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New York issues proposed amendments to combined reporting regulations

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In brief

The New York Department of Taxation and Finance published proposed amendments to its combined reporting regulations. In general, the proposed amendments update rules and codify Department interpretation regarding combined reports. The proposed amendments also reflect changes to the filing of combined reports by real estate investment trusts and regulated investment companies. Interested parties will have until at least October 29, 2012, to submit comments before the rules become final. [20 NYCRR Parts 3, 6, and 21 and addition of Part 33, as proposed, (issued 8/23/12, published in New York Register 9/12/12)]

In detail

The proposed amendments primarily reflect changes made to section 211.4 of the Tax Law, effective for tax years beginning on or after January 1, 2007, which changed the circumstances under which a taxpayer is required or permitted to file a combined report. Under section 211.4, where there are substantial intercorporate transactions between a taxpayer and a related corporation, or collectively a group of such related corporations, a combined report is required.

Many of the proposed changes are substantially similar to Department of Taxation and Finance (Department) policy introduced in TSB-M-08(2)C, Combined Reporting for General Business Corporations and Insurance Companies (3/3/08) (TSB-M).

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The following is an overview of key changes provided in the proposed amendments, highlighting those proposals that differ from policy contained in the TSB-M.

Department's discretion, Secs. 7 and 8

The proposed amendments would remove discretionary language with respect to when a combined report is permitted or required. The proposal provides that "a combined report covering a group of corporations engaged in a unitary business is required in certain circumstances. A combined report covering any taxpayer and another corporation or corporations is required" where the capital stock ownership and the substantial intercorporate transactions requirements are satisfied.

As proposed, if the capital stock requirement is met, but there are insufficient intercorporate transactions, a combined report may be required or permitted at the Department's discretion to properly reflect tax liability. The Department may require a combined report to be filed where there are intercompany transactions, or where there is some agreement, understanding, arrangement, or transaction between corporations engaged in a unitary business. The proposed language is consistent with guidance found in the TSB-M. It serves as a reminder that the Department still retains the authority to require combination in the absence of meeting the requirements set forth in the regulations if, in its discretion, it finds that income is not "properly reflected."

Capital stock requirement, Sec. 9

In general, the proposed amendments would clarify that capital stock ownership is a measurement between one corporation and any other corporation. The current regulation measures such ownership between one corporation and "all the other corporations which are to be included in the combined report."

Substantial intercorporate transactions, Sec. 10

The proposed amendments would provide guidance in determining whether substantial intercorporate transactions among related corporations exist. The proposed amendments are substantially similar to the TSB-M guidance, with the following exceptions:

- In a change from treatment under the TSB-M, the proposed amendments would consider interest paid and received on loans constituting subsidiary capital between related corporations in determining whether substantial intercorporate transactions exist. Under the TSB-M, loans constituting subsidiary capital were explicitly excluded from the determination.

- The following proposals reflect new guidance that was not addressed in the TSB-M:

  – The proposed amendments would not consider intercorporate cost allocations in the substantial intercorporate transaction determination.

  – Transfer price of intercorporate transactions are irrelevant under the proposed amendments for purposes of determining whether substantial intercorporate transactions exist.

- Centralized payroll is included in the proposed amendments as an example of a service function that is not considered in the substantial intercorporate transaction determination when such functions are incidental to the corporation's business providing such service.

Multi-year test, Sec. 10

Under the TSB-M, the multi-year test is triggered when a corporation's intercorporate receipts or expenses are between 45% and 55% of the total of the corporation's receipts or expenses. In such case, the substantial intercorporate test will be met if the corporation's receipts or expenses from one or more related corporations during the taxable year and the prior two taxable years in aggregate equals or exceeds 50% of its total receipts or expenses during the taxable year and the prior two taxable years in aggregate.

The proposed regulations substantially adopt the multi-year test articulated in the TSB-M, except that the test may alternatively be used to prove that the substantial intercorporate test is *not* satisfied. The TSB-M provides that the substantial intercorporate test "will be met" if the multi-year test is satisfied. However, the proposed regulations provide the substantial intercorporate test will be satisfied "*only if*" the multi-year test is met.

