

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

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(3) Corporation Tax
(3) Income Tax
July 8, 1988

Election of Taxable Year for Certain Partnerships,
S Corporations and Personal Service Corporations

Background

The federal Tax Reform Act of 1986 amended Internal Revenue Code Sections 441, 706 and 1378 to require certain partnerships, S corporations, and personal service corporations using a fiscal year end to change their year end to December 31, effective for taxable years beginning after 1986, unless the entity could establish a business purpose for having a different year end. However, the Deficit Reduction Act of 1987 added Section 444 to the Internal Revenue Code allowing partnerships, S corporations and personal service corporations to elect a taxable year other than the calendar year. Since New York State generally requires the same year end as is used for federal purposes, New York State will conform, to the extent possible, to the federal rules and regulations under Section 444. The following is an explanation of how the Section 444 provisions will apply for New York purposes.

Due Date of Returns

Any partnership, S corporation or personal service corporation affected by the federal blanket extension will automatically receive the same treatment for New York purposes. The due date of returns or reports of partnerships, S corporations and personal service corporations is extended to the later of the original due date of the return or report, including any New York State extensions of time to file, or August 15, 1988. The blanket extension also applies to New York State Professional Service corporation Information Returns (Form IT-2102.1-PC).

If the taxpayer did not file a return or report by the original due date, relying solely on the blanket extension, and wants an additional extension beyond August 15, 1988, the taxpayer must:

1. File Form IT-372, Application for Extension of Time to File, or Form CT-5, Application for Automatic Six-Month Extension for Filing Tax Report or Return (and subsequently Form CT-5.1, if necessary), on or before August 15, 1988, and;
2. Attach Form DTF-980, Notification of Election for Fiscal Year Filing for Certain Partnerships, S Corporations and Personal Service Corporations under Internal Revenue Code Section 444, to the front of the form filed.

However, the entire extension of time allowed for partnership and professional service corporation information returns cannot exceed a total of 6 months from the original due date and the entire extension of time allowed for corporation returns and reports cannot exceed a total of 12 months from the original due date.

The blanket extension applies only to the due dates of returns or reports required to be filed at the entity level. The due dates of returns for partners, whether individual or corporate, and for shareholders of S corporations or personal service corporations are not covered by the blanket extension. Taxpayers who did not comply with the existing requirements to extend the due date of their returns may be billed for penalties if they file late. However, if the penalty is directly attributable to the Section 444 election, the penalty may be waived. See "Penalties and Interest" for further details.

Filing of Returns and Waiver of Penalties

Partnerships, S corporations or personal service corporations that are filing their returns or reports late due to consideration of the Section 444 election must follow the instructions below to avoid the imposition of late filing penalties:

- 1) In the upper left hand corner of the face of the return or report, write in bold red letters "444 ELECTION";
- 2) Form DTF-980, Notification of Election for Fiscal Year Filing for Certain Partnerships, S Corporations and Personal Service Corporations under Internal Revenue Code Section 444, must be attached to the front of the return or report.

A corporate or individual partner, S corporation or personal service corporation shareholder, estate or trust that files its return before the entity has filed its return under Section 444 will be required to file an amended return in the event that the entity's reporting period is changed. However, as indicated below, penalties imposed for underpayment of tax, where such underpayment is a result of making (or deciding not to make) a Section 444 election, will be waived. If the change in the entity's reporting period results in an overpayment, a refund or credit may be claimed.

Penalties and Interest

Penalties imposed for failure to file, failure to pay tax or failure to file a declaration or underpayment of estimated tax, that are attributable to the Section 444 election, will be waived at the entity level. In addition, Form CT-5 will not be invalidated where an underpayment results from the Section 444 election. Penalties for underpayment of tax and underpayment of estimated tax attributable to the Section 444 election will also be waived for partners and S corporation or personal service corporation shareholders. However, these penalties will be waived only if the New York State return or report of the entity or individual is timely filed on or before the due date (including extensions), or August 15, 1988, whichever is later.

