowed investment proceeds from a REIT or RIC (or a REIT or RIC holding company) will be excluded from the deduction.

- For tax years beginning on or after January 1, 2011, 100% of disallowed investment proceeds from a REIT or RIC (or a REIT or RIC holding company) will be excluded from the deduction.

Section 1503(b)(1)(B) has been further amended to provide that the amount of the deductions from ENI for 50% of dividends other than those from subsidiaries will now also include 50% of the dividends from RIC subsidiaries (to the extent that the dividends are considered dividends under IRC section 854(a) and are designated as dividends for purposes of computing the deduction allowed under IRC section 243), and from subsidiaries that are RIC holding companies (to the extent the dividends are attributable to the holding company's ownership interest in a RIC).

For purposes of section 1503(b)(1)(B), *disallowed investment proceeds* is defined as (1) dividends from a REIT, (2) dividends from a RIC (except to the extent such dividends are considered dividends under IRC section 854(a) and are designated as dividends for purposes of computing the deduction allowed under IRC section 243), and (3) dividends from a corporation that is a member of an affiliated group (as defined in IRC section 1504 without regard to the exclusions provided for in IRC section 1504(b)) that includes the taxpayer, and that, alone or in connection with one or more other corporations in such affiliated group, owns over 50% of the capital stock of a REIT to the extent the dividends are attributable to such corporation's ownership interest in such a REIT.

Note: The net result of the provisions contained in Tax Law sections 1503(b)(1)(A), 1503(b)(1)(B), and 1503(b)(17)(E) is that only a 50% deduction for dividend income of a RIC subsidiary (to the extent that the dividends are considered dividends under IRC section 854(a) and are designated dividends for purposes of computing the deduction allowed under IRC section 243) or a subsidiary that is a RIC holding company (to the extent the dividends are attributable to the holding company's ownership interest in a RIC) will be allowed for taxable years beginning on and after 2007 under section 1503(b)(1)(B)(i).

Tax Law section 1503(b)(2)(H) provides that ENI must include interest directly or indirectly attributable and any other amount directly attributable to subsidiary capital or to income, gains, or losses from subsidiary capital. This section has been amended to provide an exception that ENI will not include any interest directly or indirectly attributable to, and any other amount directly attributable to (1) subsidiary capital (when the subsidiary is a REIT, RIC, REIT holding company, or RIC holding company), the income, gains, or losses from which are not excluded from ENI pursuant to section 1503(b)(1)(A); or (2) the income, gains, or losses from a REIT, RIC, REIT holding company, or RIC holding company that are not excluded from ENI pursuant to section 1503(b)(1)(A).

Tax Law section 1504(c)(2), which concerns the allocation of subsidiary capital, was amended to provide that the amount of subsidiary capital prior to allocation be reduced by 100% of the investments in the stock of, and any indebtedness from a subsidiary that is a REIT, RIC, REIT holding company, or RIC holding company whose income, gains, or losses are not excluded from ENI pursuant to section 1503(b)(1)(A). The reduction is limited to the extent such investments or indebtedness are directly or indirectly attributable to income, gains or losses that are not so excluded.

(Tax Law sections 209.5, 209.7, 1453(e)(11), 1453(u), 1503(b)(1)(A), 1503(b)(1)(B), 1503(b)(2)(H), 1503(b)(17), 1504(c)(2))

Grandfathered 9-A corporations (Articles 9-A and 32)

The Tax Law has been amended by adding new section 1452(n) to establish conditions under which certain corporations that elected to be taxed under Article 9-A instead of Article 32 (hereinafter, electing corporation) or were required to be taxed under Article 9-A pursuant to the Gramm-Leach-Bliley transitional provisions (see Tax Law section 1452) (hereinafter, grandfathered corporation), would become subject to tax under Article 32 of the Tax Law.

An *electing corporation* is a corporation that elected to be taxed under Article 9-A instead of Article 32 pursuant to section 1452(d) of the Tax Law or pursuant to the Gramm-Leach-Bliley transitional provisions in section 1452 of the Tax Law.

A *grandfathered corporation* is a corporation that was required to be taxed under Article 9-A pursuant to the Gramm-Leach-Bliley transitional provisions.

