

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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## SALT

### SUBJECT

**GOVERNOR CUOMO SIGNS THE 2015-2016 BUDGET BILL, WHICH REFLECTS AMENDMENTS TO THE NEW YORK STATE CORPORATION TAX AND SALES/USE TAX AND, MOST NOTABLY, SIGNIFICANT CHANGES TO THE NEW YORK CITY CORPORATE TAX FOR 2015 TO CREATE SUBSTANTIAL CONFORMITY TO THE NEW YORK STATE CORPORATION TAX CHANGES**

### SUMMARY

On April 13, 2015, New York Governor Andrew Cuomo (D) signed into law A6721-A/S4610-A and A3009-B/S2009-B (collectively, the “Budget Bill”) which, together, implement the “new” New York City Corporate Tax of 2015 as well as amendments to the New York State Franchise Tax on Business Corporations and the New York State Sales and Compensating Use Taxes. The New York City Corporate Tax of 2015 is effective for taxable years beginning on or after January 1, 2015, and in large part now conforms to the New York State Corporation Tax adopted previously. However, there are some significant differences. The amendments to the New York State Franchise Tax on Business Corporations (generally effective for taxable years beginning on or after January 1, 2015), of which there are many, are largely “corrective” in nature and the amendments to the New York State Sales and Compensating Use Taxes are not nearly as significant as those contained in earlier versions of the bill.

### DETAILS

Our BDO Insights provide a broad overview of some concepts and issues for taxpayers to consider as a result of the Budget Bill. The charts on the following pages highlight many specific provisions of the Budget Bill, including provisions regarding the New York City Corporate Tax of 2015 and some of the more notable amendments to the New York State Franchise Tax on Business Corporations and the New York State Sales and Compensating Use Taxes.



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## BDO INSIGHTS

- ▶ There are many similarities between the New York State and New York City corporate income tax regimes as a result of certain amendments to the Budget Bill. For example, both jurisdictions will now require unitary-combined reporting and market-based sourcing for sales factor purposes, and net operating loss deductions are to be applied on a post-apportionment basis. Due to the unitary-combined reporting requirement, if a corporation within a unitary group has nexus with the State or the City, the corporation's entire unitary group may be included in a State or City corporate tax return.
- ▶ While there are many similarities between the New York State and New York City tax regimes, there are some significant differences. For example: (1) the City's economic nexus standard is limited to corporations that issue credit cards while the State's economic nexus standard applies generally, including to corporations that issue credit cards; (2) the City's tax on business capital is not subject to phase-out while the State's tax on business capital is scheduled to be phased out for taxable years beginning on or after January 1, 2021; and (3) the City continues to subject S corporations to a corporate level tax (albeit under the "old" corporate tax using the "old" apportionment rules) while the State conforms to federal flow-through treatment. The City's Unincorporated Business Tax is unaffected by the Budget Bill.
- ▶ Under the City's newly enacted law, investment income, which is not subject to income tax, cannot comprise more than 8% of a taxpayer's entire net income. Any investment income in excess of the 8% cap may be recharacterized as business income, the apportionment of which may run afoul of the Due Process and Commerce Clauses of the United States Constitution to the extent not unitary with the in-state business.
- ▶ While the Budget Bill contains many "corrective" changes to the State's corporate tax reform of last year, some of the more impactful changes relate to investment income and investment capital. For example, the newly enacted law narrows the definition of investment capital and investment income and, thus, reduces the amount that may be subtracted from the business income tax base and the business capital base, respectively. In addition, the Budget Bill imposes a compliance burden with respect to investment capital, which requires taxpayers to "clearly" identify in records stock as held for investment at the time of purchase in the same manner as under section 1236(a)(1) of the Internal Revenue Code, but allows stock acquired prior to October 1, 2015, to be so identified subsequent to the purchase but prior to October 1, 2015.
- ▶ The City has issued transitional rules for current Banking Corporation Tax and General Corporation Tax filers in *Finance Memorandum 15-2*, New York City Department of Finance (April 17, 2015), and the State posts answers to frequently asked questions (FAQs) relating to its corporate tax reform at [www.tax.ny.gov/bus/ct/corp\\_tax\\_reform\\_faqs.htm](http://www.tax.ny.gov/bus/ct/corp_tax_reform_faqs.htm).
- ▶ The sales/use tax changes adopted by the State focus on relief to purchasers/users of aircraft and vessels. New York State did not adopt some of the potentially significant sales/use tax changes that appeared in earlier versions of the bill including: (1) imposition of a sales tax collection responsibility on a marketplace provider; (2) a limitation on the nonresident use tax exemption; (3) disregarded treatment for limited liability companies, and (4) acceleration of tax on payments under a related party lease.

