

# New York tax overhaul package amended

February 21, 2014

## In brief

Since being introduced in the legislature in January, New York Governor Andrew Cuomo's 2014-15 Executive Budget, which significantly reforms the state's business tax structure, has been subject to a series of amendments. The amendments, so-called 21-day amendments and 30-day amendments, keep intact the most significant tax reforms (repealing the bank franchise tax, establishing economic nexus, and replacing the state's existing combined reporting provisions). However, the amendments address and amend proposals to revise the state's net operating loss, and provisions related to foreign corporations, corporate partners, the tax base, manufacturers, as well as other changes. [[A8559-A; S6359-A](#), amended 2/12/14; 2/21/14 (see [Budget Amendments](#))]

[View our summary of introduced budget proposal](#)

## In detail

### Net Operating Loss

#### 21-day amendment

The base year of the NOL conversion credit is changed to 2014 from 2013. However (see 30-day amendment), the conversion credit is replaced by a new credit NOL subtraction.

#### 30-day amendment

The 30-day amendment revises the proposed revisions to the state's NOL provisions. The originally proposed NOL conversion credit is being replaced with a new 'prior net operating loss conversion subtraction' (PNOL). In computing business income, taxpayers are allowed both this

PNOL and a net operating loss deduction (NOLD), the latter of which was provided for in the original budget proposal.

The PNOL will be applied against the business income base before the NOLD.

The PNOL is calculated in the following manner:

1. The taxpayer must calculate the tax value of its unabsorbed NOL the base year. The value is equal to the product of (I) the amount of the taxpayer's unabsorbed NOL, (II) the taxpayer's base year business allocation percentage (BAP), and (III) the taxpayer's base year tax rate.

2. The product determined under 1 (above) is divided by 6.5% (or in the case of a qualified New York manufacturer, 5.7%). This result will equal the taxpayer's prior net operating loss conversion subtraction pool.
3. The taxpayer's PNOL for the taxable year will equal 10% of its NOL conversion subtraction pool plus any amount of unused PNOL from preceding taxable years. The PNOL of a small business corporation will not be subject to the 10% limitation.

The amendments also provide a method for determining the PNOL for taxpayers that are members of a combined group.

For purposes of the PNOL, the following definitions apply:

- Base year - the last taxable year beginning on or after January 1, 2014, and before January 1, 2015.
- Unabsorbed net operating loss - the unabsorbed portion of NOL as calculated under prior law (either Art. 9-A or Art. 32) as was in effect on December 31, 2014, that was not deductible in previous taxable years and was eligible for carryover on the last day of the base year, including any NOL sustained by the taxpayer during the base year.
- Base year BAP – the taxpayer's business allocation percentage as calculated for corporate franchise tax purposes under Tax Law §210(3)(a) for the base year, or the taxpayer's allocation percentage as calculated for bank franchise tax purposes under Tax Law §1454 as such sections were in effect on December 31, 2014.
- Base year tax rate – the taxpayer's tax rate for the base year as calculated under Article 9-A or Article 32, as such provisions were in effect on December 31, 2014.

The PNOL conversion subtraction may be used to reduce the taxpayer's tax on allocated business income to the higher of the tax on the capital base or the fixed dollar minimum. Any amount of unused subtraction will be carried forward to the subsequent tax year or years until tax years beginning on or after January 1, 2036, and will not be subject to the 10% limitation in subsequent tax years.

## **Foreign (alien) corporations**

### *21-day amendment*

Under the 21-day amendment, an alien corporation would not be deemed to be doing business, employing capital, owning or leasing property, or maintaining an office in this state if its in-state activities in this state are limited solely to (a) investing or trading in stocks and securities for its own account (b) investing or trading in commodities for its own account or (c) any combination of these activities. In addition, the amendment provides that an alien corporation with no effectively connected income for the taxable year would not be subject to the corporate franchise tax for that year.

## **Tax Base and Addback Provisions**

### *21-day amendment*

As originally proposed, an addback is required when a taxpayer attributes interest deductions to other exempt income and the amount subtracted exceeds other exempt income. Taxpayers would have to add back the excess of the interest deductions over other exempt income. The 21-day amendment provides that other exempt income does not include any amount treated as dividends under IRC §78.

The 21-day amendment provides new addbacks for:

- the amount of any federal deduction for the excise tax on telecommunication services to the extent such taxes are used as the basis of the calculation of the tax-free New York area excise tax on telecommunication services credit
- 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.

### *30-day amendment*

The 30-day amendment removes provisions that eliminate the treaty exception to the state's royalty expense addback provisions.

In addition, the amendment also requires taxpayers to add back the amount of any deduction allowed for federal income tax purposes for (i) any amount paid or incurred to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry into such potential violation, with exceptions or (ii) any amount paid or incurred as reimbursement to the government or entity for the costs of any investigation or litigation.

