

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

TSB-M-90
Corporation Tax (11)
Income Tax (7)
September 17, 1990

1990 Legislation
Franchise Tax on New York S Corporations

Chapter 190 of the Laws of 1990 imposes a franchise tax under Article 9-A of the Tax Law on New York S corporations for tax years beginning after 1989 and repeals the filing fee of such corporations imposed by section 658 (Article 22, Personal Income Tax) of the Tax Law.

Definitions

A New York S corporation is a federal S corporation taxable under Article 9-A of the Tax Law for which a New York S election under Section 660(a) of the Tax Law is in effect.

A New York C corporation is a corporation taxable under Article 9-A of the Tax Law that is not a New York S corporation.

A New York S year is a tax year of a New York S corporation.

A New York C year is a tax year of a New York C corporation.

The Article 22 tax equivalent is the amount determined by multiplying the New York S corporation entire net income base under Article 9-A by the highest rate of tax in effect under Article 22 of the Tax Law for the tax year corresponding to the tax year of the corporation. That rate for tax years beginning in 1990 is 7.875%.

A termination year is any tax year of a corporation during which the New York S election terminates on a day other than the first day of the year. The portion of the tax year ending before the first day for which the termination is effective is the "S short year" and the portion of the year beginning on the first day is the "C short year"

A New York S termination year is any termination year which is not also a federal S termination year. This occurs when a corporation continues to be a federal S corporation but ceases to be a New York S corporation because the corporation ceases to be an Article 9-A corporation, the shareholders revoke the New York S election, or an incoming shareholder refuses to consent to the New York election.

Computation of Tax

The franchise tax is computed in the following manner. The higher of the tax on the entire net income base or the fixed dollar minimum tax (not including the \$800 tax) is reduced by the article 22 tax equivalent. The franchise tax generally cannot be less than \$325. However, for short periods the \$325 may be reduced under the existing short period rules by 25% if the tax period is more than six months but not more than nine months, and by 50% if the tax period is not more than six months.

Entire net income is calculated as if the corporation were a federal C corporation, and is allocated to New York State using the same business and investment allocation percentages used by New York C corporations, except that in determining the business allocation percentage, a three-factor, rather than four-factor, formula is used. To calculate entire net income as if the corporation were a federal C corporation, the corporation may use a proforma federal Form 1120. In general, the items affected by this proforma calculation are dividends, interest, capital gain net income and contributions.

Computation of Tax in Termination Year

For a termination year, the tax for the S short year is the tax on the entire net income base less the Article 22 tax equivalent.

The tax for the C short year is the highest of the amount of tax on the entire net income base, the capital base, or the minimum taxable income base plus the tax on subsidiary capital base, if any.

In the case of a small business taxpayer, annualization is required for both short years. See "Short Period Computation for the Small Business Taxpayer" at the end of this memo.

In no event will the total tax for the S short year and C short year be less than the fixed dollar minimum tax determined as if the corporation were a C corporation for the entire year. The due date of the S short year return (Form CT-3-S) is the same as the C short year even though they are treated as separate short taxable years.

Net Operating Loss Deduction

The net operating loss deduction of a New York S corporation shall not include any net operating loss sustained during a New York C year or during a New York S year beginning before 1990. A New York C corporation shall not include any net operating loss sustained during a New York S year. A New York S year is, however, treated as a tax year when determining the number of tax years to which a net operating loss may be carried back or forward.

Surcharges

The New York S corporation tax is not subject to the metropolitan transportation business tax surcharge. New York S corporations are, however, subject to the tax surcharge enacted as part of Chapter 190 of the Laws of 1990.

A 15% tax surcharge applies to tax years ending after June 30, 1990, but before July 1, 1992. A 10% tax surcharge applies to tax years ending after June 30, 1992, but before July 1, 1993.

The surcharge applies to the tax (on the entire net income base or the fixed dollar minimum) without reduction by the Article 22 tax equivalent. Note: the surcharge amount may therefore exceed the tax amount.

Special rules apply to New York S corporations that are small business taxpayers under section 210.1(f) of the Tax Law. Any S corporation that is a small business taxpayer with entire net income of \$200,000 or less is not subject to the tax surcharge. For New York S corporations that are small business taxpayers with entire net income of more than \$200,000 and less than \$290,000, the tax surcharge will be an amount equal to the tax surcharge computed on the entire net income base multiplied by a fraction, the numerator of which is the difference between the corporation's entire net income and \$200,000 and the denominator of which is \$90,000.

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Example: A small business New York S corporation has entire net income of \$280,000. The taxpayer would compute the tax and surcharge for calendar year 1990 as follows:

ENI Base at Article 9A Tax Rate	\$ 24,700*	
ENI Base at Article 22 Tax Rate	\$ <u>22,050</u>	\$ 2,650
Base for regular surcharge	\$ 24,700	
\$ 24,700 x 15% =	\$ 3,705	
<u>Excess of ENI over 200,000</u>	88.89%	
90,000		
Tax Surcharge \$ 3,705 x 88.89% =		\$ <u>3,293</u>
Total Tax and Surcharge Due		\$ 5,943

*Tax is 16,000 plus 9% of the amount over \$200,000 plus 5% of the amount over \$250,000.

The surcharge is generally effective for tax years ending after June 30, 1990. Because of the effective date of the initial imposition of the franchise tax on New York S corporations (tax years beginning after 1989), however, the surcharge will first apply to fiscal year New York S corporations for the tax year ending after June 30, 1990 which is also a tax year beginning after December 31, 1989. For example, in the case of a New York S corporation whose fiscal year is 8/1/89-7/31/90, the surcharge will first apply to the following fiscal year 8/1/90-7/31/91. The surcharge is applicable for short periods beginning in 1990 and ending after June 30, 1990.

