APRIL 2014
www.bdo.com

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

BDO KNOWS: SALT

SUBJECT

ON MARCH 31, 2014, NEW YORK GOVERNOR CUOMO SIGNED INTO LAW THE 2014-2015 BUDGET BILL AND, ALONG WITH IT, SWEEPING CHANGES TO ARTICLE 9-A, FRANCHISE TAX ON BUSINESS CORPORATIONS.

SUMMARY

Just before midnight on March 31, 2014, New York Governor Andrew Cuomo signed into law S6359-D, which implements components of the state's fiscal plan for the 2014-2015 fiscal year, including Article 9-A reforms. The Article 9-A reforms, most of which are effective for taxable years beginning on or after January 1, 2015, unless otherwise noted in the bill, include, among many others: (1) the addition of a bright-line nexus standard based on receipts, (2) modification of the income tax and capital tax bases as well as phase-out of the capital tax, (3) repeal of the tax on subsidiary capital and the alternative tax on minimum taxable income, (4) expansion of customer-focused receipts sourcing for purposes of apportionment, and (5) a change to mandatory unitary combined reporting.

DETAILS

The charts on the following pages summarize many of the Article 9-A reforms. BDO will issue separate alerts related to the tax credit reforms, the real property tax and estate tax changes, and certain net operating loss deduction calculations under S6359-D.

BDO INSIGHTS

- New York manufacturers are the real winners in this legislation. The bill adds new benefits for qualified New York manufacturers such as a zero percent tax rate on income and a credit for real property taxes. These benefits to qualified New York manufacturers are layered onto existing New York tax provisions that help New York manufacturers already, including the investment tax credit, single sales factor, and no throwback rule. The key for corporations will be to determine eligibility as a qualified New York manufacturer.

CONTACT:

WEST:

ROCKY CUMMINGS, Tax Partner
415-490-3130 / rcummings@bdo.com

PAUL MCGOVERN, Tax Senior Director
714-913-2592 / pmcgovern@bdo.com

NORTHEAST:

JANET BERNIER, Tax Partner
212-515-5405 / jbernier@bdo.com

MATTHEW DYMENT, Tax Senior Director
617-239-4130 / mdyment@bdo.com

JONATHAN LISS, Tax Senior Director
215-636-5502 / jliss@bdo.com

MARK SEIDEN, Senior Director
212-885-8004 / mseiden@bdo.com

SOUTHEAST:

ASHLEY MORRIS, Tax Senior Director
919-278-1963 / amorris@bdo.com

ATLANTIC:

JEREMY MIGLIARA, Tax Senior Director
703-770-0596 / jmigliara@bdo.com

CENTRAL:

ANGELA ACOSTA, Tax Senior Director
248-688-3313 / aacosta@bdo.com

NICK BOEGEL, Tax Senior Director
414-615-6773 / nboegel@bdo.com

JOE CARR, Tax Partner
312-616-3946 / jcarr@bdo.com

GENE HEATLY, Tax Senior Director
214-665-0716 / gheatly@bdo.com

MARIANO SORI, Tax Partner
312-616-4654 / msori@bdo.com

RICHARD SPENGLER, Tax Senior Director
616-776-3687 / rspengler@bdo.com

- Disagreements over subsidiary capital and non-interest expense allocations will cease, inasmuch as these provisions were eliminated by the new law.

- New York has finally adopted mandatory combined reporting for unitary groups, with an election available to combine non-unitary corporations. The endless battles with the New York Department of Taxation and Finance over distortion and substantial inter-corporate transactions should finally wane as pre-2015 taxable years are closed by the statute of limitations or through the examination process. The controversy may shift somewhat to whether or not corporations are unitary.

- The expanded market sourcing apportionment rules under the new law similarly should temper some audit challenges on whether an item is a service or sale of an intangible, because both will now be market-sourced for purposes of the sales factor.

- The switch from taxing worldwide income of alien corporations (subject to New York tax) to taxing effectively connected income may on its face be welcomed by multinationals. This is only a partial measure, however, as effectively connected income that is treaty protected and not otherwise precluded from state taxation, and interest and dividends effectively connected to a United States trade or business are also within New York's reach under the new law.

- It is ironic that the Metropolitan Transportation Authority (MTA) surcharge, enacted in the 1980s as a temporary surcharge, will actually increase for many taxpayers under the new law.