Conditions for revoking election. If any of the conditions listed below apply to an electing corporation, the electing corporation is deemed to have revoked the election and will be subject to tax under Article 32 as of the first day of the taxable year in which the condition applies. If any of the conditions listed below apply to a grandfathered corporation that meets the definition of a banking corporation under Tax Law section 1452(a), the corporation will be subject to tax under Article 32 on the first day of the taxable year in which such condition applies.

The conditions are as follows:

- The corporation ceases to be a taxpayer under Article 9-A.

- The corporation becomes subject to the fixed dollar minimum tax under Tax Law section 210.1(d)(1)(F).

- The corporation (1) has no wages and no receipts allocable to New York State, or (2) is otherwise inactive. This condition will not apply to a corporation engaged in the active conduct of a trade or business, or to a corporation where substantially all of the assets of which are stock and securities of corporations that are directly or indirectly controlled by it and are engaged in the active conduct of a trade or business. A corporation that has either wages or receipts allocable to New York State will remain taxable under Article 9-A of the Tax Law.

- Sixty-five percent or more of the voting stock of the corporation becomes owned or controlled directly by a corporation that acquired the stock in a transaction (or series of related transactions) that qualifies as a purchase within the meaning of Internal Revenue Code (IRC) section 338(h)(3) unless the corporation whose stock was acquired and the corporation acquiring the stock were, immediately prior to such purchase, members of the same affiliated group (as such term is defined in IRC section 1504 without regard to the exclusions provided for in 1504(b)). Any acquisition that was completed on or before January 3, 2007, will be treated as an acquisition made before January 1, 2007.

- The corporation, in a transaction or series of related transactions, acquires assets, whether by contribution, purchase, or otherwise, having an average value (determined in accordance with Tax Law section 210.2) in excess of forty percent of the average value, or, if greater, in excess of forty percent of the total tax basis, of all the assets of the corporation immediately prior to such acquisition and as a result of such acquisition the corporation is principally engaged in a business that is different from the business immediately prior to such acquisition, provided that such different business is described in section 1452(a)(9)(i), (ii), or (iii) of the Tax Law.

Definition of a banking corporation. The definition of a *banking corporation* in section 1452(a)(9) of the Tax Law has been amended by:

- adding clause (iii) to include a corporation that is principally engaged in holding and managing investment assets (including, but not limited to, bonds, notes, debentures, and other obligations for the payment of money, stocks, partnership interests or other equity interests, and other investment securities) if 65% or more of the stock of the corporation is owned or controlled, directly or indirectly, by a bank or a bank holding company and the corporation is not a business described in section 1452(a)(9)(i) or (ii) of the Tax Law; and

- providing that a banking corporation includes a corporation principally engaged in a business as closely related to banking or managing or controlling banks as to be a proper incident thereto as set forth in section 4(K)(4)(f) of the federal Bank Holding Company Act of 1956, as amended, if 65% or more of the stock of the corporation is owned or controlled directly or indirectly by a bank or a bank holding company.

These provisions are effective for tax years beginning on or after January 1, 2007.

(Tax Law, sections 1452(n), 1452(a)(9))

Franchise tax on banking corporations (Article 32)

The provisions of the bank tax that were scheduled to expire for tax years beginning on or after January 1, 2008, have been extended for two years.

(Chapter 60 of the Laws of 2007)

Transitional provisions for the federal Gramm-Leach-Bliley Act (Articles 9-A and 32)

The transitional provisions for financial holding companies that were scheduled to expire for tax years beginning on or after January 1, 2008, have been extended for two years.

Specifically, the transitional provisions for financial holding companies contained in section 1452(l) of the Tax Law were extended by adding new section 1452(m) of the Tax Law.

Unlike previous extenders (Tax Law sections 1452(h), (i), (j), (k), and (l)), new section 1452(m) contains language stating that a banking corporation (in existence before January 1, 2008, and subject to tax under Article 32 for its last tax year beginning before January 1, 2008), remains taxable under Article 32 for tax years beginning on or after January 1, 2008, and before January 1, 2010, unless, as a result of a transaction or series of transactions occurring on or after January 1, 2008, the corporation (1) no longer meets the definition of a banking corporation under Tax Law section 1452(a); or (2) no longer satisfies the requirements for a corporation to elect to be taxable under Article 32.