## NEW YORK CITY CORPORATE TAX OF 2015

### Snapshot Highlights

(please see actual legislation for details and additional provisions)

#### Subjectivity

... The tax is imposed on corporations (including C corporations and banks).

... S corporations and qualified subchapter S subsidiaries continue to be subject to the pre-existing General Corporation Tax.

#### Nexus

... A corporation may have nexus with New York City ("NYC") where: (1) it conducts business, employs capital, owns/leases property, or maintains an office in NYC; (2) it issues credit cards to 1,000 or more customers who have a mailing address in NYC; (3) it has merchant customer contracts totaling 1,000 or more locations in NYC to whom the corporation remitted payments for credit card transactions; (3) the sum of its credit cards issued to NYC customers and NYC merchant customer contracts equals 1,000 or more; or (4) it is a partner in partnership that has nexus with NYC.

... A "foreign corporation" is not considered to be doing business if its NYC presence is limited to one or more of the following: (1) the maintenance of cash balances with banks or trust companies in NYC; (2) the ownership of shares of stock or securities kept in NYC; (3) the taking of any action by a bank, trust company or broker incidental to the rendering of safekeeping or custodian service to a corporation; (4) the maintenance of a NYC office by one or more officers or directors of the corporation who are not employees; or (5) keeping of books and records in NYC.

... An "alien corporation" is not considered to be doing business in NYC if: (1) it is not treated as a "domestic corporation" under IRC § 7701 and has no effectively connected income, or (2) its activities are limited to investing or trading in stocks and securities for its own account, investing or trading in commodities for its own account, or both, within the meaning of IRC § 864(b)(2).

#### Tax Rates

... The tax is Imposed on the greater of: (1) 9% of Business Income ("BI") for financial corporations and 8.85% of BI for all other corporations; or (2) 0.15% of Business Capital ("BC") minus \$10,000 and subject to a \$10 million cap, except cooperative housing corporations (0.04% of BC) or corporations subject to the utility tax or insurance corporations (0.075% of BC); or (3) a fixed dollar minimum tax ranging from \$25 to \$200,000, depending upon NYC receipts.

... Reduced BI tax rates apply to corporations with allocated BI less than \$1 million (reduced rates starting at 6.5%, depending upon allocated BI) and "qualified New York manufacturing corporations" with allocated BI less than \$40 million (reduced rates starting at 4.425%, depending upon allocated BI).

... A "qualified New York manufacturing corporation" is a corporation that: (1) principally engages in the manufacturing and sale thereof of tangible personal property; and (2) has property in New York the adjusted basis of which at the close of the taxable year is at least \$1,000,000 or more than 50% of its real and personal property located in the State.

#### Business Income ("BI") Tax Base

... BI equals Entire Net Income ("ENI"), less Investment Income ("II"), less Other Exempt Income ("OEI"). The sum of II and OEI may not exceed ENI.

... ENI means income from all sources (generally, federal taxable income adjusted as required).

... OEI equals Exempt CFC Income, plus Exempt Unitary Corporation Dividends ("Exempt Dividends"). OEI does not include IRC § 78 gross-up.