- The tax simplifications from this legislation will be somewhat elusive until New York City decides whether to follow suit.

NEW YORK TAX LAW ENACTMENT – CORPORATE FRANCHISE TAX PROVISIONS

Snapshot Highlights

Article 32 Repealed (Tax on Banking Corporations)
… Banking Corporations are now taxed under Article 9-A.
Nexus Expanded to Include New York Source Receipts (Economic Nexus)
… Corporations are now taxable in New York if they have New York receipts of $1 million or more.
Tax Rate Reduction/Elimination
… Tax on Minimum Taxable Income - Repealed. … Tax on Subsidiary Capital - Repealed. … Tax on Investment Income - Repealed. … Tax on Investment Capital - Repealed. … Tax on Business Capital phased-out by 2021. … Other rate changes (see next pages).

Unitary Group Mandatory Combined Reporting Enacted

… Generally, the combined group is limited to a "water's edge" group.

… The substantial intercorporate transactions requirement is eliminated, but the requirement to be unitary remains.

… The threshold for inclusion is 50 percent common ownership.

… Taxpayers may make a binding seven-year election year to include all entities that meet the common ownership requirement and otherwise could be included in a combined group, regardless of whether they are unitary or not (referred to as a "commonly owned group").

… Any corporation entering a commonly owned group subsequent to the year of election is required to be included in the combined group and is considered to have waived any objection.

… Includes alien corporations treated as United States domestic corporations for federal income tax purposes.

… Includes alien corporations with income effectively connected with a United States trade or business ("ECI").

… Includes captive REITs, RICs and certain captive insurance companies.

… Does not include other alien corporations, REITs, RICs, or insurance companies.

… Does not include a corporation taxable under Article 9 or Article 33.

… If only nexus in unitary group is through a limited partnership interest, file that corporation separately.

Net Operating Loss Deduction Changes

… The limitation on New York net operating loss to federal net operating loss is eliminated.

… The net operating loss deduction has been changed from a pre-allocation deduction to a post-allocation deduction.

… A three-year net operating loss carryback has been added, but no carryback to pre-2015 taxable years is permitted.

… The law provides for a 20-year carryforward of net operating losses generated during taxable years beginning on or after January 1, 2015.

… The unabsorbed pre-allocation net operating losses which a taxpayer would have carried into its 2015 taxable year are not deductible under the new law's net operating loss provisions and instead are converted into what is referred to as the taxpayer's prior net operating loss conversion subtraction pool, the “subtraction pool.”

… The taxpayer is permitted to subtract against allocated business income 1/10th of the subtraction pool, plus any amount of its unused prior net operating loss conversion subtraction from preceding taxable years such that the tax on business income is not reduced below the greater of the tax on capital or the fixed dollar minimum. The subtraction amount is used before the net operating loss deduction.

… The 1/10th limitation on utilization of the subtraction pool per year is not applicable to "small business corporations." Small business corporation generally means a taxpayer with entire net income of not more than $390,000, not more than $1 million in contribution to capital for stock and paid-in surplus, not part of a federal affiliated group (as defined in section 1504), unless such group if it had filed a New York combined return would have been a small business corporation, and has 100 or fewer employees excluding general executive officers.

… In lieu of a taxpayer taking the subtractions for the subtraction pool described above, a taxpayer may make an election that the taxpayer's prior net operating loss conversion subtraction for taxable years beginning on or after January 1, 2015, and before January 1,2017, shall equal, in each year, not more than one-half of its subtraction pool. If the taxpayer makes this election, it has to be made on its return for the taxable year beginning on or after January 1, 2015, and before January 1, 2016, by the due date for such return, determined with regard to extensions.

… The prior net operating loss 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 unused subtraction shall be carried forward to subsequent taxable year(s) until taxable years beginning on or after January 1, 2036. If the election to take the subtraction in taxable years beginning on or after January 1, 2015, and before January 1, 2017, is made, the taxpayer shall not carry forward any unused subtraction amount beyond its taxable year beginning on or after January 1, 2016, and before January 1, 2017.

… Application of the law where taxpayers go from separate to combined, or change the composition of a combined group will be the subject of a separate tax alert.