The combined reporting requirements of the transitional provisions contained in section 1462(f)(2)(iv) of the Tax Law were also extended for two years.

For more information on the provisions that were extended, see page 6 of TSB-M-02(1)C, *Summary of Legislative Changes Enacted in 2001*.

(Tax Law, sections 1452(l), 1452(m), and 1462(f)(2)(iv))

Extension of tax shelter reporting requirements (Articles 9, 9-A, 13, 22, 32, and 33)

Part I of Chapter 60 of the Laws of 2007 amended Part N of Chapter 61 of the Laws of 2005. The amendment extends the expiration date of the reporting requirements and related administrative provisions concerning the disclosure of certain federal and New York State reportable transactions and related information regarding tax shelters to July 1, 2009. The provisions were due to expire on July 1, 2007.

For more information regarding the reporting requirements and related administrative provisions concerning the disclosure of certain transactions and related information, see the following documents that are available on the Tax Department's Web site (*www.nystax.gov*):

- TSB-M-05(2)C,(4)I, *Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*;

- TSB-M-05(2.1)C,(4.1)I, *Supplement to the Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*;

- TSB-M-05(2.2)C,(4.2)I, *Additional Supplement to the Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*;

- TSB-M-07(4)C,(4)I, *Amendments to the Procedural Regulations Relating to New York Reportable Transactions*;

- TSB-M-07(1)C, *Additional Supplement to the Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*; and

- TSB-M-07(5)C,(5)I, *Notification of New York Listed Transaction - Certain Charitable Contribution Deductions.*

(Tax Law sections 25, 683(c)(11), 685, 1083(c)(11), and 1085, and Tax Regulations, Part 2500 (20NYCRR Part 2500))

Combined filing requirements (Articles 9-A, 32, and 33)

Article 9-A. Tax Law section 211.4(a) has been amended to require a taxpayer to file a combined tax report with its related corporations if there are substantial intercorporate transactions among the related corporations, regardless of the transfer price for the intercorporate transactions.

It is not necessary that there be substantial intercorporate transactions between any one corporation and every other related corporation. It is necessary, however, that there are substantial intercorporate transactions between the taxpayer and a related corporation or collectively, a group of such related corporations.

For purposes of Article 9-A, a *related corporation* is a corporation that:

- owns or controls, either directly or indirectly, substantially all the capital stock of one or more other corporations, or substantially all the capital stock of which is owned or controlled, either directly or indirectly, by one or more other corporations; or

- is owned or controlled, either directly or indirectly, by interests that own or control, either directly or indirectly, substantially all the capital stock of one or more other corporations.

In determining whether there are substantial intercorporate transactions, the Commissioner of Taxation and Finance shall 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 common customers of related corporations;
5) incurring expenses that benefit, directly or indirectly, one or more related corporations; and
6) transferring assets, including such assets as accounts receivable, patents, or trademarks from one or more related corporations.

Under the new law, a combined report covering any corporation that does not have substantial intercorporate transactions with the taxpayer or with one or more related corporations will not be required unless the commissioner deems a combined report necessary because of intercompany transactions or some agreement, understanding, arrangement, or transaction referred to in section 211.5 of the Tax Law.

The provisions in Tax Law section 211.4(a)(5), which excluded corporations doing business in Puerto Rico that made an election under Internal Revenue Code section 936 from being included in a combined report, have been repealed. In addition, the section has been further amended to clarify that a corporation organized under the laws of a country other than the United States cannot be included in a combined report.

Section 208.9(o)(2)(A) has been amended to provide that if a taxpayer is included in a combined report under section 211.4 with a related member, the taxpayer will not be required to add back royalty payments to that related member that are deductible in calculating federal taxable income.

Article 32. Section 1453(r)(2)(A) has been amended to provide that if a taxpayer is included in a combined report with a related member under section 1462(f), the taxpayer will not be required to add back royalty payments to the related member that are deductible in calculating federal taxable income.

Note: No further amendments were made to the combined filing requirements for Article 32 taxpayers by the 2007-2008 New York State budget bill.

Article 33. Section 1503(b)(14)(B)(i) has been amended to provide that if an insurance corporation is included in a combined return with a related member under section 1515(f), the insurance corporation will not be required to add back royalty payments to the related member that are deductible in calculating federal taxable income.

