Inside New York State Tax Reform: Understanding the impact on manufacturers

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In brief

On March 31, 2014, New York Governor Andrew Cuomo signed into law S.B. 6359-D, A 8559-D, (Chapter 59), enacting significant changes to New York State's corporate tax regime, most of which take effect for the 2015 tax year. However, the legislation contains important tax benefits specifically applicable to manufacturers, some of which are effective for tax years beginning on or after January 1, 2014. Among these benefits are a 0% business income tax rate and a 20% property tax credit. Based upon the executive budget issued in January, it was anticipated that such benefits would be limited to certain upstate manufacturers; however, the final budget did not contain such limitation.

The legislation also provides for other important changes, which include: merging the bank franchise tax with the corporate franchise tax, establishing economic nexus provisions, replacing the state's existing combined reporting provisions with a unitary combined reporting system along with an effectively connected income approach, and updating the single receipts factor apportionment formula to permit customer sourcing provisions for all taxpayers. (Click here for more on New York tax reform).

In detail

Treatment of qualified manufacturers prior to reform

Rates

For tax years beginning on or after January 1, 2007, the entire net income tax rate imposed upon qualified New York manufacturers is 6.5%, as compared to 7.1% for most non-manufacturers. Qualified New York manufacturers were also subject to a reduced cap on the capital tax of $350,000, as compared to $1 million for most non-manufacturers. The capital tax cap was $10 million for most non-manufacturers for tax years beginning on or after January 1, 2008 and before January 1, 2011.

Definition of qualified New York manufacturer

A qualified New York manufacturer, prior to the reform, is defined as a 'manufacturer' with certain qualified property in New York that is eligible for the investment tax credit and either (1) the adjusted basis of which for federal income tax purposes is at least $ 1 million or (2) all the manufacturer's real and personal property is in New York (Property Test).

A manufacturer is a taxpayer 'principally engaged' in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing. A taxpayer or a combined group shall be 'principally engaged' in such activities if, during the taxable year, more than 50% of the gross receipts of the taxpayer are derived from the sale of goods produced by such activities (Receipts Test). In computing a combined group's gross receipts, intercorporate receipts shall be eliminated. The generation and distribution of electricity, the distribution of natural gas, and the production of steam associated with the generation of electricity are not qualifying activities.

In addition, a qualified New York manufacturer is defined to include a qualified emerging technology company (QETC) as defined under the state's Public Authorities Law, absent that law's $10 million annual sales threshold.

Phased-in tax rate reduction

As part of the budget bill enacted in 2013, the entire net income tax rate on qualified New York manufacturers was 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 applied to the capital base, the minimum taxable income base, and the fixed dollar minimum tax. (View a summary of 2013 legislation)

'Eligible Qualified New York manufacturers'

For taxable years beginning on or after January 1, 2012, and before January 1, 2015, the entire net income tax rate applicable to 'Eligible Qualified New York manufacturers' is 3.25%. Similar tax rate reductions apply to the minimum taxable income base and the fixed dollar minimum tax. An 'Eligible Qualified New York manufacturer' is a qualified New York manufacturer that meets the Property and Receipts Tests set forth above and meets the following additional requirements: (1) the taxpayer's metropolitan commuter transportation district allocation percentage is less than 15% and (2) the average number of the taxpayer's employees in New York State is 100 or fewer.

Tax reform treatment of qualified manufacturers

Rate

Under the tax reform legislation enacted on March 31, 2014, effective for tax years beginning on or after January 1, 2014, the entire net income tax rate imposed on a 'qualified New York manufacturer' is 0%. The entire net income tax base is replaced with a business income tax base effective for tax years beginning on or after January 1, 2015. The business income tax base rate for a 'qualified New York manufacturer' is 0%. This should be contrasted with the reduced 6.5% rate for other taxpayers effective in 2016.

Definition

The pre-reform definition of a 'qualified New York manufacturer' is generally retained; however, the definition is expanded to include certain large manufacturers. Under the reform, a qualified New York manufacturer is a taxpayer that meets the Property and Receipts Tests set forth above. In addition, the definition is expanded to include taxpayers or combined groups that employ at least 2,500 employees in manufacturing in New York, and have manufacturing property in New York, the adjusted basis of which is at least $100 million dollars at the close of the taxable year.

Other rates

Under the legislation, the capital base tax rate will be gradually phased to 0% for all taxpayers by 2021, with the phase-out commencing with tax years beginning on or after January 1, 2016. The rate of tax applicable to qualified New York manufacturers is lower than that of other taxpayers during this phase-out period. The cap for manufacturers is retained at $350,000 and increased to $5 million from $1 million for other taxpayers. For purposes of the capital tax base, the definition of a 'qualified New York manufacturer' under the reform is identical to the definition applicable to the business income base; however, the definition also includes QETCs.

In 2014, the minimum taxable income tax rate for 'eligible qualified New York manufacturers' is 0.75% and for qualified New York manufacturers the rate is 1.36%. The minimum taxable income tax is eliminated for tax years beginning on or after January 1, 2015. The fixed dollar minimum tax imposed on qualified New York manufacturers is reduced from the pre-reform rates for tax years beginning on or after January 1, 2014. Further fixed dollar minimum tax rate reductions apply to subsequent years.

Qualified emerging technology companies

For purposes of the business income base, the definition of a qualified New York manufacturer ***no longer*** includes QETCs. Rather, under the reform, the phased-in tax rate reduction set forth above applies to the business income tax rates imposed upon QETCs. Thus, the tax rate on QETCs is 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%.

QETCs are subject to the same phased-out rates under the capital base as qualified New York manufacturers. In 2014, the minimum taxable income tax rate for QETCs is 1.36%, and the alternative minimum tax is eliminated for tax years beginning on or after January 1, 2015. The qualified emerging technology company employment credit and the credit for investing in a qualified emerging technology company are retained.

Real property tax credit

Effective for tax years beginning on or after January 1, 2014, qualified New York manufacturers receive a corporate franchise credit equal to 20% of real property taxes paid during the taxable year related to New York real property owned (or in certain cases leased) by such taxpayer principally used during the taxable year for manufacturing. The credit is not allowed for property taxes deducted in the computation of entire net income or for property taxes included in another credit claimed by the taxpayer. Unlike other real property tax credits in New York, eligible property taxes for the 20% credit do not include a payment in lieu of taxes made by the qualified New York manufacturer. Property tax payments made by a lessee may qualify for the credit under certain conditions. The tax credit cannot reduce a taxpayer's liability below $25.

The legislation requires taxpayers to add back the amount of any federal deduction for real property taxes to the extent such taxes are used as the basis of the calculation of the real property tax credit for manufacturers.

Previous versions of the budget provided that any tax credit not currently deductible was eligible for a refund. As enacted, any credit not deductible in a given tax year is not refundable to corporate taxpayers.

The takeaway

The tax benefits created by the legislation are a marked expansion from what was originally proposed in that the benefits are not limited to upstate New York manufacturers. In addition, the amendments already come on the heels of tax breaks enacted in 2013.

Taxpayers previously defined as eligible qualified New York manufacturers or qualified New York manufacturers should reassess whether they will continue to qualify, and taxpayers that do not currently qualify, should reassess whether they meet the definition, particularly given the expansion of the definition to include certain large manufacturers.

Affected taxpayers need to carefully review the tax reform legislation as there are two sections of the bill that affect manufacturers (Part A: business tax reform; and Part R, the real property tax credit). These provisions amend the same provisions of the tax law and taxpayers need to harmonize them, absent additional guidance from the Department.

Let's talk

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