... II equals income from investment capital ("IC"), including capital gains in excess of capital losses and excluding IRC § 78 gross-up, to the extent included in computing ENI, less allowable interest deductions. II cannot exceed 8% of the taxpayer's ENI, determined without regard to interest deductions.

... Exempt CFC Income equals IRC § 951(a) income from a unitary corporation that is not included in a combined report, less allowable interest deductions.

... Exempt Dividends equals dividends from a unitary corporation that is not included in a combined report, less allowable interest deductions.

... IC equals investments in stocks, less directly or indirectly attributable liabilities, that: (1) are capital assets under IRC § 1221; (2) are held for investment more than one year; (3) disposition is or would be treated as a long-term capital gain or loss under the IRC; (4) for stocks acquired on or after January 1, 2015, have never been held for sale to customers in the ordinary course of business; and (5) are identified in taxpayer's records as stock held for investment. IC does not include: stocks of unitary corporations and corporations included in a combined report, stocks used by the taxpayer, and investments the income from which is excluded from ENI.

... In lieu of interest expense deductions, a taxpayer may make a revocable election to reduce Exempt CFC Income, Exempt Dividends and Investment Income by 40%.

### Business Capital ("BC") Tax Base

... BC equals total assets, less the following: IC; stock issued by the corporation; liabilities not deducted from IC; and assets and liabilities the income or loss from which is not reflected in ENI.

### Apportionment

... The general apportionment factor is weighted as follows: in 2015, 80% sales, 10% property, 10% payroll; in 2016, 87% sales, 6.5% property, 6.5% payroll; in 2017, 93% sales, 3.5% property, 3.5% payroll; and in 2018 and after the apportionment factor is 100% sales.

... For its first taxable year beginning on or after January 1, 2018, a taxpayer that has \$50 million or less in NYC receipts may make a one-time, revocable election on an original or amended return to determine its allocation based upon a three factor formula weighted as follows: 93% sales, 3.5% property, and 3.5% payroll.

... Receipts are sourced using market-based rules (see details on the next pages).

### Combined Reporting

... "Water's edge" combined reporting is required for unitary corporations directly or indirectly owned/controlled greater than 50%, including captive REITs, captive RICs, combinable captive insurance companies, and alien corporations that satisfy the control/ownership and unitary requirements and meet the definition of "domestic corporation" under IRC § 7701 or have effectively connected income for the taxable year.

... Taxpayers may make an irrevocable seven-year election on a timely filed original return to include all non-unitary entities that meet the common control or ownership requirement and otherwise could be included in a combined return. The election is subject to automatic renewal unless revoked and applies to any corporation entering a commonly owned group subsequent to the year of election.

... In determining the business allocation percentage for a combined report: (1) receipts, net income, net gains and other items of each member of the combined group, whether or not they are a taxpayer, are included; and (2) intercorporate receipts, income and gains are eliminated (i.e., a *Finnigan* approach).

### Net Operating Losses

... A corporation is allowed a post-apportioned "net operating loss deduction" ("NOLD") and "prior operating loss conversion subtraction" ("PNOLS"). NOLD may be carried back three years (but not to a pre-2015 taxable year) and carried forward 20 years. PNOLS may be carried forward 20 years but no longer than a taxable year beginning on or after January 1, 2035).

... The "net operating loss deduction" is the sum of a taxpayer's net operating losses arising in a taxable year beginning on or after January 1, 2015.

... The PNOLS which is applied before the NOLD, is generally made up of a taxpayer's unused net operating losses arising under the "old" General Corporation Tax (i.e., "unabsorbed net operating losses" or "UNOL") and, for any given year equals 1/10th of its "prior year net operating loss subtraction pool" ("PYNOLSP"), plus the unused PYNOLS from prior taxable years, but may not reduce business income below the greater of the tax on BC or the fixed dollar minimum tax.

... PYNOLSP equals the product of UNOL, Base Year BAP, Base Year Tax Rate, all divided by 8.85% (or 9% if a financial corporation), where Base Year BAP and Base Year Tax Rate are the business allocation percentage and tax rate, respectively, used by the taxpayer in its last year subject to the pre-existing General Corporation Tax.

