REVISED REGULATORY IMPACT STATEMENT

DEPARTMENT OF TAXATION AND FINANCE

1. Statutory authority: Tax Law, sections 171, subdivision First; 1096(a), 1468 and 1519. Section 171, subdivision First, provides for the Commissioner to make reasonable rules and regulations, which are consistent with the law, that may be necessary for the exercise of the Commissioner's powers and the performance of the Commissioner's duties under the Tax Law. Section 1096(a) of Article 27 authorizes the Commissioner to make such rules and regulations as are necessary to enforce the New York State Franchise Tax on Business Corporations imposed by Article 9-A of the Tax Law. Section 1468 of Article 32 cites the provisions of Article 27 as being applicable and having the same force and effect on the Franchise Tax on Banking Corporations imposed by Article 32 of the Tax Law. Section 1519 of Article 33 cites the provisions of Article 27 as being applicable and having the same force and effect on the Franchise Taxes on Insurance Corporations.

2. Legislative objectives: The rule is being proposed pursuant to such authority and in accordance with the legislative objectives that the Commissioner administer the provisions of the Tax Law by providing guidance with respect to legislative amendments made by Chapter 60 of the Laws of 2007 to section 211.4 of the Tax Law. The amendments changed the circumstances under which a taxpayer corporation is required or permitted to file a combined report with other related corporations. The rule also reflects technical corrections to the Chapter 60 amendments made by Chapter 57 of the Laws of 2008, relating to the filing of combined reports by Real Estate Investment Trusts (REITs) and Regulated Investment Companies (RICs).

3. Needs and benefits: The rule makes amendments to Subpart 6-2 of the regulations titled, Combined Reports. A taxpayer is now required to file a combined report with its related corporations if there are substantial intercorporate transactions among the related corporations, regardless of the transfer price of such intercorporate transactions. Related corporations are corporations that meet the existing ownership and control

requirements of section 211.4 of the Tax Law and section 6-2.2 of the regulations (generally an 80 percent direct or indirect stock ownership test). In addition, a combined report may be required or permitted where substantial intercorporate transactions are absent if a combined report is necessary in order to properly reflect the tax liability under Article 9-A of the Tax Law. Under prior law and regulations, a group of related corporations could only, in the discretion of the Commissioner, be permitted or required to file a combined report if reporting on a separate basis distorted the activities, business, income, or capital in New York State of the related corporations. The activities, business, income, or capital were presumed to be distorted if there were substantial intercorporate transactions among the corporations. The Department issued a technical memorandum (TSB-M-08(2)C) that outlined and interpreted the provisions and provided guidance with respect to determining what corporations are required to be included in a combined report. The rule largely codifies the information contained in the TSB-M. The codification will benefit taxpayers and practitioners by providing guidance as to when a combined report is required or permitted and, if so, what corporations are to be included in the report.

A draft of the rule was circulated to outside organizations for comment. Comments were received from the Tax Section of the New York State Bar Association (Bar) and the Business Council of New York State (Business Council). Both the Bar and the Business Council were concerned with the removal of the unitary business principle as a prerequisite for combination. In response, language was added to acknowledge that the unitary business principle continues to apply. Both organizations also provided comments regarding the asset transfer test for substantial intercorporate transactions, some of which warranted revising the rule. As a result, language was added to make it clear that the test applies to assets transferred after January 1, 2007. Language was also added to provide that gross income directly derived from an asset includes partnership interests and that where the asset transferred is an interest in a partnership or an entity treated as a partnership, the income distributed to the transferee by such entity is gross income directly derived from the transferred asset. The Bar

also suggested that the rule regarding the multi-year test for substantial intercorporate transactions be explicit that the test be used not only to satisfy the substantial intercorporate transactions test, but to prove that the test is not satisfied. A clarifying revision was made in response. Several other minor clarifying revisions were made as a result of the comments received.

As a result of internal discussions regarding the comments, several changes were made to the rule that represent a departure from interpretations set forth in the TSB-M. These changes relate to the substantial intercorporate transactions determination. Specifically, the rule changes the treatment of interest paid and received on loans between related corporations where the loan constitutes subsidiary capital. Under the TSB-M, these loans were not considered in the determination. It also provides that, generally, only assets transferred in exchange for stock or paid in capital are considered for purposes of the asset transfer test. Under the rule, transfers of assets other than for stock or paid in capital, including through a nonmonetary property dividend, would not be considered unless the principal purpose of the transfer is the avoidance or evasion of tax. Previously, only assets transferred in exchange for stock or paid in capital would be considered. In addition, the rule expands the treatment of income from the sale of items produced from transferred production equipment. It now provides that income from the sale of items produced from transferred assets, by itself, would not constitute gross income derived directly from the transferred assets, but a transfer of assets constituting substantially all of the production process, including associated intangibles, such as might occur in the transfer of an operating division, would constitute gross income derived directly from the transferred assets. Several technical and clarifying changes were also made. The rule will benefit taxpayers and practitioners by providing guidance and clarification with respect to these changes in interpretation.

