

### **Summary of Income Tax Legislative Changes Enacted in 2002**

This memorandum contains brief summaries of the income tax changes that are part of the 2002-2003 New York State budget bill (Chapter 85 of the Laws of 2002), Chapter 83, Chapter 84 and Chapter 359 of the Laws of 2002, that are effective for tax years beginning on or after January 1, 2000.

#### **Residential fuel oil storage tank credit**

Effective April 1, 2002, section 606(p-1) of the Tax Law, relating to the residential fuel oil storage tank credit, has been amended. The amendment extends the credit for an additional year (2003) and changes the requirements for claiming the credit for residential fuel oil storage tanks removed or permanently closed after March 31, 2002.

If an unprotected residential fuel oil storage tank is removed or permanently closed after March 31, 2002, but before January 1, 2004, the tank that was removed or permanently closed must be replaced with a new residential fuel oil storage tank in order to qualify for the credit. The credit is equal to the lesser of the total cost of tank removal or permanent closure **and** replacement, or \$500.

Prior to April 1, 2002, the credit was allowed for up to \$250 of the cost for tank removal, up to \$250 of the cost for permanent closure, and up to \$250 of the cost for the purchase and installation of a replacement tank. Additionally, taxpayers were not required to replace a residential fuel oil storage tank that was removed or permanently closed in order to qualify for the credit.

(Tax Law, section 606(p-1))

#### **Electronic funds transfer (EFT) program for withholding tax**

The EFT program for withholding tax has been expanded by reducing the threshold for mandatory remittance of withholding tax by EFT from \$400,000 to \$100,000 of annual withholding tax liability. The Tax Department must notify affected employers of their new requirement to pay by EFT by September 1, 2002. The first EFT payments from new EFT employers are due beginning in January 2003.

(Tax Law, section 9)

### **Low- income housing credit**

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 to reward construction of low-income housing from \$2 million to \$4 million per year. This provision takes effect immediately.

(Public Housing Law, section 22)

### **Alzheimer's disease assistance fund**

Provides an additional annual appropriation of funds into the Alzheimer's disease assistance fund matching the amount of funds deposited into the Alzheimer's disease assistance fund during the preceding calendar year from revenue derived pursuant to section 629 of the Tax Law (income tax check-off gifts).

(State Finance Law, section 89-e)

### **College tuition credit and deduction**

Technical amendments were made to the college tuition credit and deduction to clarify the original legislative intent. These amendments provide that the dollar limitation on tuition expenses is \$10,000 per year for each *eligible student*. In addition, a dependent student is not entitled to claim the credit or deduction. Instead, any tuition paid by a dependent student would be attributed to the parent and used by the parent to claim the credit or deduction. Conforming amendments were also made to the New York City personal income tax. These technical amendments are effective for tax years beginning on or after January 1, 2001.

Note: The 2001 version of Form IT-272, *Claim for College Tuition Credit for New York State Residents*, reflects these technical changes. Accordingly, there is no need for taxpayers to file amended returns.

(Tax Law, section 606(t); Administrative Code of the City of New York, section 11-1715 (d))

### **Victims of certain terrorist attacks**

The Tax Law has been amended to provide personal income tax relief for victims of the September 11, 2001, terrorist attacks. Under the new law, the New York State, New York City and Yonkers personal income tax liabilities of those who died as a result of the terrorist attacks is generally erased for the 2000 tax year and all later years up to, and including, the year of death.

For more detailed information on the tax relief being provided, see Publication 59, *New York State Tax Relief for Victims of Terrorist Attacks*.

(Tax Law, section 696; Administrative Code of the City of New York, section 11-1796)

### **Interest on overpayments and underpayments**

Section 697(j) of the Tax Law, relating to the rate of interest to be set by the Commissioner of Taxation and Finance, is amended to provide for separate rates of interest to be set for overpayments and underpayments of personal income tax.

The computation of the rate of interest on overpayments remains the same. That is, the rate is the sum of the federal short-term rate as provided under section 697(j)(3) of the Tax Law plus two percentage points.

The computation of the rate of interest on underpayments has been changed. The new computation is the sum of the federal short-term rate as provided under section 697(j)(3) of the Tax Law plus four percentage points. The new rate applies to the amount of the underpayment that remains or becomes due on or after April 1, 2003.