... A taxpayer may make a revocable election on its first return filed in 2015 to use up to 50% of its PYNOLSP in each of its taxable years beginning on or after January 1, 2015, and before January 1, 2017. Any unused PYNOLSP as of a taxable year beginning on or after January 1, 2017, is forfeited.

... The law provides specific provisions for PYNOLS related to combined groups.

## Apportionment Highlights

Receipt From ...	Source to NYC If ...
<b>General Sourcing Provisions</b>	
... Tangible personal property	... Shipped to NYC
... Sales of electricity	... Delivered to NYC
... Net gain from sale of real property	... NYC property
... Rent from real or tangible personal property	... NYC property
... Use of patents, copyrights, trademarks, and similar intangibles	... Used in NYC
... Sale of rights for closed-circuit or cable television transmission of an NYC event	... To the extent attributable to transmissions received or exhibited in NYC
... Sale, license or remote access to digital products	... Use customer-focused hierarchy (i.e., benefit received, delivery, etc.)
... Other services or business receipts	... Use customer-focused hierarchy (i.e., benefit received, delivery, etc.)
<b>Financial Transactions / Broker-Dealer Activities</b>	
... Interest on loan secured by real property	... NYC property
... Interest on loan not secured by real property	... NYC borrower
... Net gain from sale of loan secured by real property	... Multiply by proceeds from sales of loans secured by NYC real property divided by proceeds from all loans secured by real property
... Net gain from sale of loan not secured by real property	... Multiply by proceeds from sales of loans not secured by real property to NYC purchasers divided by proceeds from all loans not secured by real property

... Interest/net gain from federal, state or municipal debt instruments	... (1) Exclude from the numerator interest/net gain from a debt instrument issued by the US or any state or municipality; and (2) include in the denominator 100% of receipts/net gain from a debt instrument issued by the US or New York or any of its political subdivisions, and only 50% of receipts/net gain from debt instruments issued by other states or their political subdivisions.
... Interest from asset-backed security or other government agency debt	... 8% of receipts
... Net gain from asset-backed security or other government agency debt	... 8% of net gain if government issued or sold through broker-dealer; otherwise, multiply net gain times proceeds from sales to NYC purchasers divided by proceeds from all such purchasers
... Interest from corporate bonds	... Issuing corporation's commercial domicile is NYC
... Net gain from sale of corporate bond	... 8% of net gain if sold through broker-dealer or through licensed exchange; otherwise, multiply net gains by proceeds from sales to NYC purchasers divided by proceeds from all such purchasers
... Net interest from reverse repurchase agreement	... 8% of net interest income
... Net interest from federal funds	... 8% of net interest
... Dividend/net gain from stock or partnership interest	... Exclude from numerator and denominator unless the Commissioner determines inclusion is necessary
... Receipt/net gain from a qualified financial instrument	... 8% of net gain/receipt if fixed percentage method is elected; otherwise, source according to rules related to non-qualified financial instruments.
... Interest from other financial instruments	... Payor located in NYC
... Net gain from sale of other financial instrument	... 8% of receipt if sold through broker-dealer or on licensed exchange; otherwise, NYC payor
... Net income from sale of physical commodities	... Multiply by receipts from commodities delivered to NYC (if no physical delivery, commodities sold to NYC purchaser) divided by all such receipts
... Brokerage commission on sales of securities/commodities, margin interest on brokerage accounts, certain underwriting fees, account maintenance fees, certain advisory/management fees,	... Customer responsible for paying has NYC address, but if can't determine mailing address, then 8 percent of receipts
... Interest on loans/advances made to an affiliated corporation not included in a combined report	... Principal place of business of affiliated corporation is in NYC
... Management, administration or distribution services to an investment company	... Multiply by the average of the monthly percentages of NYC shares of the investment company owned by NYC shareholders

