New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

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Corporation Tax
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Business Tax Reform and Rate Reduction Act of 1987
Tax Rate and Base Changes

<u>Introduction</u>

Prior to corporate tax reform, the franchise tax was computed upon four different bases, the taxpayer was required to pay the highest of the four resulting taxes, plus a tax computed on allocated subsidiary capital. The four tax bases were: entire net income, capital, entire net income plus officer's compensation, and minimum tax of $250. Chapter 817 retains a four base tax but makes the following changes:

1. The tax rate applicable to the entire net income base is reduced from 10% to 9%. For small business taxpayers, the rate is 8% on the first $200,000 of allocated entire net income, 9% on any excess over $200,000, and an additional 5% on the entire net income base between $250,000 and $290,000. A small business taxpayer is one:

   (a) with entire net income of not more than $290,000 (before allocation); and

   (b) where the aggregate amount of money and other property received by the corporation for stock, as a contribution to capital, and paid in surplus does not exceed $1 million; and

   (c) that is not part of an affiliated group (unless that group, as defined by section 1504 of the Internal Revenue Code, taken as a whole would qualify as a small business).

2. The present capital tax is retained at the existing rate (.00178), but with three significant changes. First, a deduction is permitted for long-term liabilities as well as short-term liabilities. Second, there is a $350,000 cap on the tax liability to be computed on this base. In the case of combined filers, the $350,000 cap applies to the combined group. Finally, real property and marketable securities continue to be valued at fair market value. However, personal property other than marketable securities is to be valued at accounting book value using generally accepted accounting principles (GAAP).

3. The entire net income plus officer's compensation base is repealed.

4. A new minimum tax base is added to the law. For taxable years beginning in 1987, 1988 and 1989, this tax will be 3.5% of the pre-1990 minimum taxable income base. The pre-1990 minimum taxable income base is entire net income allocated by the three factor formula, but using single-weighting of the receipts factor subject to any modification required because of optional depreciation.

In addition, no tax credits will be allowed against such tax. Starting in 1990 a new type of minimum tax will begin. This tax will be computed at the rate of 3% of the minimum taxable income base, which is entire net income, plus certain tax preferences, and plus or minus certain adjustments. This minimum taxable income base will also be allocated using the single-weighting of the receipts factor.

Entire Net Income Base

The starting point for computing a taxpayer's entire net income base is total net income from all sources. This is presumably the same as

(1) the entire taxable income (not alternative minimum taxable income) the taxpayer is required to report to the United States Treasury Department; or

(2) that the taxpayer would have been required to report to the United States Treasury Department if it had not made an election under Subchapter S of Chapter 1 of the Internal Revenue Code; or

(3) that the taxpayer, in the case of a corporation which is exempt from federal income tax (other than the tax on unrelated business taxable income imposed under Section 511 of the IRC), but which is taxable under Article 9-A of the Tax Law, would have been required to report to the United States Treasurv Department if not for such exemption.

In computing New York entire net income, many modifications must be made. Among the changes made by Chapter 817 are the following:

(1) A new subparagraph 3-a is added to Section 208.9(b) to require an add-back of taxes on or measured by profits or income, or that includes profits or income as a measure, paid or accrued to any other states, or any political subdivisions of such state or to the District of Columbia. Such taxes include those expressly in lieu of any of the above taxes otherwise generally imposed by any other state of the United States, or any political subdivision thereof, or the District of Columbia.

(2) The dollar denominated allowable deduction under Section 208.9(b)(5) relating to interest on certain stockholder indebtedness is increased from $1,000 to $10,000. Chapter 817 further provides for the repeal in 1989 of the add-back of interest paid to more than 5% shareholders.

(3) Section 211 of the Tax Law was amended by adding a new subparagraph 2-a which requires information returns for payments to shareholders owning, directly or indirectly, individually or in the aggregate, more than 50% of the issued capital stock of the taxpayer, where such payments are treated as interest payments in the computation of entire net income or minimum taxable income. No separate return is required to be filed. The information returns will be included as schedules on forms CT3 and CT4.

(4) Subsidiary expenses required to be added back in the computation of entire net income now include non-interest expenses indirectly attributable to subsidiary capital.

(5) Repeals the expensing option for pollution control property.

Capital Base

The present capital tax is retained at the existing rate of 1.78 mills, (.4 mills in the case of a cooperative housing corporation as defined in the IRC). In no event can the tax on the capital base exceed $350,000 in any one taxable year. In the case of combined filers, the $350,000 cap applies to the combined group. A deduction is now permitted for long-term liabilities as well as short-term liabilities in the computation of subsidiary capital, investment capital and business capital. Real property and marketable securities are to be valued at fair market value. All other property is now to be valued at book value using generally accepted accounting principles (GAAP).

Minimum Taxable Income Base(s)

For taxable years beginning after December 31, 1986 and before 1990, the "pre-1990 minimum taxable income base" is taxed at the rate of 3.5%. Real Estate Investment Trusts (REIT's) and Regulated Investment Companies (RIC's) are subject to this new minimum tax. No tax credits will be allowed against this tax.

Starting in 1990, a new minimum taxable income base will be in effect. The tax will be computed at the rate of 3% of the minimum taxable income base, which is entire net income increased by the amount of certain federal tax preference items set forth in Section 57 of the IRC. These federal adjustments pertain to:

(a) Depreciation, other than for decoupled property (Section 56(a)(1)IRC);

(b) Mining exploration and development costs (Section 56(a)(2)IRC);

(c) Treatment of certain long-term contracts (Section 56(a)(3)IRC);

(d) Installment sales of certain property (Section 56(a)(6)IRC);

(e) Circulation expenditures of personal holding companies (Section 56(b) (2) (C) IRC);

(f) Merchant marine capital construction funds (Section 56(c)(2)IRC);

(g) Disallowance of passive activity losses (Section 58(b)(IRC); and

(h) Adjusted basis (Section 56(a)(7)IRC)(but excluding references to Section 56(a)(5)IRC).

Subsequent memoranda will be issued addressing the computation of tax on the pre-1990 minimum taxable income base, the minimum taxable income base for 1990 and thereafter, and the computation of the special minimum tax credit.