If a partner of a partnership or a shareholder of an S corporation is assessed a penalty for late filing, late payment or underpayment of a first quarter 1988 estimated tax payment, the portion of the penalty that is directly attributable to consideration of the Section 444 election will be waived. In addition, if a partner or shareholder does not have a valid extension of time to file because sufficient tax was not paid with Form IT-370, Application for Automatic Extension of Time to File or Form CT-5, Application for Automatic Six-Month Extension for Filing Tax Report or Return, New York State will waive the penalty for late filing if the failure to pay sufficient tax was directly attributable to the consideration of the Section 444 election and the return is otherwise timely filed. The burden of proof is on the taxpayer to show that any assessed penalty is a result of the Section 444 election.

The portion of a penalty attributable to Section 444 is an amount equal to the difference between what the penalty would be assuming the Section 444 election is made and what the penalty would be assuming the Section 444 election is not made. In addition, the penalty waiver applies only to the portion of the penalty that is attributable to late filing and late payment from the original due date through August 15, 1988, and for the first quarterly payment of 1988 estimated tax.

To obtain a waiver of a penalty that has been billed, taxpayers must return a copy of their tax notice to the New York State Tax Department with a computation of the amount of the penalty attributable to consideration of the Section 444 election. In addition, they must furnish the legal name of each partnership or S corporation (or both) involved, the employer identification number(s) and, where more than one entity is involved, a breakdown showing the portion of the penalty attributable to each entity.

Interest on any underpayment of tax is required by Sections 684(a) and 1084(a) of the New York State Tax Law. There is no provision in the statute that allows interest to be waived. Accordingly, interest will be computed from the original due date of the return or report, (regardless of any extensions allowed) to the date the tax is paid.

The following examples illustrate New York State's treatment of penalties and interest.

Example 1: John and Jane Doe file a joint New York State income tax return for the calendar year 1987. They own an interest in XYZ, a partnership that historically used a June 30 taxable year. As of April 15, 1988, XYZ had not decided whether it was going to make an Internal Revenue Code Section 444 election to retain its fiscal year ending June 30 for the taxable year beginning July 1, 1987. John and Jane Doe's 1987 New York State income tax liability will be \$8,000 if XYZ makes a Section 444 election and \$10,000 if XYZ does not make a Section 444 election. On or before April 15, 1988, they had filed Form IT-370, Application for Automatic Extension of Time to File, and paid an amount to bring their total tax payments for the year to \$8,000. On July 1, 1988, John and Jane Doe were informed that XYZ did not make a Section 444 election. Therefore, when they file their 1987 New York State income tax return on August 15, 1988, they must pay additional tax of \$2,000. Since John and Jane Doe failed to pay at least 90% of their taxes as finally determined ($\$10,000 \times .90 = \$9,000$), they do not have a valid extension of time and would normally be subject to late filing and late payment penalties (Section 685(a)(1) and (a)(2) of the Tax Law). However, New York will waive the above penalties because they are attributable to section 444. Interest on the \$2,000 underpayment of tax will not be waived.

Example 2: Corporation X filed Form CT-3, General Business Corporation Franchise Tax Report, for the taxable period 2/1/87 to 1/31/88 on 7/15/88, and attached Form DTF-980 to the front of Form CT-3.

Corporation X, a federal S corporation (which did not make the New York election) or a federal personal service corporation, qualified to make a Section 444 election, properly filed federal Form 8716 and filed federal and New York State Tax Returns for the taxable year 2/1/87 to 1/31/88. Corporation X **did not** file Form CT-5 for the taxable year 2/1/87 to 1/31/88. Corporation X **did not** file Form CT-400, Manual Installment of Estimated Corporation Tax, and pay installments of estimated tax on 7/15/87, 10/15/87 or 1/15/88. The New York State blanket extended due date for Form CT-3 for the taxable year 2/1/87 to 1/31/88 was determined to be 8/15/88.

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Since Corporation X filed Form CT-3 for the taxable year 2/1/87 to 1/31/88 on or before 8/15/88, waiver of penalty under Section 1085(a)(1)(A), 1085(a)(2) and 1085(c) was granted. The waiver of penalty under Section 1085(c) applies to installments of estimated tax that were required to be made on 4/15/87, 7/15/87, 10/15/87 or 1/15/88 for the taxable year 2/1/87 to 1/31/88 and the mandatory 1st installment of estimated tax for the next taxable year.

Had Corporation X filed Form CT-3 for the taxable year 2/1/87 to 1/31/88 after 8/15/88, penalty under Section 1085(a)(1)(A), 1085(a)(2) and 1085(c) would be computed in accordance with the New York State Tax Law.