Substantial intercorporate asset transfers, Sec. 10

The proposed amendments provide guidance and examples regarding the qualification that substantial intercorporate transactions may be satisfied when 20% or more of a transferee's gross income is derived directly from transferred assets. The proposed amendments are substantially similar to guidance in the TSB-M, with the following exceptions:

- The proposed amendments provide that "only assets to the extent that they are transferred in exchange for stock or paid in capital are considered 'qualifying assets.' Transfers of assets other than in exchange for stock or paid in capital, including transfers of assets through a nonmonetary dividend, are not considered unless the principal purpose of the transfer is the avoidance or evasion of tax." The TSB-M provides that only assets transferred in exchange for stock or paid in capital are considered, without exception.

- The TSB-M required that the transferor and transferee be engaged in a unitary business for an intercorporate asset transfer to satisfy the substantial intercorporate transaction test. The proposed regulations do not include this unitary requirement.

- The proposed regulations include "partnership interests" among the assets that may directly produce gross income. The regulations also provide that when the asset transferred is an interest in a partnership (or entity treated as a partnership), the income distributed to the transferee is gross income directly received from the transferred asset. The TSB-M is silent regarding these partnership matters.

- The proposed regulations provide that income from selling products made by transferred production equipment is not considered to be gross income derived directly from the equipment. However, gross income from the sale of items

produced from transferred 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. The TSB-M is silent regarding the sale of substantially all of a production process.

Ten-Step analysis, Sec. 11

The proposed amendments provide a ten-step analysis to determine whether a combined report is required and, if so, which corporations are included in that combined report. The analysis is substantially similar to guidance provided in the TSB-M.

One exception is that the proposed regulations provide that New York S corporations and out-of-state federal S corporations are eliminated from the combined group. The TSB-M is silent to the treatment of S corporations.

Foreign corporations, Sec. 14

The proposed amendments would explicitly provide that corporations organized under the laws of a country other than the United States may not be included in a combined report. This change is consistent with section 211.4(a)(5) of the Tax Law as it was amended.

Excluded corporations, Sec. 14

Under the proposed amendments, corporations taxable under another New York State franchise tax (or would be taxable under another franchise tax if subject to tax) may not be included in a combined report.

Examples, Sec. 16

The proposed amendments would provide detailed examples illustrating when a combined report is required or permitted. The examples are substantially similar to examples provided in the TSB-M.

Same Accounting Periods, Sec. 18.

The proposed amendments would reverse the current requirement that all corporations in a combined group have the same accounting period. The proposed amendment provides that where a corporation's taxable year is different from that of the taxpayer parent, the applicable taxable year to be included in the combined group is the taxable year that ends within the taxable year of the taxpayer parent.

REITs and RICs, Secs. 2 and 3

The proposed amendments would refer taxpayers to NY Tax Law Sec. 211.4 for rules relating to the inclusion of REITs and RICs in a combined report. Similar to the requirements of the TSB-M, the proposed amendments would generally require, by reference to section 211.4, captive REITs and RICs whose capital stock is substantially owned or controlled, directly or indirectly, by another corporation to be included in the combined report of that corporation.

Actions to think about

Taxpayers observing the TSB-M's guidance should find that little will change regarding their combined reporting analysis following the adoption of the proposed amended regulations in their current form. However, taxpayers should be aware of those proposals that reflect a reversal in policy, or that add new guidance that may not be well defined.

For example, taxpayers following TSB-M guidance that loans constituting subsidiary capital were excluded from determining substantial intercorporate transactions will find that this rule has been reversed under the proposed amendments. It is unclear from the proposal what the effective date of this change will be or whether this change will be applied retroactively. Additionally, it is unclear how the Department will apply the proposal that "intercorporate cost allocations" are not to be considered under the substantial intercorporate transaction test since there is no indication of how an "intercorporate cost allocation" is defined. These and other matters will likely require further clarification from the Department.

While New York City has not issued any similar guidance, we expect that the City will follow the State's methodology.

Let's talk

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