New York governor signs budget bill revising royalty addback, reducing manufacturer tax rate, extending MTA surcharge, and extending personal income rate on highest brackets

March 29, 2013

In brief

The New York budget bill effectively replaces the state's existing related party royalty addback requirement by adopting provisions based on the Multistate Tax Commission's addback statute, provides tax reductions for qualified manufacturers, and extends the increased 8.82% tax rate on the highest tax bracket. The bill makes additional changes, including extending the MTA surcharge and modifying the film production tax credit.

The rate reduction and personal income tax rate extensions represent a compromise between legislators and the governor to achieve another on-time budget. The bill was signed by the governor on March 28, 2013. [N.Y. S.B. 2609-D]

In detail

Related-party royalty

Since 2003, New York requires taxpayers to add back royalty payments to a related member during the taxable year to the extent deductible in calculating federal taxable income. An exception for combined filers was added in 2007.

Part E of the budget legislation (legislation) substantially rewrites these provisions, effective for tax years beginning on or after January 1, 2013. The revised addback provision applies to the corporate franchise tax, bank franchise tax, tax on unrelated business income, personal income tax, insurance company tax, and taxes imposed by New York City, including the tax on unincorporated business income.

Royalty income exclusion

Current law allows for an exclusion of royalty income received if the related member that made the royalty payment is required to add back the payment to its income. The legislation eliminates this exclusion.

Revised addback exceptions

Under the legislation, taxpayers must add back royalty payments directly or indirectly paid, accrued, or incurred in connection with one or more direct or indirect transactions with one or more related members. No addback is required if the taxpayer establishes, by clear and convincing evidence, any of the following exceptions.

- A 'conduit' exception if: (1) the related member was subject to tax in New York, another state or US possession, or a foreign nation, on the royalty payment; (2) the related member during the same tax year, directly or indirectly, paid, accrued or incurred such portion to a person that is not a related member; and (3) the transaction giving rise to the royalty payment was undertaken for a valid business purpose.
- A 'subject to tax' exception if: (1) the related member was subject to tax on income tax in New York, or another state or US possession; (2) the tax base included the royalty payment; and (3) the aggregate effective tax rate applied to the related member is not less than 80% of the statutory rate of tax that applied to the taxpayer in New York for the taxable year (Tax Law Sec. 210).
- A 'treaty' exception if: (1) the royalty payment was paid, accrued, or incurred to a non-US related member; (2) the related member's income from the transaction was subject to a comprehensive income tax treaty between such country and the US; (3) the related member was subject to tax on a foreign nation on that royalty payment; (4) the related member's income from the transaction was taxed in the foreign country at an effective tax rate at least equal to that imposed by New York; and (5) the royalty payment was paid, accrued, or incurred pursuant to transaction undertaken for a valid business purpose using terms reflecting an arm's-length relationship.

In addition, the addback does not apply if the taxpayer and commissioner reach an agreement to use alternative adjustments or computations.

'Related member' is a related person as defined under IRC Sec. 465(b)(3)(C), except that 50% is substituted for 10%.

Qualified New York Manufacturer rate reduction

Presently, qualified New York manufacturers are subject to tax at the rate of 6.5% of entire net income (3.25% for 'eligible qualified New York manufacturers'). Under the legislation (Part Z), the tax rate on qualified New York manufacturers will be reduced by 9.2% for tax years beginning in 2014 and gradually reduced so that by 2018 and thereafter, the rate will be reduced by 25%.Corresponding rate reductions would apply to the capital base, the minimum taxable income base, and the fixed dollar minimum tax.

Personal income tax rate increase extended

Background

Prior to legislation enacted in 2011, the State of New York utilized seven personal income tax rate brackets, with the highest rate of 8.82% on income of over $500,000. For tax years beginning after 2011, the highest rate bracket was scheduled to be 6.85% on income over $20,000 for unmarried individuals, $40,000 for married persons and surviving spouses, and $30,000 for heads of households.

Under 2011 legislation (click here for our summary) beginning after 2011, a new top rate of 8.82% is imposed on unmarried individuals with income over $1 million, on married persons and surviving spouses with income over $2 million, and on heads of households with income over $1.5 million. Certain lower income brackets experience no change or a reduced rate compared to pre-2012 rates. Beginning after 2014, the rates are scheduled to revert to a top rate of 6.85%.

Extension

Under Part FF of the budget legislation, the increased rates will stay in effect through 2017.

Other changes

Additionally, the legislation:

- extends the MTA business tax surcharge for another five years, to taxable years ending before December 31, 2018 (Part A)
- extends the film production tax credit through 2019, makes other modifications to the credit related to post-production, expands the definition of a qualified film, and provides an additional credit (starting in 2015) for film production in certain Upstate New York counties (Part B)
- extends for three years the limitation on charitable deduction contributions to 25% for individuals with New York State or New York City adjusted gross income over $10 million and to 50% for individuals with AGI over $1 million but not more than $10 million (Part D)
- reforms how the Industrial Development Authority provides sales and use tax benefits and how those benefits are claimed (Part J).

The takeaway

Extension of the increased personal income tax rates coupled with the rate reduction for qualified manufacturers were not part of the original budget proposal and represents a compromise between Senate Republicans and Governor Cuomo. Adoption of the MTC addback statutes will undoubtedly garner a lot of interest, yet it is only expected to generate an additional $28 million in annual revenue for the state.

Let's talk

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