4. Costs:

(a) Costs to regulated persons: The rule does not impose any new reporting, recordkeeping or other compliance costs on regulated persons. The rule benefits regulated persons by providing guidance needed to

determine when a combined report is required or permitted and as to which corporations are included. Since the rule largely codifies legislative amendments and the interpretations set forth in TSB-M-08(2)C, the impact on the regulated persons is estimated to be none or minimal. The changes that depart from the interpretations set forth in the TSB-M (see Needs and Benefits) may have an impact on the tax liability of some taxpayers. The impact of these changes on a particular taxpayer, which could be positive or negative, will depend on the specific circumstances of the taxpayer. We estimate that these changes will have minimal revenue impact on taxpayers as a whole.

(b) Costs to the agency and to the State and local governments for the implementation and continuation of this rule: It is estimated that the implementation and continued administration of this rule will not impose any costs upon this agency, New York State, or its local governments.

(c) Information and methodology: These conclusions are based upon an analysis of the rule from the Department's Taxpayer Guidance Division, Office of Counsel, Office of Tax Policy Analysis, Office of Budget and Management Analysis, and Management Analysis and Project Services Bureau. The rule largely codifies legislative amendments that require corporations with substantial intercorporate transactions to file a combined report. The combined report more properly reflects the tax on related corporations.

5. Local government mandates: The rule imposes no mandates upon any county, city, town, village, school district, fire district, or other special district.

6. Paperwork: The rule imposes no reporting requirements, forms, or other paperwork upon the regulated parties beyond those required by existing law and regulations.

7. Duplication: There are no relevant rules or other legal requirements of the Federal or State governments that duplicate, overlap, or conflict with this rule.

8. Alternatives: Since the legislative amendments made by Chapter 60 of the Laws of 2007 and by Chapter 57 of the Laws of 2008 significantly changed the circumstances under which a taxpayer corporation

will be required or permitted to file a combined report with other related corporations, updating the existing rules relating to combined reports was the only viable alternative.

In developing the rule, the Department solicited feedback from various industry groups and associations (see Section 7 of the Regulatory Flexibility Analysis for Small Businesses and Local Governments). Several alternatives that were considered resulted from comments received from the Tax Section of the New York State Bar Association (Bar) and the Business Council of New York State (Business Council).

Both the Bar and the Business Council were concerned about the removal of the unitary business requirement as a prerequisite for combination. While the legislative amendments did not specifically express that the related corporations be engaged in a unitary business for combination to be permitted or required, such principle is embedded in federal case law. The Department decided that the concern was valid and included language in the rule to acknowledge the unitary principle.

Another alternative considered arose from a concern expressed by the Bar in the determination of substantial intercorporate transactions. The legislative amendments provide that one of the transactions/activities considered in determining whether substantial intercorporate transactions exist is "incurring expenses that benefit, directly or indirectly, one or more related corporations". Specifically, the Bar suggested that the Department offer more guidance with respect to what types of activities and transactions are considered and how the determination of expenses directly versus expenses indirectly be made. The Department views these determinations as factual and based on the facts and circumstances for each taxpayer. Therefore, it was decided that offering further guidance in this area was not an alternative.

Another suggestion was made by the Bar regarding the multi-year test for substantial intercorporate transactions. The rule provides that in any year where intercorporate receipts or expenditures are between 45% and 55%, that the substantial intercorporate transactions test will be satisfied if, during that taxable year and prior two years, the intercorporate transactions are in aggregate, 50% or more of the total receipts or

expenditures for that period. It was suggested that the rule make it explicit that the multi-year test should be used not only to satisfy the substantial intercorporate transactions test, but to prove that the test is not satisfied. The Department considered providing clarity in this area to be a valid alternative. A clarifying revision was made.

Lastly, both the Bar and the Business Council provided comments concerning the asset transfer test for substantial intercorporate transactions. The Department felt some of these comments warranted revising the rule. As a result, language was added to make it clear that the test applies to assets transferred on or after January 1, 2007. Language was also added to provide that gross income directly derived from an asset includes partnerships interests and that where the asset transferred is an interest in a partnership or an entity treated as a partnership, the income distributed to the transferee by such entity is gross income directly derived from the transferred asset.

It should be noted that the main focus of the comments received from the Business Council were basically the same as those submitted regarding technical memorandum TSB-M-08(2)C. The Business Council felt that the methodology used in determining which corporations are included in the group would be difficult for large multinational corporations to follow. They also felt that the methodology exceeded the scope of the authority the legislature granted with respect to which corporations are required to be included in the combined return. The Department continues to disagree and believes that the interpretations contained in the technical memorandum and the draft rule are the proper reflection of the legislative intent of the statutory amendments.

9. Federal standards: The rule does not exceed any minimum standards of the Federal government for the same or similar subject area.

10. Compliance schedule: The amendments will take effect on the date the Notice of Adoption is published in the State Register and apply to taxable years beginning on or after January 1, 2013. No additional time is needed in order for the regulated parties to comply with this rule.