Credits

... A new credit for Qualified New York Manufacturers has been enacted; the credit generally equals 20 percent of real property tax, **effective January 1, 2014** (no deduction is allowed for the real property tax on which such credit is claimed).

... A separate tax alert will provide more detail on credits.

Maximum Fixed Dollar Minimum Tax Increased to $200,000

... The increase does not apply to Qualified New York Manufacturers and New York S corporations (see next pages for details).

Apportionment Changes - Market Sourcing

... For detail on apportionment changes, see next pages.

Income Tax Base

... The New York tax on income is now imposed solely on business income ("BI").

... BI = Entire Net Income ("ENI") - Other Exempt Income ("OEI") - Investment Income.

... OEI = Exempt CFC Income + Exempt Unitary Corporation Dividends ("Exempt Dividends").

... Exempt Dividends are dividends from a corporation that is unitary but not combined, net of interest expense attribution.

... Exempt CFC Income means federal section 951(a) income from a unitary corporation that is not combined, net of interest expense attribution.

... Investment income is income from investment capital (see below), net of interest expense attribution and certain "hedging" cost attribution.

... Non-interest expense attribution - Repealed.

... Interest expense is attributed to Exempt CFC Income, Exempt Dividends, and Investment Income.

... In lieu of interest expense attribution, a taxpayer may elect to reduce Exempt CFC Income, Exempt Dividends, and Investment Income by 40 percent.

... The ENI modification adding back foreign taxes is repealed.

Alien Corporation Tax Base

... ENI includes ECI.

... ECI that is treaty protected federally, and not otherwise excluded from state taxation, is added to and included in ENI.

... Also added to ENI are dividends and interest effectively connected to a United States trade or business.

Capital Tax

... Tax is only on business capital and, as noted above, no longer on investment or subsidiary capital.

... Business capital generally consists of those assets, other than investment capital and stock issued by the taxpayer, the income, loss or expense of which are reflected in ENI, less liabilities not deducted from investment capital. Investment capital generally consists of stock, other than stock issued by the taxpayer, in nonunitary corporations that is held for more than six months and not for sale in the regular course of business, less attributed liabilities.

... Maximum tax increases to $5 million (except for Qualified New York Manufacturers).

... Maximum tax for a Qualified New York Manufacturer remains at $350,000.

... Rate phases-out by 2021.

MTA Surcharge Filing

... Receipts nexus applies for MTA Surcharge purposes. If a taxpayer has $1 million or more of MTA receipts, it is subject to the MTA surcharge.

... The computation of the MTA Surcharge increases to 25.6% of New York tax from 17%, and is now computed before credits; however, it now uses the actual tax rather than a recomputed New York tax.

... The 25.6% rate for the MTA Surcharge on New York tax before credits is for the 2015 taxable year; thereafter, the New York Tax Commissioner may adjust the rate subject to certain parameters.

Tax Rates Highlights

Tax on Income

... The rate on Business Income is reduced to 6.5% for taxable years **beginning on or after** January 1, 2016.

... The tax on Investment Income is eliminated from tax base effective for taxable years beginning on or after January 1, 2015.

... The rate applied to Qualified New York Manufacturers is reduced to 0% effective for taxable years beginning on or after January 1, 2014.

Tax on Minimum Taxable Income

... Tax on Minimum Taxable Income is eliminated from the tax base effective for taxable years beginning on or after January 1, 2015.

Tax on Capital

... The rate is gradually reduced from .15% to 0% between 2016 and 2021 and the rate is 0% for taxable years beginning on or after January 1, 2021.

... The maximum tax is increased from $1 million to $5 million effective for taxable years beginning on or after January 1, 2015.

... The maximum tax for Qualified New York Manufacturers remains at $350,000.

... Investment Capital, as newly defined, is removed from the tax base effective for taxable years beginning on or after January 1, 2015, and, thereafter, the tax is on Business Capital.

Fixed Dollar Minimum

... For corporations other than Qualified New York Manufacturers and New York S Corporations, the maximum tax is increased to $200,000.

... For Qualified New York Manufacturers, the maximum tax is gradually reduced to $3,750 by 2018.

... For New York S corporations, there is no change.

MTA Surcharge

... The rate is increased to 25.6% effective for taxable years beginning on or after January 1, 2015, but before January 1, 2016, and, thereafter, the New York Tax Commissioner may adjust the rate annually within certain parameters.