The 30-day amendment also provides that investment income does not include any amount treated as dividends under IRC §78.

## **Apportionment**

### *21-day amendment*

Under the 21-day amendment, a patent, copyright, trademark, or similar intangible property is used in the state to the extent the activities related to such items are carried on in the state.

### *30-day amendment*

Sourcing rules for asset backed securities would apply to securities issued by a government agency.

## **Corporate partners**

### *21-day amendment*

Pursuant to the 21-day amendment, corporate partners must compute tax under the aggregate method as determined by regulation, unless such regulation provides or allows for

another method of computation. Under the aggregate method, a corporate partner is deemed to have an undivided interest in the partnership's assets, liabilities, and items of receipts, income, gain, loss and deduction. Under the aggregate method, the corporate partner treated as participating in the partnership's transactions and activities.

### *30-day amendment*

The 30-day amendment provides that if a partnership has nexus with New York, a corporate partner of the partnership will likewise have nexus. Specifically, the amendment provides that if a partnership is doing business, employing capital, owing or leasing property in the state, or deriving receipts from activity in the state, any corporation that is a partner in the partnership will be subject to the corporate franchise tax.

### **Manufacturers**

#### *21-day amendment*

Qualified manufacturers would also include qualified New York agricultural and mining businesses.

#### *30-day amendment*

The 30-day amendment defines an upstate New York manufacturer as a qualified New York manufacturer that does not own or lease any tangible personal or real property in the metropolitan commuter transportation district and does not pay any wages, salaries, or other personal service compensation within the district.

The amendment extends the real property tax credit for manufacturers by including in the term 'real property tax' taxes paid by the taxpayer upon real property principally used by the taxpayer in manufacturing and that is leased by the taxpayer from an unrelated third party provided that (1) the tax is paid by the taxpayer as

lessee under the explicit requirements of a written lease, and (2) the taxpayer such taxes directly to the taxing authority and has received a written receipt for payment.

### **Credit**

#### *21-day amendment*

The 21-day amendment would allow a taxpayer to first claim a credit on an amended report only under the following circumstances:

- the taxpayer's eligibility for the credit or the amount of the credit is determined by a government agency other than the Department of Finance and Taxation
- the information necessary to determine the taxpayer's eligibility for a credit or the amount of the credit is contained in an information return received by the taxpayer *after* the original return for the taxable year is filed
- the taxpayer is required to file an amended report for a taxable year and the changes or corrections that necessitate the filing of the amended report impact the taxpayer's eligibility for, or the amount of, a credit.

#### *30-day amendment*

The 30-day amendments provide that, notwithstanding the repeal of investment tax credits, a taxpayer would be allowed to utilize any carryforward amounts of credits to which the taxpayer was entitled as of the close of the taxable year beginning in 2013. Notwithstanding such repeal, a taxpayer is required in a taxable year beginning on or after January 1, 2014, to recapture all or a portion of such investment tax credit if recapture would have been otherwise required.

### **Other**

#### *30-day amendment*

Small banks - A deduction proposed for a thrift institution or qualified community bank is extended to small thrift institutions.

Lower Manhattan – Certain sales and use tax and property tax benefits, credits, and tax abatement programs for lower Manhattan would be extended (New Section GG).

### **The takeaway**

Although both the 21 and 30 day amendments to the governor's budget proposal contain several important technical corrections and clarifications, the elimination of the NOL conversion credit, creation of the PNOL subtraction, and a reinstated 'treaty exception' to the royalty add back provision stand out.

The newly drafted PNOL subtraction reduces business income before credits. The eliminated conversion credit would have applied (like all other credits) after determining business income allocable to the state. This may seem like a nuance but it will likely have a meaningful impact on taxpayers that do business in the Metropolitan Commuter Transportation District. Under current law, the MTA surcharge is calculated after New York State tax credits are applied. Under the current proposal, the MTA surcharge will be calculated before the application of tax credits. As such, by changing from an NOL conversion credit to a PNOL subtraction, unabsorbed NOLs that are otherwise eligible to be carried forward from taxable years prior to the effective date of the Governor's proposal can now be used to offset the MTA surcharge.

After significant comments and feedback from industry groups, trade associations, and taxpayers, the 'treaty exception' to the royalty addback

provision was reinstated. According to many, the elimination of this exception would have contradicted the governor's goals of reforming and

modernizing the state's business climate.

With the governor's excellent track record of negotiating an on time

budget, the next six weeks or so should be of great interest to the New York tax community.

## ***Let's talk***

For a deeper discussion of how this issue might affect your business, please contact:

### ***State and Local Tax Services***

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