Section 1515(f), relating to the franchise tax on insurance corporations, has been amended to require a taxpayer to file a combined tax return with its related corporations if there are substantial intercorporate transactions among the related corporations, regardless of the transfer price for the intercorporate transactions.

It is not necessary that there be substantial intercorporate transactions between any one corporation and every other related corporation. It is necessary, however, that there are substantial intercorporate transactions between the taxpayer and a related corporation or collectively, a group of such related corporations.

For purposes of Article 33, a *related corporation* is a corporation that:

- owns or controls, either directly or indirectly, substantially all the capital stock of one or more other corporations, or substantially all the capital stock of which is owned or controlled, either directly or indirectly, by one or more other corporations; or

- is owned or controlled, either directly or indirectly, by interests that own or control, either directly or indirectly, substantially all the capital stock of one or more other corporations.

In determining whether there are substantial intercorporate transactions, the Commissioner of Taxation and Finance shall 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 common customers of 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 such assets as accounts receivable, patents or trademarks from one or more related corporations.

Under the new law, a combined report covering any corporation that does not have substantial intercorporate transactions with the taxpayer or with one or more related corporations will not be required unless the commissioner deems a combined report necessary because of intercompany transactions or some agreement, understanding, arrangement, or transaction referred to in section 1515(g) of the Tax Law, in order to properly reflect the tax liability under Article 33. Non-life insurance corporations are not required or permitted to be included in a combined return.

These provisions apply to taxable years beginning on or after January 1, 2007.

(Tax Law sections 211.4(a), 208.9(o)(2)(A), 1453(r)(2)(A), 1503(b)(14)(B)(i), 1515(f))

Personal service corporations (Articles 9-A and 22)

Section 632-a has been added to the Tax Law to allow the Commissioner of Taxation and Finance to allocate all income, deductions, credits, exclusions, and other allowances between a personal service corporation or an S corporation (even if the personal service corporation or S corporation is taxed under Article 9-A of the Tax Law or is not subject to tax in this state) and its employee-owner(s) if allocation is necessary (1) to prevent avoidance or evasion of New York State income tax or (2) to clearly reflect the source and the amount of the income of the personal service corporation or S corporation or its employee-owner(s).

Section 632-a of the Tax Law provides that the commissioner may make the allocation described above if:

- substantially all of the services of a personal service corporation or S corporation are performed for or on behalf of another corporation, S corporation, partnership, or other entity; and

- the effect of forming or availing of the personal service corporation or S corporation is the avoidance or evasion of New York income tax by reducing the employee-owner's income (or in the case of a nonresident, the employee-owner's New York source income), or securing for any employee-owner the benefit of any expense, deduction, credit, exclusion, or other allowance that would not otherwise be available.

For purposes of this new section, all related persons as defined by IRC section 144(a)(3) shall be treated as one entity. In addition, the following definitions apply:

- A *personal service corporation* is a corporation whose principal activity is the performance of personal services and such services are substantially performed by the employee-owner(s) of the corporation.

- An *S corporation* is a corporation for which an election under IRC section 1362 is in effect for that taxable year and whose principal activity is the performance of personal services and such services are substantially performed by the employee-owner(s) of the corporation.

- An *employee-owner* is any employee who owns, on any given day during the taxable year, more than 10% of the outstanding stock of the personal service corporation or S corporation.

Section 632-a applies to tax years beginning on or after January 1, 2007.

(Tax Law section 632-a)

Mandatory New York S corporation election (Articles 9-A and 22)

Section 660(i) has been added to the Tax Law to provide that if more than 50% of an eligible S corporation's federal gross income (as defined in Internal Revenue Code section 61(a)) for the current tax year is derived from investment income, then the shareholders of that eligible S corporation are deemed to have made the election to be a New York S corporation for the entire current tax year. The new provision does not apply to eligible S corporations that are subject to tax under Article 32 of the Tax Law.

The following definitions apply for purposes of section 660(i):

- An *eligible S corporation* is (1) an S corporation that is subject to tax under Article 9-A; or (2) an S corporation that is the parent of a qualified subchapter S subsidiary subject to tax under Article 9-A, where the shareholders of such parent corporation are entitled to make the election under section 660(a) by reason of section 208.9(k)(3).