The above example would also apply if Corporation X had filed Form CT-4 or Form CT-3M/4M, Metropolitan Transportation Business Surcharge Report, for the taxable year 2/1/87 to 1/31/88, except Form CT-4 or Form CT-3M/4M has no provisions for payments of estimated tax.

Example 3: Corporation Y filed Form CT-3 for the taxable year 4/1/87 to 12/31/87 on 8/15/88, and attached Form DTF-980 to the front of Form CT-3.

Corporation Y, a federal S corporation (which did not make the New York election) or a federal personal service corporation, qualified to make a Section 444 election, but did not do so, and filed federal and New York State Tax Returns for the taxable year 4/1/87 to 12/31/87. Corporation Y properly filed Form CT-5 for the taxable year 4/1/87 - 12/31/87 on 3/15/88. Corporation Y did not file Form CT-400 and pay installments of estimated tax on 9/15/87 or 12/15/87. The New York State extended due date for filing Form CT-3 for the taxable year 4/1/87 - 12/31/87 was determined to be 9/15/88 (extended due date as requested on Form CT-5).

Since Corporation Y filed Form CT-3 for the taxable year 4/1/87 to 12/31/87 on or before the New York State extended due date of 9/15/88, waiver of penalty under the New York State extended due date for Section 1085(a)(1)(A), 1085(a)(2) and 1085(c) was granted. The waiver of penalty under Section 1085(c) applies to installments of estimated tax required to be made on 6/15/87, 9/15/87 and 12/15/87 for the taxable year 4/1/87 to 12/31/87 and the mandatory 1st installment of estimated tax for the next taxable year.

Had Corporation Y filed Form CT-3 for the taxable year 4/1/87 to 12/31/87 after the New York State extended due date of 9/15/88, penalty under Section 1085(a)(1)(A), 1085(a)(2) and 1085(c) would be computed in accordance with the New York State Tax Law.

The above example would also apply if Corporation Y had filed Form CT-4 or Form CT-3M/4M for the taxable year 4/1/87 to 12/31/87, except Form CT-4 or Form CT-3M/4M has no provisions for payments of estimated tax.

Deduction Limitations

Personal service corporations making the Section 444 election are limited by Internal Revenue Code Section 280H in the amount of deductions they can take in the election year unless certain minimum distributions are made to the employee-owners. Since the starting point for computing New York corporation tax, except for Article 9, is federal taxable income, the deduction limitations of section 280H apply for New York purposes.

Special Payments

New York State does not have provisions in its Tax Law requiring partnerships and S corporations making the Section 444 election to make special estimated tax payments similar to those required by Internal Revenue Code Section 7519.

Reactivating a New York State S Election -- Form CT-6

New York State will follow procedures similar to the federal in allowing a corporation to reactivate its New York State S status for a taxable year beginning in 1987. The New York State reactivation will be allowed for a corporation that has reactivated its election for federal tax purposes, provided the corporation did all of the following:

- Timely filed federal Form 2553 for a taxable year beginning in 1987;
- Timely filed a New York State Form CT-6, Election by a Small Business Corporation, for a taxable year beginning in 1987;
- Terminated its federal S election for a taxable year beginning in 1987 based upon denial to file a fiscal year return, based upon business purposes,
- Reactivated its federal S election for a taxable year beginning in 1987 by filing a Section 444 election.

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In addition, the federal S election must be approved for a taxable year beginning in 1987, and all the shareholders of the corporation must agree to the reactivation of the New York State S election for a taxable year beginning in 1987.

Corporations that qualify and wish to reactivate their New York State S election should write to:

New York State Tax Department
Processing Division - Corporation Tax
Registration Section
Building 8, Room 409
W.A. Harriman Campus
Albany, NY 12227

A copy of federal Form 2553 for taxable year beginning in 1987, a copy of federal Form 8716, and a statement signed by each shareholder agreeing to reactivate the New York State S election for a taxable year beginning in 1987 should be enclosed with the reactivation request.

A federal S corporation that is taxable under Article 9, 13, 13-A, 32 or 33 of the New York State Tax Law cannot file Form CT-6 to apply for a New York State S election. Only a federal S corporation that would be taxable under Article 9-A of the New York State Tax Law can file Form CT-6 and apply for a New York State S election.