For purposes of an overpayment or underpayment of withholding tax, the rate of interest is determined in accordance with the provisions of section 1096(e)(1) of the Tax Law. That section currently provides for separate rates of interest on overpayments and underpayments. However, the underpayment rate determined in accordance with that section has also been similarly amended. The new rate is the sum of the federal short-term rate plus five percentage points, and applies to the amount of the underpayment of withholding tax that remains or becomes due on or after April 1, 2003.

The increase in the interest rate for underpayments also affects other computations. For instance, the penalty for understatement of estimated tax under section 685 (c) of the Tax Law is based on the interest rate for underpayments. Additionally, if a recapture of a previously claimed investment credit (ITC) is required, the interest rate for underpayments in effect on the last day of the tax year is used to compute the additional recapture amount.

Conforming amendments have also been made to section 11-1797(j) of the Administrative Code of the City of New York.

To find the current and previous interest rates on the Department web site at [www.tax.state.ny.us](http://www.tax.state.ny.us), click on *Site Index* and then click on *Interest Rates*.

(Tax Law, sections 697(j), 1096(e)(1); Administrative Code of the City of New York section 11-1797(j))

## **Electronic signatures**

The Tax Law has been amended to add a new section 171-k, which authorizes the Commissioner of Taxation and Finance to provide for the use of electronic signatures on tax returns and reports filed electronically. The law states that electronic signatures must be consistent with the requirements of the State's Electronic Signatures and Records Act (ESRA). However, if the Commissioner determines that electronic signatures used by the Internal Revenue Service (IRS) in tax administration are not consistent with the requirements of ESRA, the Commissioner, after conferring with the Office for Technology, may prescribe the manner and form of electronic signature on any return or report. Such an electronic signature must conform, to the extent practicable, with the electronic signature used by the IRS.

(Tax Law, section 171-k)

## **Investment tax credit (ITC) relief for property destroyed as a direct result of the terrorist attacks of September 11, 2001**

Generally, if property on which an investment tax credit (ITC) has been allowed is disposed of or ceases to be in qualified use prior to the end of its useful life, a portion of the credit must be recaptured and added to the tax due in the year of disposition or disqualification. The amount required to be recaptured (the recapture amount) is the difference between the original credit allowed and the credit for actual use. The recapture amount is augmented with interest computed at a rate equal to the underpayment rate in effect on the last day of the tax year in which the recapture occurs. Additionally, the investment credit base used in computing the ITC for any replacement property is the cost or other federal basis of the replacement property. Such cost or other federal basis, in the instance of an involuntary conversion, includes any basis reduction required by Internal Revenue Code (IRC) section 1033.

The Tax Law has been amended to provide the following ITC relief for property that was destroyed or ceased to be in qualified use as a direct result of the terrorist attacks of September 11, 2001. Qualifying taxpayers may make one of the following elections:

- Taxpayers may defer ITC recapture to the next tax year. The amount required to be recaptured in the next succeeding year will be augmented with interest computed at a rate equal to two times the underpayment rate on the last day of the tax year in which the recapture occurs. However, qualifying taxpayers that elect the deferment and retain a significant percentage of employees in New York State are not required to recapture any ITC with respect to the qualifying property. The Department of Taxation and Finance has interpreted the term *significant percentage* to be at least 75 percent. Also, if 50 percent or more of a taxpayer's employees died as a direct result of the attacks, the taxpayer may elect to utilize this provision and will not be required to recapture any ITC with respect to the qualifying property, whether or not the taxpayer meets the employment test.

- Taxpayers may elect not to defer the ITC recapture. Instead, these taxpayers may elect to follow the normal recapture rules and elect not to reduce the basis of any replacement property as required by IRC section 1033 in computing the ITC on replacement property. For purposes of this election, it does not matter when the destroyed property was placed in service, or whether an ITC was claimed on the destroyed property.

For additional information see TSB-M-02(7)I.

(Tax Law, section 606(a))

**Amended definition of an *owner of a new business* for the purpose of determining refund eligibility of certain tax credits**

The provisions in the Personal Income Tax Law regarding the investment tax credit (ITC) include a definition of an *owner of a new business*. A taxpayer who qualifies as an owner of a new business may be entitled to a refund of the ITC.

