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Accountants and Consultants

Multi-State Tax News

ISSUE:
NEW YORK STATE ANTI-PIC LEGISLATION

DATE:
On October 21, 2003, New York's Governor Pataki signed into law legislation closing certain perceived "loopholes" in the anti-passive investment company ("Anti-PIC") legislation that passed earlier this year. The new legislation potentially affects many New York taxpayers.

BACKGROUND & DETAILS:
On May 15, 2003, New York State and New York City enacted legislation requiring the addback of certain interest and royalty expenses paid to related members. Over the past few months, a perception grew that the exceptions to the addback requirements were too liberal. The new "cleanup" legislation makes the following key changes to the addback provisions, retroactive to taxable years beginning on or after January 1, 2003:

New Anti-PIC Provisions:
- The legislation repeals provisions contained in the May 15, 2003 legislation requiring the addback of interest payments made to related parties.
- The legislation expands the definition of "royalty" payments to include patent royalties and amounts allowable as interest deduction under IRC Sec. 163 to the extent related to the acquisition, use, maintenance, ownership, sale, exchange, or disposition of intangible assets.
- The legislation provides a new exception for royalties paid or incurred to a related member organized under the laws of a foreign country that is subject to a "comprehensive income tax treaty" with the U.S., if such payments are taxed in the foreign country at a rate at least equal to that imposed by New York.
- The legislation eliminates the safe harbor for payments between related members that are made pursuant to a contract that reflects arm's-length terms and that are made for a valid business purpose.
- The legislation would impose an arm's-length requirement for the unrelated member exception.

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New Anti-PIC Provisions (continued…)

- The legislation repeals the rebuttable presumption that a transaction was entered into for tax avoidance where the majority of the taxpayer's deductions are not reportable to New York as income by the other taxpayers.

- The legislation repeals a provision providing for caps on the combined tax paid by a taxpayer and its related member resulting from the addback provisions; the cap was equal to the amount that would have been paid if no royalty payments were made.

New Withholding Relief:
The new legislation gives the Commissioner the authority to waive the recently enacted withholding requirements for pass-through entities, provided shareholders, partners or members can establish either that they are not subject to New York State income tax or that they timely file their return and pay their New York State estimated taxes. The Commissioner also was given the authority to waive the withholding requirements when withholding is not necessary to ensure the collection of New York taxes due from a nonresident individual or corporate shareholder, partner or member.

RECOMMENDED ACTION:

Companies taking advantage of the Passive Investment Company or similar "Holding Company" structures should review their existing planning since they can no longer take tax benefit for New York State or New York City tax purposes, retroactive to January 1, 2003.

HOW BDO SEIDMAN CAN HELP:

BDO Seidman can facilitate the replacement of your current Delaware Holding Company with state tax-reducing strategies that fit naturally around your business operations.

FOR MORE INFORMATION
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