
Proposed New York budget amends related party royalty addback, proposes other changes

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In brief

Released on January 22, 2013, New York Governor Andrew Cuomo's executive budget for 2013-14 would effectively replace the state's existing related party royalty addback requirement by adopting provisions based on the Multistate Tax Commission's addback statute. The changes include the removal of the royalty income exclusion and replacing it with three new exceptions. The proposal would also make additional tax changes, including extending the MTA surcharge, and modifying and extending the film tax credit.

Taxpayers claiming the royalty income exclusion or taking the addback need to consider the affects of any proposed changes should they become law. [[2013-14 New York State Executive Budget, Revenue Article VII Legislation](#)]

Update. The budget was introduced in the Legislature as [Assembly Bill 3009](#) and [Senate Bill 2609](#).

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 proposed executive budget (proposal), substantially rewrites these provisions. The proposal 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, and would apply to taxable years beginning on or after January 1, 2013.

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

proposal would eliminate this exclusion.

Revised addback exceptions

The proposal would require taxpayers to add back royalty payments directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with, one or more related members. Under the proposal, no addback would be required if the taxpayer establishes, by clear and convincing evidence, any of the following exceptions.

- A 'conduit' exception would apply 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 would apply 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 would apply 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 would not apply if the taxpayer and commissioner reach an agreement to use alternative adjustments or computations.

Other changes

Additionally, the proposal would:

- extend the MTA business tax surcharge for another five years, to taxable years ending before December 31, 2018 (Part A)
- extend the film production tax credit through 2019 and make other modifications to the credit related to post-production and expand the definition of a qualified film (Part B)
- extend 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 (Part D)

- make permanent the provisions enacted in 2011 designed to improve sales tax compliance (Part H)
- reform how the Industrial Development Authority provides sales and use tax benefits and how those benefits are claimed (Part J).

The takeaway

While the royalty provisions will likely garner the most interest, the changes are only expected to generate an additional \$28 million in revenue for the state annually. While it may be amended in some form once it's formally introduced in the Legislature, passage of the royalty amendments is likely and taxpayers claiming the income exclusion or making the addback need to consider the affects of any proposed changes.

In addition, there was some concern that the deferral of specified credits enacted in 2010 and applicable through 2012 ([click here for our summary](#)) would be extended. However, the budget does not include an extension, thereby allowing the deferral to sunset on schedule.

Let's talk

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