

New York State's Tax Reform and Reduction Act of 1987
Business Tax Reform and Rate Reduction Act of 1987

New York State Additions and Subtractions

The New York State Tax Reform and Reduction Act (Chapter 28) and the Business Tax Reform and Rate Reduction Act of 1987 (Chapter 817) have repealed or amended many of the addition and subtraction modifications in arriving at New York gross adjusted income under Section 612 of the Tax Law. The following is a summary of the changes and their effective dates.

PASS Plans

The Parent's and Student's Savings Plan (PASS) provided for a subtraction from federal adjusted gross income for contributions to a higher education fund as described under the law. The fund is used for paying the educational expenses of a beneficiary of the fund who attends a college or other institution of higher education anywhere in the United States (TSB-M-78-(4)-I).

The Tax Reform and Reduction Act repealed Sections 612(b)(14), 612(c)(16), 612(k) and 618(5) of the Tax Law, thereby eliminating PASS plans as of April 20, 1987. No new accounts may be established as of this date.

Contributions of up to \$750.00 per eligible beneficiary, made to a qualified higher education fund prior to April 20, 1987, are allowable as a subtraction in arriving at New York adjusted gross income. However, any contributions made to these accounts on or after that date will not be an allowable subtraction modification in arriving at New York adjusted gross income.

The subtraction modification relating to income realized from a qualified higher education fund and to payments made by such fund under Section 612(k)(2) remains in effect for the 1987 tax year. Where a PASS account is terminated after April 20, 1987, only the income earned by the fund in 1987 prior to the date of termination qualifies for the subtraction. No subtraction will be allowed for income earned by the fund during 1987 that is attributable to contributions made to the fund on or after April 20, 1987. For tax years beginning after 1987, income realized from the fund will be taxable to the same extent as for federal tax purposes.

The act also repealed, effective April 20, 1987, Section 601-D relating to the separate tax on qualified higher education funds and Section 612(1) which provided for addition modifications upon the termination of a fund and for distributions made to beneficiaries of the fund. Accordingly, if a PASS account is terminated on or after April 20, 1987, the creator of the fund will not have to pay a separate tax on the value of the fund, or make the special 110% addition to income. However, if the account was terminated before April 20, 1987, the creator of the fund will, depending upon how the fund was terminated, be subject to the separate tax or will be required to make the 110% addition to income. In addition, the beneficiary of a fund will no longer be required to make the 20% addition modification for the amounts received from a fund.

Tuition Deduction

Section 612(c)(17) of the Tax Law provides for a subtraction from federal adjusted gross income for a portion of tuition expenses paid by a taxpayer for his dependent for full time attendance at college or other institution of higher education located in New York State (TSB-M-78-(4)-I). This modification is repealed for tax years beginning after 1988.

Professional Service Corporations

Over a three-year period the Tax Reform and Reduction Act eliminates the three addition modifications required of shareholders in professional service corporations (PC's):

- (a) Section 612(b)(9), the modification for health, accident and life insurance premiums is repealed for tax years beginning after 1986.
- (b) Section 612(b)(7), the modification for pension payments is repealed for tax years beginning after 1987.
- (c) Section 612(b)(8), the modification for the F.I.C.A. deduction (exclusive of medicare) is repealed for tax years beginning after 1988.

The Section 612(c)(12) subtraction modification has been retained. This modification permits a shareholder {or former shareholder} of a professional service corporation who is receiving retirement benefits to subtract from federal adjusted gross income the amount necessary to prevent taxation of amounts previously included in New York adjusted gross income under Section 612(b)(7) of the Tax Law prior to its repeal (TSB-M-82-(3)-I(Rev.)).

Two-Earner Married Couple Deduction

A new subtraction modification Section 612(c)(29) has been added to the Tax Law to allow a deduction in arriving at New York adjusted gross income for a two-earner married couple. This deduction is essentially the same as the federal "deduction for a married couple when both work" provided by Section 221 of the Internal Revenue Code prior to its repeal. The allowable deduction is 10% of the lesser of \$30,000 or the qualified earned income of the spouse with the lower of such income.

To qualify for the modification a husband and wife must each have qualified earned income (as defined in Section 221 of the Code prior to its repeal) and must file a joint New York return. The qualified earned income shall consist of items included in New York adjusted gross income, reduced by any deductions or exclusions related to that income, determined without regard to this modification. The deduction is allowed for the 1987 tax year only.

Research and Development Expenditures

Section 612(g) has been amended to terminate the subtraction modification for research and development expenditures for tax years beginning on or after January 1, 1987. In addition, the unused portion of any expenditure deduction allowable for a taxable year beginning before 1987 may not be carried forward to taxable years beginning after 1993.

Investments in research and development property remain eligible for the investment tax credit (TSB-M-87-(9)I).

Pollution Control Facilities

Section 612(h) has been amended to terminate the subtraction modification for industrial waste treatment facilities and air pollution control facilities for tax years beginning on or after January 1, 1987. However, investments in this type of property remain eligible for the investment tax credit (TSB-M-87-(9)I).

New Business Investment Exclusion

The new business investment gain modification under Section 612(o) provides for a subtraction in computing New York adjusted gross income for up to 100% of the amount of capital gain includable in federal adjusted gross income which was realized from the sale of a "new business investment" (TSB-M-81-(5)-I).

The Tax Reform and Reduction Act has amended various provisions in this section to provide that no "new business investment" may be issued after 1987. Accordingly, this subtraction modification will now apply only to gains realized on the sale of new business investments that are held for four or more years and were issued on or after July 1, 1981, and before January 1, 1988.

New Business Investment Deferral

The new business investment deferral under Section 612(p) is an optional modification whereby an amount of long term capital gain that is reinvested in a new business may be subtracted from federal adjusted gross income (TSB-M-82-(8)-I). This modification is eliminated for taxable years beginning after 1987.

In addition, Section 612(q) has been amended, effective for tax years after 1987, to require an addition in computing New York State adjusted gross income for an amount previously deferred under Section 612(p) when the new business investment is sold, even though the proceeds of the sale of the new business investment are reinvested. Accordingly, you can no longer continue deferral by reinvesting in another new business.

Exemption for Estates and Trusts

Section 618(1) of Article 22 of the Tax Law which requires an estate or trust to add back the amount of its federal exemption and allows a subtraction of \$600 as the New York exemption is repealed for tax years beginning after 1989. Accordingly, for tax years after 1989, the estate or trust will be allowed the federal exemption amount in the computation of New York taxable income.

Capital Gain Deduction

The New York State Tax Reform and Reduction Act has removed any reference made to the federal capital gain deduction throughout Section 612 of the Tax Law to conform with the Federal Tax Reform Act of 1986.