Tax Credits

No credits are allowed against the New York S corporation tax and surcharge.

Tax credits arising during a New York S year cannot be carried to a New York C year, but rather are carried to the shareholders as long as Article 88 has a comparable tax credit. The shareholder may carry forward any carryable credit.

Tax credits arising during a New York C year cannot be carried to a New York S year. Unused credits arising in a New York C year do not flow through to the shareholders and may only be used by the taxpayer if it reverts to New York C status. New York S years count as elapsed years, however, for those credits with limited carryover.

Example- A corporation's shareholders elected to be treated as a New York S corporation effective with the tax year beginning 1/1/90. During the tax year beginning 1/1/89, the corporation acquired property eligible for the investment tax credit and claimed a credit of \$2,500, of which \$2,000 is available for carryforward. If the corporation reverts to C status prior to 1997 the carryforward will be available in C years prior to 1997.

Estimated Tax

New York S corporations that expect their tax (including surcharge) to exceed \$1,000 are required to file a declaration of estimated tax and pay the tax estimated to be due. The time for filing a declaration of estimated tax is the same as that for all Article 9-A taxpayers.

See Subparts 7-2 and 7-3 of the Business Corporation Franchise Tax Regulations for further information on declarations and payments of estimated tax.

Section 27 of Chapter 190 of the Laws of 1990 provides that no penalty will be imposed for an underpayment of estimated tax with respect to any installment payment due before September 22, 1990.

Example- For the calendar year beginning January 1, 1990 and ending December 31, 1990, no estimated tax penalty will be imposed on a New York S corporation if the amount paid with the installment due December 15, 1990 is at least 90% of the finally determined tax plus the applicable tax surcharge; there is no provision for payment of 100% of the prior year's Article 22 \$325 filing fee for a valid exception to penalty.

Extensions

New York S corporations are eligible for an automatic six month extension of time to file the franchise tax report, in the same manner as C corporations. Payment of the tax and applicable tax surcharge must accompany the extension application on Form CT-5.4. Generally, since the shareholders of New York S corporations are not eligible for extensions of time beyond six months to file the personal income tax return, New York S corporations will not be eligible for additional extensions of time (beyond six months) which are available to New York C corporations.

To have a valid extension:

- for filing periods beginning in 1989 you are required to estimate and pay at least 90% of the \$325 filing fee in accordance with Article 22 of the New York State Tax Law; there is no provision for payment of 100% of the prior year's Article 22 \$25 filing fee for a valid extension.
- for filing periods beginning in 1990, except for short periods, you are required to estimate and pay at least 90% of the finally determined tax plus the applicable tax surcharge. The 100% of prior year's tax rule does not apply.
- for short periods beginning in 1990 and ending before July 1, 1990 you must pay at least 90% of the finally determined tax. For short periods beginning in 1990, and ending after June 30, 1990, you must pay at least 90% of the finally determined tax plus the applicable tax surcharge. The 100% of prior year's tax rule does not apply.
- for filing periods beginning after 1990, you must estimate and pay at least 90% of the finally determined tax plus applicable tax surcharge or 100% of the previous year's tax plus the applicable surcharge (if the previous year was 12 months).

Article 22 Tax on Shareholders

Chapter 190 made no major changes in the New York S treatment with regard to the taxation of the shareholders under the Article 22 income tax.

Certain amendments relating to allocation of income in New York S termination years were made, however, to conform to federal amendments made by the Tax Reform Act of 1984.

Short Period Computation for the Small Business Taxpayer

A "small business taxpayer" is one defined in section 210.1(f) of the Tax Law to have, among other criteria, entire net income of not more than \$290,000 for the tax year. Chapter 190 amends the definition to provide that income must be annualized to determine this status if the tax year is less

than twelve months, and to provide that allocated entire net income (entire net income base) must be annualized in determining the tax on entire net income.

Entire net income and base are annualized as follows:

Entire Net Income (Base)	X	12 ÷ by the number of months in the short tax year
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Taxpayers then use these amounts to determine if entire net income is not more than \$290,000 and, if not, to determine the proper rate of tax. The entire net income base thus annualized, and multiplied by the proper rate of tax, is then multiplied by the number of months in the taxpayer's short tax year and divided by 12 to determine the annualized tax.

EXAMPLE:

For a short period beginning January 1, 1991 and ending June 30, 1991, a New York S corporation has only business income of \$140,000 and a business allocation percentage of 90%.

Small business taxpayer status is determined as follows:

ENI \$140,000 x 12 = \$1,680,000 ÷ 6 =	\$280,000
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Tax determined as follows:

ENI base \$140,000 x 90% =	\$126,000
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ENI base annualized \$126,000 x 12 = \$1,512,000 ÷ 6 =	\$252,000
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Tax on annualized ENI base is \$16,000 plus 9% of the amount over \$200,000 plus 5% of the amount over \$250,000	\$ 20,780
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Tax for short period \$20,780 x 6 = \$124,680 ÷ 12 =	\$ 10,390
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Article 22 tax equivalent \$126,000 x 7.875% =	<u>9,923</u>
Tax due	\$ 467

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Tax surcharge determined as follows:

Base for surcharge	\$10,390	
$\$10,390 \times 15\% =$	1,559	
<u>Excess of \$280,000 over \$200,000</u>		
90,000	88.89%	
Tax surcharge due		
$\$1,559 \times 88.89\% =$		<u>1,386</u>
Total tax and surcharge due		\$ 1,853