The Tax Law has been amended to expand and clarify the definition of an owner of a new business. A taxpayer that has previously received a refund of the ITC can now qualify as an *owner of a new business* and therefore is eligible to receive another refund of the ITC. The amendment also makes it clear that a taxpayer qualifies as a new business during its first five taxable years, excluding short taxable years.

As amended, an *owner of a new business* is defined as a taxpayer who is either a sole proprietor or a partner of a partnership (including a member of an LLC if the LLC is treated as a partnership for Federal income tax purposes), unless either of the following conditions apply:

- the business of which the taxpayer is an owner is substantially similar in operation and in ownership to a business entity taxable, or previously taxable, under the:
  - ▶ franchise tax on business corporations under Article 9-A;
  - ▶ corporation taxes under sections 183, 184, 185, or 186 of Article 9;
  - ▶ franchise tax on banking corporations under Article 32;
  - ▶ franchise tax on insurance corporations under Article 33; or the
  - ▶ unincorporated business tax under Article 23 of the Tax Law, or that would have been subject to the tax under such Article 23 (as that article was in effect on January 1, 1980), or the income (or losses) of which is (or was) included under the personal income tax under Article 22 of the Tax Law whereby the intent and purpose of sections 606(a)(10) and 606(a)(5) of the

Tax Law with respect to refunding of credit to a new business would be evaded; or

- the taxpayer has operated the new business entity in New York State for more than five taxable years excluding short tax years.

A shareholder of a New York S corporation qualifies as an *owner of a new business* if the corporation qualifies as a *new business* under Article 9-A of the Tax Law (see TSB-M-02(5)C).

The refund eligibility rules for several other credits also rely on this definition of an owner of a new business. Those credits are:

- Investment tax credit for the financial services industry
- EZ Wage tax credit
- ZEA Wage tax credit
- EZ Investment tax credit and EZ Employment Incentive Credit
- EZ Investment tax credit and EZ Employment Incentive Credit for the financial services industry

In addition, this amendment eliminates the condition that prevents a taxpayer that otherwise qualifies as an owner of a new business under the qualified emerging technology company (QETC) rules, from claiming a refund of the credit for the purpose of the QETC employment credit because the taxpayer has previously received a refund of an ITC.

The provisions relating to the refund eligibility rules apply to tax years beginning on or after January 1, 2002.

(Tax Law, sections 606(a)(10), 606(i)(B), 606(k)(5) and 606(q)(5)).

### **Amendments to empire zone (EZ) and zone equivalent area (ZEA) wage tax credit**

The Empire Zone (EZ) wage tax credit and the Zone Equivalent Area (ZEA) wage tax credit are allowed to taxpayers whose businesses are certified under Article 18-B of the General Municipal Law and meet certain increased employment levels in New York State and in the EZ or ZEA during the tax year.

The Tax Law was amended with respect to several provisions of the EZ and ZEA Wage Tax Credit.

*Effect of subsequent Article 18-B certifications.* The Department's existing policy regarding a subsequent Article 18-B certification was added to the Tax Law. The policy is that if a taxpayer's business becomes certified in more than one Empire Zone or Zone Equivalent Area, the five year period in which the taxpayer is eligible to claim the EZ or ZEA wage tax credit begins in the first tax year in which the taxpayer's business first meets all eligibility requirements. Subsequent

certifications of the taxpayer's business in a different EZ or ZEA under Article 18-B do not extend the five year period for claiming the wage tax credit.

(Tax Law, section 606(k)(3))

*Calculation of average number of employees.* The Tax Law was amended to add the requirement that for purposes of calculating the amount of the EZ or ZEA wage tax credit, an individual employed by a related person (as related person is defined in Internal Revenue Code (IRC) section 465(b)(3)(c)), in an empire zone within the immediately preceding sixty months is not included in the calculation of average number of employees unless the related person was never allowed a wage tax credit for that employee. This provision applies to tax years beginning on or after January 1, 2002.

(Tax Law, section 606(k)(4))

### **Qualified Empire Zone Enterprise (QEZE) Technical Amendments**

For tax years beginning on or after January 1, 2001, the Empire Zones Program Act provides tax credits for a Qualified Empire Zone Enterprise (QEZE) - the QEZE credit for real property taxes, and the QEZE tax reduction credit. A QEZE is a business enterprise which is certified as an Empire Zone business under Article 18-B of the General Municipal Law prior to July 1, 2005, and which annually meets an employment test.