### Credit Card Activities

... Interest, fee, penalty, or service charge	... Cardholder mailing address is in NYC
... Merchant discount	... Merchant is in NYC, but if merchant is within and without NYC attributable to sales made from NYC
... Credit card authorization, processing and clearing	... Credit card processor's customer accesses the processor's network in NYC
... Other receipts from credit card activities	... Multiply by average of 8% and percentage of NYC access points

### Other Industries

... Advertising (newspapers and periodicals)	... Multiply by number of newspapers or periodicals delivered to NYC divided by number of all newspapers or periodicals
... Advertising (television, radio, other)	... Multiply by number of NYC viewers/listeners divided by number of all viewers/listeners
... Railroad/trucking business	... NYC miles divided by everywhere miles
... Aviation service (air freight forwarding)	...100% NYC if both NYC pick-up and delivery, but 50 percent NYC if either NYC pick-up or delivery
... Other aviation service	... Multiply by average of percentage of NYC aircraft arrivals and departures, percentage of NYC revenue tons, and percentage of NYC originating revenue
... Transportation/transmission of gas	... Multiply by NYC transportation units divided by all transportation units
... Operation of vessels	... Multiply by percentage of working days vessel is within NYC territorial waters

## NEW YORK STATE CORPORATION TAX AND SALES/USE TAX AMENDMENTS

### Snapshot Highlights

(please see actual legislation for details and additional provisions)

#### Nexus

... Clarifies that, for purposes of determining whether a combined group meets the economic nexus threshold, use unitary members that meet the 50% ownership test and have at least \$10,000 in New York receipts or, in the case of a credit card corporation, at least ten New York customers and/or merchant locations

... Clarifies that an alien corporation is not “deriving receipts from activity in this state” if its New York activity is limited to investing or trading for its own account (within the meaning of I.R.C. § 864) stocks, securities and/or commodities

#### Net Operating Losses

... Requires taxpayers to first carry back a net operating loss arising in a taxable year beginning after January 1, 2015, but allows taxpayers to make an irrevocable election on a timely filed original return (determined with regard to extensions) to waive the three-year carryback period

... Clarifies that: (1) if a taxpayer makes the revocable election to accelerate the use of a prior year net operating loss subtraction pool and the pool is not exhausted by its last taxable year beginning before January 1, 2017, then the remainder of the prior year net operating loss subtraction pool is forfeited; and (2) where a taxpayer does not make the revocable election to accelerate the use of a prior year net operating loss subtraction pool, it may carry forward a prior year net operating loss subtraction 20 taxable years or to its last taxable year beginning before January 1, 2036, whichever comes first

#### Investment Income

... Removes the deduction from investment income for a loss, deduction, and/or expense attributable to a hedging transaction related to an item of investment capital

... Limits investment income determined without regard to attributed interest deductions to 8% of entire net income where investment income determined without regard to attributed interest deductions exceeds entire net income

... Makes the election to reduce investment income by 40% (in lieu of the interest deduction) revocable

#### Exempt CFC Income/Exempt Unitary Dividends

... Allows a taxpayer to revoke an election to reduce exempt controlled foreign corporation (CFC) income and exempt unitary dividends by 40% (in lieu of the interest deduction), but it also incorporates provisions that require the taxpayer to revoke the election made with respect to exempt CFC income, exempt unitary dividends and interest income if the taxpayer revokes the election for any one of the foregoing types of income

#### Investment Capital

... Redefines “investment capital” (which is used for purposes of determining investment income) to mean an investment in stock: (1) that meets the definition of “capital asset” under I.R.C. § 1221 during the period the taxpayer owned it during the taxable year; (2) that is held by the taxpayer as an investment for more than one year; (3) the disposition of which would be treated as generating long-term capital gains; (4) that has never been held for sale to customers in the regular course of business (applies only if acquired on or after January 1, 2015); and (5) is identified in the taxpayer’s records as being held for investment