- *Investment income* is the sum of an eligible S corporation's gross income from interest, dividends, royalties, annuities, rents, and gains derived from dealings in property (real, intangible, and tangible), including the corporation's share of such items from a partnership, estate, or trust, to the extent such items would be includable in the corporation's federal gross income for the taxable year.

Under the new provision, an eligible S corporation will be treated as a New York S corporation only for a tax year for which the 50% test described above is met. If the 50% test is not met for a tax year, the eligible S corporation will be treated as a New York C corporation for that year, even if the corporation was treated as a New York S corporation under the provisions of section 660(i) for the prior year.

When making current tax year estimated tax payments, an eligible S corporation and its shareholders may rely on the eligible S corporation's filing status for the prior tax year in determining the amounts required to be paid. If the status of the eligible S corporation changes from a New York C corporation to a New York S corporation or from a New York S corporation to a New York C corporation, any estimated taxes (along with required declarations of estimated tax for corporations) that would have otherwise been required to be made by the corporation or the shareholders during the current tax year can be made without penalty, by January 15 of the calendar year following the close of the taxpayer's tax year, regardless of whether the taxpayer's tax year is a calendar or fiscal year. In addition, either the corporation or the shareholders, when filing their tax returns for the year, can claim a refund of any estimated taxes overpaid due to the change in the corporation's filing status.

Note: A fiscal year taxpayer **is required** to pay any tax due on or before January 15 or the due date of his, her, or its tax return, without regard to extensions, whichever is earlier.

Example: *Corporation A was a federal S corporation but a New York State C corporation for fiscal year 6/1/06 - 5/31/07. Corporation A has one individual shareholder (Shareholder X). Shareholder X is a New York State resident.*

For fiscal year 6/1/07 - 5/31/08, Corporation A derives ***more than*** *50% of its federal gross income from investment income. Accordingly, Corporation A is deemed to have made the New York S corporation election for this fiscal year and is required to file a New York S corporation return. Corporation A based its estimated tax payments for this fiscal year on its New York C corporation status for the prior fiscal year. Corporation A's return is due by 8/15/08. Although Tax Law section 660(i) allows Corporation A until 1/15/09 to correct its estimated payments without incurring estimated tax penalties, the corporation must pay the total tax due as shown on its Form CT-3-S,* New York S Corporation Franchise Tax Return, *by the filing due date of 8/15/08 in order to avoid incurring a late payment penalty. If Corporation A is requesting an extension of time to file, it must make any required payment with its extension request. If Corporation A overpaid its franchise tax for this fiscal year, it may claim a refund when it files its franchise tax return.*

For fiscal year 6/1/08 – 5/31/09, Corporation A derives ***50% or less*** *of its federal gross income from investments. Accordingly, Corporation A is not deemed to be a New York S corporation for this fiscal year and must file as a New York C corporation. Corporation A based its estimated tax payments for this fiscal year on its New York S corporation status for the prior fiscal year. Corporation A's return is due by 8/17/09. Although Corporation A has until 1/15/10 to correct its estimated payments without incurring estimated tax penalties, the corporation must pay the total tax due shown on its Form CT-3,* General Business Corporation Franchise Tax Return, *by the filing due date of 8/17/09 to avoid incurring a late payment penalty. If Corporation A is requesting an extension of time to file, it must make any required payment with its extension request. If Corporation A overpaid its franchise tax for this fiscal year, it may claim a refund when it files its franchise tax return.*

Shareholder X files her personal income tax return using the calendar year. Since Corporation A is deemed to have made the New York S election for fiscal year 6/1/07 – 5/31/08, Shareholder X will report the income passed through from Corporation A for that year on her 2008 calendar year federal and New York State income tax returns. However, she based her 2008 estimated tax payments on Corporation A's New York C status for the prior tax year. Under Tax Law section 660(i), Shareholder X has until 1/15/09 to correct her 2008 estimated tax payments without incurring estimated tax penalties. If Shareholder X has overpaid her tax for 2008, she may claim a refund when she files her personal income tax return.