The Tax Law has been amended to reflect technical changes with regard to the QEZE credits.

*For purposes of the QEZE tax credits, the benefit period is renamed the "business tax benefit period" and redefined as follows:*

- The business tax benefit period for a QEZE with a test date occurring on or before December 31, 2001, is the first fifteen tax years beginning on or after January 1, 2001.
- The business tax benefit period for a QEZE with a test date occurring on or after January 1, 2002, is the first fifteen tax years following the test year.

Previously, the benefit period was defined as the fifteen next taxable years following the test year.

This provision is effective for tax years beginning on or after January 1, 2001.

*For purposes of the QEZE tax credits, the term "employment test" is redefined and certain provisions of the test are modified as follows:*

- The definition of the term "employment test" was amended to eliminate the requirement that in determining the number of employees within the empire zone,

a QEZE could include only those employees working in empire zones in which the QEZE is certified under Article 18-B of the General Municipal Law. As amended, if a QEZE is certified in at least one empire zone, all qualified employees working in any empire zone will be considered employees within those empire zones for purposes of the employment test, regardless of whether the QEZE is certified in all of the empire zones.

- For QEZEs that have a base period of zero years and an employment number in empire zones greater than zero, the employment test will be met only if the QEZE meets the following new business test:
  - ▶ An individual who is either a sole proprietor or a partner of a partnership (including a member of an LLC, if the LLC is treated as a partnership for Federal income tax purposes), shall qualify as an *owner of a new business* unless the business of which the individual is an owner is substantially similar in ownership and operation to a business entity (or entities) that is:
    - taxable, or previously taxable under sections 183, 184, 185, or 186 of Article 9;
    - taxable, or previously taxable under Articles 9-A, 32, 33, 23;
    - taxable under Article 23, or would have been taxable under Article 23 as that Article was in effect on January 1, 1980; or
    - had income or losses that are (or were) included in computing the personal income tax under Article 22.

A shareholder of a New York S corporation shall be treated as the owner of a new business if the corporation qualifies as a new business under Article 9-A of the Tax Law (see TSB-M-02(5)C).

This new business test applies to a taxpayer's business certified under Article 18-B of the General Municipal Law on or after August 1, 2002.

- Where a taxpayer's business is located in an empire zone as a result of a boundary revision or in a newly designated empire zone, the employment test will be calculated as if the taxpayer's business was always in that location and as if that location was always included in that empire zone. In computing the number of employees in the empire zone for the current year, base period and test year, the business will include as empire zone employees all qualified employees that were employed at that empire zone location during those years.
- When a business enterprise relocates to an empire zone from a business incubator facility, the employment test will be calculated as if the business enterprise was located in the empire zone during its base period. The employees of the business who worked at the business incubator facility during the base period shall be "empire zone employees" for that period.



With certain exceptions noted above, these provisions are effective for tax years beginning on or after January 1, 2001.

***For purposes of the QEZE tax credits, the following terms are redefined, effective for tax years beginning on or after January 1, 2001 (unless otherwise noted):***

The term “***test year***” is redefined as the last taxable year of the business enterprise ending before the test date. Previously, the test year was defined as the last taxable year ending *on or before* the test date. The term was further clarified for business enterprises that were not subject to tax in New York State in the year(s) prior to their year of certification. For these businesses, the test year is the last calendar year ending on or before the test date, or in the case of a business owned by a taxpayer who is a fiscal year filer, the last fiscal year ending on or before the test date, regardless of whether the business had a tax year prior to the year it was certified under Article 18-B.

The term “***test date***” means the later of July 1, 2000, or the date prior to July 1, 2005, on which the business enterprise was first certified under Article 18-B of the General Municipal Law. Subsequent certifications under Article 18-B will not change the test date for the business enterprise.

The term “***employment number***” was modified to exclude any individual who was employed in the preceding sixty months by a related person to the QEZE (as related person is defined in IRC section 465(b)(3)(c)). This provision is effective for tax years beginning on or after January 1, 2002.

The term “***eligible real property taxes***” was amended to add the requirement that the real property taxes on property owned by the QEZE for which a QEZE real property tax credit is claimed, become a lien on the real property in a year in which the business enterprise is both certified and qualifies as a QEZE. The term was also amended to codify Department policy that the term *eligible real property taxes* includes certain payments in lieu of taxes (PILOT payments). However, the amendment includes a requirement that the PILOT payments be made pursuant to a written agreement approved by both the New York State Department of Economic Development and Office of Real Property Services as satisfying generally accepted and recognized standards of real property tax appraisals.