... Clarifies that if the taxpayer does not own a stock on the last day of the taxable year, the presumption that the stock was held for more than one year does not apply and the actual period of time during which the taxpayer owned the stock must be used to determine whether the stock should be classified as investment capital (and adds that if the presumption is relied upon for a taxable year and the stock is not held for more than one year, business capital in the succeeding taxable year must be increased by the amount included in investment income)

### Apportionment

... Provides a clarifying definition of “qualified financial instrument,” including a clarification that, with respect to a corporation included in a combined report, the determination is made on a combined basis

... Excludes from the definition of “qualified financial instrument:” (1) loans secured by real property and defines a loan secured by real property to mean a secured loan where 50% or more of the value of the collateral consists of real property; and (2) stock that meets the definition of investment capital

... Clarifies that the election to use the fixed percentage method to source receipts/net gains from qualified financial instruments must be made on a timely filed original return determined with regard to extensions and that, if the election is made, marked-to-market net gains are among the items of income that must be treated as business income

... Removed “the location of the treasury function of the business entity” as a criterion for determining commercial domicile for purposes of sourcing receipts (making “the seat of management and control of the business entity” the first criterion)

... Adds sourcing provisions for marked-to-market net gains (including a definition of marked-to-market net gains) and receipts from the operation of a vessel

... Extends the apportionment provisions related to “other aviation services” to a “qualified air freight forwarder” and provides a definition for “qualified air freight forwarder”

... Clarifies that receipts from physical commodities that are not actually delivered are included in the denominator of the fraction used to determine the receipts from physical commodities that are sourced to the State

### Combined Returns

... Eliminates the requirement that the designated agent on a combined return must be the parent corporation

... Clarifies that the election to file a combined return for a commonly owned group must be made on a timely filed original return determined with regard to extensions

... Adds that the election to waive an NOL carryback and an election to deduct a prior year net operating loss subtraction pool over a two-year period applies to all members of a combined group

### Qualified New York Manufacturers

... Establishes a .0132% capital tax rate for qualified New York manufacturers for taxable years beginning in 2015

... Adds fixed dollar minimum tax tables for S corporations that are qualified New York manufacturers and provides that a combined group must meet the qualified New York manufacturer definition to use the related fixed dollar minimum tax tables

... Limits the type of property that may be used to satisfy the definition of a qualified New York manufacturer to New York investment tax credit (ITC) property that is “principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing”

... Clarifies that, with respect to a combined return, the qualified New York manufacturer test is applied at the combined group level

... Limits the property a broker-dealer, a business providing investment advisory services to a regulated investment company, and an exchange registered as a national securities exchange may use for purposes of the investment tax credit to that which was placed in service before October 1, 2015

### New York State Sales and Compensating Use Tax Amendments

... Effective June 1, 2015, provides relief to purchasers of vessels (i.e., an exemption for receipts from the sale of a vessel in excess of \$230,000 and exempts the use of a vessel from tax until the earlier of use in the state in excess of 90 consecutive days, the date the vessel is first required to be registered, or the date upon which the vessel is registered)

... Adds an exemption for: (1) certain receipts from the sale of electricity by a person primarily engaged in the sale of solar energy equipment and/or electricity generated by such equipment (effective December 1, 2015); (2) the use of certain items at a tasting held by a licensed brewery, cider producer, or distillery (effective June 1, 2015); (3) "general aviation aircraft" and machinery and equipment installed on such aircraft (effective September 1, 2015); and (4) certain transfers between related persons pursuant to a divestiture authorized under the Dodd-Frank Wall Street Reform and Consumer Protection Act (effective on the first day of a sales tax quarterly period commencing at least ninety days after April 1, 2015)

... Effective September 1, 2015, removes: (1) "aircraft" from the exception to the exclusion from sales tax that applies to certain mergers, consolidations, contributions, and distributions; and (2) certain small aircraft from the requirement to accelerate payments under a lease with a term of one year or more

... Effective April 1, 2015, expanded the definition (and taxability) of a "prepaid telephone calling service" to include a "prepaid mobile calling service"

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