For calendar tax year 2009, Shareholder X based her estimated tax payments on Corporation A's New York S status for its prior tax year. Since Corporation A will be treated as a New York C corporation for its fiscal year 6/1/08 – 5/31/09, Shareholder X will report the income passed through from Corporation A on her 2009 calendar year federal and New York State income tax returns, but will make the necessary New York modifications to remove that income from her New York adjusted gross income. Under Tax Law section 660(i), Shareholder X has until 1/15/10 *to correct her estimated tax without incurring estimated tax penalties. If Shareholder X has overpaid her income tax for 2009, she may claim a refund when she files her 2009 personal income tax return.*

This provision applies to tax years beginning on or after January 1, 2007.

(Tax Law section 660(i))

Low-income housing credit (Articles 9-A, 32, and 33)

The New York State low-income housing tax credit program was established in 2000 to promote the construction and rehabilitation of low-income housing in New York State. The credit is similar to the federal low-income housing credit and is administered by the New York State Division of Housing and Community Renewal.

The Public Housing Law has been amended to increase the statewide aggregate dollar amount of low-income housing tax credits that may be used for qualifying low-income housing projects from $12 million to $16 million.

This provision took effect April 9, 2007.

(Public Housing Law, section 22(4))

Corporate tax rate changes and new manufacturers tax rate (Articles 9-A, 32, and 33)

General. The rate of tax on the entire net income (ENI) base for Articles 9-A, 32, and 33 taxpayers, except small business taxpayers under Article 9-A, has been reduced from 7.5% to 7.1% for taxable years beginning on or after January 1, 2007.

The small business taxpayer rate under Article 9-A has also been reduced. The new rate and tax computation effective for tax years beginning on or after January 1, 2007, are as follows:

- If the ENI base does not exceed $290,000, the tax rate is 6.5% of the ENI base.

- If the ENI base exceeds $290,000 but does not exceed $390,000, the tax is computed by adding the following amounts:

  1) $18,850 plus,
  2) 7.1% of the excess of the ENI base over $290,000 plus,
  3) 4.35% of the excess of the ENI base over $350,000.

Reduced rate for qualified New York manufacturers. The Article 9-A rate on the entire net income base for qualified New York manufacturers for taxable years beginning on or after **January 31, 2007**, has been reduced to 6.5%.

Note: Because of the effective date contained in the new legislation, the tax rate applicable for calendar-year qualified New York manufacturers that are not small business taxpayers and whose tax year begins prior to January 31, 2007, is 7.1% for tax year 2007.

A *qualified New York manufacturer* is a manufacturer that either (1) has property in New York State of the type described for the investment tax credit under Tax Law section 210.12(b)(i)(A) that has an adjusted basis for federal income tax purposes of at least one million dollars at the end of the tax year; or (2) has all its real and personal property in New York State. In addition, a qualified emerging technology company (QETC), as defined in section 3102-e of the Public Authorities Law (determined without regard to the $10 million limitation contained in section 3102-e(1)(c)(1) of that law), is a qualified New York manufacturer. A combined group may be considered a QETC and meet the definition of a qualified New York manufacturer if all members of the group meet the definition of a QETC (as described in the previous sentence).

A *manufacturer* is defined in the law as a taxpayer that during the taxable year is principally engaged in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing. However, the generation and distribution of electricity, the distribution of natural gas, and the production of steam associated with the generation of electricity are not qualifying activities for a manufacturer under this definition. A combined group is considered a manufacturer for purposes of this subparagraph only if the combined group during the taxable year is principally engaged in the activities set forth in this definition or any combination thereof. A taxpayer or combined group is principally engaged in activities described above if, during that taxable year, more than 50% of the gross receipts of the taxpayer or combined group, respectively, are derived from receipts from the sale of goods produced by such activities. In computing a combined group’s gross receipts, intercorporate receipts are eliminated.

Minimum taxable income base. The tax rate on the minimum taxable income base for Article 9-A taxpayers has been reduced to 1.5% for taxable years beginning on or after January 1, 2007.

Note: The rate of tax on the entire net income (ENI) base for Articles 9-A, 32, and 33 taxpayers and the tax rate on the minimum taxable income base for Article 9-A taxpayers described above do not apply when computing the MTA surcharge. (see MTA surcharge below)

(Tax Law sections 210.1(a), 1455(a), 1502(a)(1), 210.1(c)(ii))

MTA surcharge (Article 9-A)

Subdivision 1 of section 209-B of the Tax Law has been amended to clarify the method by which the MTA surcharge is to be calculated for Article 9-A taxpayers for tax years beginning on or after January 1, 2007.