Tax on Subsidiary Capital

... The Tax on Subsidiary Capital is eliminated effective for taxable years beginning on or after January 1, 2015.

Tax Apportionment Highlights

Receipt From ...	Source to New York If ...
General Sourcing Provisions	
... Tangible personal property	... Delivered to New York
... Net gain from sale of real property	... New York property
... Rent from real or personal property	... New York property
... Rent from intangible property	... Used in New York
... Digital product	... Use customer-focused hierarchy (i.e., use, customer received, etc.)
... Other services or business receipts	... Use customer-focused hierarchy (i.e., benefit received, delivery, etc.)

Financial Transactions / Broker-Dealer Activities	
… Interest on loan secured by real property	… New York property
… Interest on other loans	… New York borrower
… Net gain from sale of loan secured by real property	… Multiply such net gains by the proceeds from sale of loans secured by New York property divided by proceeds from all secured loans
… Net gain from sale of other loan	… Multiply such net gains by proceeds from sale of unsecured loans to New York purchasers divided by all proceeds from all unsecured loans
… Interest from asset-backed security or other government agency debt	… 8 percent of such receipts
… Net gain from sale of asset-backed security or other government debt	… 8 percent of net gain if government issued or sold through broker-dealer; otherwise, multiply net gain times proceeds from sales to New York purchasers divided by proceeds from all such purchasers
… Interest from corporate bonds	… Issuing corporation's commercial domicile is in New York
… Net gain from sale of corporate bond	… 8 percent of net gain if sold through broker dealer; otherwise, multiply net gains by proceeds from sales to New York purchasers divided by proceeds from all such purchasers
… Net interest from reverse repurchase agreement	… 8 percent of such receipts
… Net interest from federal funds	… 8 percent of such receipts
… Dividend or net gain from sale of stock	… Excluded unless Commissioner determines that inclusion is necessary
… Receipt or net gain from a "qualified financial instrument"	… 8 percent of net gain or receipt if the annual irrevocable election is made; otherwise, source to customer location (i.e., billing address if an individual or commercial domicile if a business entity). A "qualified financial instrument" is an instrument that is marked to market under federal section 475 or section 1256 and not a loan secured by real property
… Interest from other financial instruments	… Payor located in New York
… Net gain from sale of other financial instrument	… 8 percent of receipt if sold through broker-dealer or on licensed exchange; otherwise, New York payor
… Net income from sale of physical commodities	… Such net income is multiplied by a fraction, receipts from commodities actually delivered in New York (if no physical delivery, if sold to New York purchaser) divided by all such receipts
… Broker-dealer commission on securities or commodities, margin interest, certain underwriting related services/fees, account maintenance fees, certain M&A fees	… Customer's mailing address is in New York (customer responsible for paying amounts), but if can't determine mailing address, then 8 percent is New York sourced
… Certain services to investment companies (management, administration or distribution services)	… Based on the average of monthly percentages, each of which is determined by dividing the number of shares in the investment company owned by New York shareholders by the total number of shareholders (for individual, estate, or trust use mailing address on records of the investment company, for business use its commercial domicile (commercial domicile hierarchy: (i) treasury function, (ii) seat of management and control, (iii) billing address in taxpayer's records)

Credit Card Activities	
… Interest, fee, penalty or service charge	… New York cardholder (mailing address of the cardholder in the records of the taxpayer)
… Merchant discount	… The merchant is located in New York, but if the merchant has locations within and without New York only discounts from sales made from locations in New York
… Credit card authorization, processing, clearing	… Credit card processor's customer accesses the processor's network in New York
Other Industries	
… Advertising (newspapers and periodicals)	… Number of newspapers or periodicals delivered to New York divided by number of all newspapers or periodicals
… Advertising (television, radio, other)	… Number of New York viewers and listeners divided by number of all viewers and listeners
… Railroad and trucking business	… New York miles divided by everywhere miles
… Aviation service (air freight forwarding)	… 100 percent New York if New York pick-up and delivery but 50 percent New York if only New York pick-up or delivery
… Aviation service (other)	… Based on the average of a percentage of New York aircraft arrivals and departures, a percentage of New York revenue tons, and a percentage of New York originating revenue
… Transportation or transmission of gas	… New York transportation units divided by all transportation units