***A limitation on the amount of QEZE Real Property Tax Credit which may be claimed in a tax year was added for businesses that are certified under Article 18-B of the General Municipal Law on or after August 1, 2002.***

The credit shall be limited to the greater of the following amounts:

- The *employment increase limitation*, calculated by multiplying the increase in the employment number in the empire zones in which the QEZE is certified by \$10,000; **or**
- The *capital investment limitation*, calculated at 10% of the *cost or other basis* of real property, owned by the QEZE and located in an empire zone in which the QEZE is

certified, multiplied by the greater of:

- ▶ the sum of the percentage of physical occupation of the real property by the QEZE and the percentage of physical occupancy of the real property by a related person to the QEZE, as *related person* is defined in IRC section 465(b)(3)(c); **or**
- ▶ the percentage of the cost or other basis attributable to the construction, expansion or rehabilitation of the real property (as opposed to the acquisition). If 50 percent or more of the cost or other basis is attributable to the construction, expansion or rehabilitation of the real property (as opposed to the acquisition), then the percentage of physical occupation by the QEZE shall be deemed to be 100 percent.

The *cost or other basis* is the greater of:

- the cost or other basis for federal income tax purposes on the later of January 1, 2001, or on the effective date of certification under Article 18-B of the General Municipal Law; **or**
- the cost or other basis for federal income tax purposes on the last day of the tax year.

Any business enterprise certified under Article 18-B of the General Municipal Law before August 1, 2002 is not subject to this limitation in any year of the business tax benefit period.

***A recapture requirement has been added for the QEZE Real Property Tax Credit.***

For tax years beginning on or after January 1, 2001, a portion of the QEZE real property tax credit must be recaptured if the amount of the real property taxes on which the credit was calculated is subsequently reduced by a final order in any proceeding under Article 7 of the Real Property Tax Law. The recapture amount is equal to the amount of the credit originally taken, less the amount of credit recalculated using the reduced property taxes.

***The QEZE Tax Reduction Credit has been amended to codify the computation of the tax factor for sole proprietors, partners, and S corporation shareholders of a QEZE.***

Sole proprietors, New York S corporation shareholders and individual partners of a QEZE shall determine the tax factor used in the computation of the tax reduction credit by multiplying the New York State tax shown on their return by a ratio, the numerator of which is the income from the QEZE allocated within New York State and included in their New York adjusted gross income and the denominator of which is their New York adjusted gross income. In no event may the ratio exceed one. The commissioner of the Department of Taxation and Finance may prescribe other methods which reasonably reflect the portion of tax attributable to the QEZE.

These provisions are a codification of current Tax Department policy and are effective for

tax years beginning on or after January 1, 2001.

***The effect on the Empire Zone Program if the effective date of the program is not extended beyond July 31, 2004.***

The Tax Law was amended by Chapter 85 of the Laws of 2002 to provide that if the designation of an area as an Empire Zone is no longer in effect because section 969 of the General Municipal Law was not amended to extend the effective date of that designation beyond July 31, 2004, a business enterprise that was certified pursuant to Article 18-B of the General Municipal Law on or before July 31, 2004 will be deemed to continue to be certified for purposes of the QEZE tax benefits. In addition, all references to Empire Zones in the provisions of the Tax Law concerning QEZEs shall be read as meaning areas designated as Empire Zones as of July 31, 2004.

(Tax Law, sections 14, 15, 16, and 606)

**Enhanced STAR exemption program**

The Tax Law has been amended to add a new section 171-k. This new section requires the Tax Department, in accordance with an agreement with the State Board of Real Property Services, to verify, to the extent practicable, whether applicants for the enhanced STAR exemption meet income eligibility requirements for that exemption. The Tax Department will report in each case whether an applicant for the enhanced exemption does or does not meet such requirements or whether eligibility cannot be verified. Verification begins with the 2002 income tax year, for enhanced 2003 STAR eligibility.

Income verification by the Tax Department will eliminate the need for enhanced STAR exemption applicants to submit copies of their tax returns to their local tax assessors.

(Tax Law, section 171-k; Real Property Tax Law, section 425)