The MTA surcharge, as well as any required estimated payments of the MTA surcharge, is calculated using the highest of the tax bases imposed (tax on the entire net income (ENI) base, the minimum taxable income (MTI) base, the capital base, or the fixed dollar minimum). However, if the highest tax before application of credits is the tax on the ENI base, the MTI base, or the capital base, then the surcharge will be computed as if the tax rates and limitations for such bases were the tax rates and limitations in effect for tax years commencing on or after July 1, 1997, and before July 1, 1998.

(Tax Law section 209-B.1)

Power for Jobs Tax Credit (Article 9)

The power for jobs tax credit has been extended to include calendar year 2008. The extension enables a utility to claim a credit on its 2008 return for power properly allocated in prior years. The power for jobs tax credit is available to qualified electric corporations that are local distribution companies. The credit is claimed on Forms CT-186-P, *Utility Services Tax Return – Gross Income*, and CT-186-E, *Telecommunications Tax Return and Utility Services Tax Return*. To claim the power for jobs tax credit, taxpayers must obtain a certificate from the Department of Public Service to verify the correctness of the calculation of the tax credit.

(Tax Law section 186-a(9))

<u>Expiring Provisions</u>

The following section of this memorandum contains information relating to Tax Law provisions enacted in prior years that have expired.

Industrial or manufacturing business (IMB) credit (Article 9-A)

For taxable years ending after January 1, 2000, and before January 1, 2007, a taxpayer that was an eligible industrial or manufacturing business (IMB) was allowed a credit against the tax imposed under Article 9-A of the Tax Law. The credit was equal to the sum, or pro-rata share of the sum, of the taxes imposed under sections 186-a, 186-c, 189, and 189-a of Article 9 of the Tax Law (but only for gas, electricity, steam, water, or refrigeration; or gas, electricity, steam, water, or refrigeration services, used or consumed in New York State), that were paid by or passed through to the IMB during the taxable year.

Effective for tax years ending on or after January 1, 2007, the IMB credit has expired.

(Tax Law sections 14-a, 210.26-a)

Clean heating fuel credit (Article 9-A)

For tax years beginning in 2006 and 2007, Article 9-A taxpayers that purchased bioheat for space heating or hot water production for residential purposes within New York State were allowed a tax credit against the tax imposed under Article 9-A of the Tax Law. The bioheat had to be purchased on or after July 1, 2006, and before July 1, 2007. The credit was based on the portion of the bioheat comprised of biodiesel, calculated at $.01 per gallon for each percent of biodiesel included in the bioheat, not to exceed $.20 per gallon.

The clean heating fuel credit has expired for bioheat purchased on or after July 1, 2007.

(Tax Law, section 210.39)

Filing fees for limited liability companies and limited liability partnerships (Article 22)

The increased filing fees enacted in 2003 for limited liability companies (LLCs) treated as partnerships for federal income tax purposes and limited liability partnerships (LLPs), and the filing fee for single-member LLCs that are disregarded entities for federal income tax purposes have expired for tax years beginning after 2006.

Accordingly, for tax years beginning after 2006, the filing fees for LLPs and LLCs (that are treated as partnerships for federal income tax purposes) that have income from New York State sources, are $50 multiplied by the total number of members or partners in the LLC or LLP, subject to a minimum amount of $325 and a maximum amount of $10,000. LLCs and LLPs that are subject to the filing fee must file Form IT-204-LL within 30 days after the last day of the tax year of the LLC or LLP, together with full remittance of any filing fee due.

In addition, for tax years beginning after 2006, single-member limited liability companies (SMLLC) that are disregarded entities for federal income tax purposes no longer have to file Form IT-204-LL, *Limited Liability Company/Limited Liability Partnership Filing Fee Payment Form*, or pay the $100 filing fee. The filing fee for an LLC with more than one member that is a disregarded entity for federal income tax purposes (for example, an LLC owned solely by a husband and wife who are residents of a community property state that can elect disregarded status for federal purposes under Revenue Procedure 2002-69) has also expired.

(Tax Law, section 658(c)(3))

NOTE: A TSB-M is an informational statement of existing Department policies or of changes to the law, regulations, or policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in Department policies could affect the validity of the information presented in a TSB-M.