Corporate Tax Reform – Year 1
Reasons for Reform

- Structure was outdated
  - Separate articles for banks and general corporations
  - Did not reflect modern service and digital economies

- Structure created disincentives to doing business and expanding in New York

- Complexity
  - Hard to comply for taxpayers
  - Invited aggressive tax planning

- Uncertainty
  - Significant percentage of corporate tax revenues collected on audit
Improvements

- Gone but not missed
  - Article 32 & cross-article inequities
  - Alternative minimum tax
  - Separate tax on subsidiary capital
  - Investment allocation percentage
  - Complex NOL rules
  - §180 - Organization tax and taxes on changes of capital on domestic corporations
  - §181 - License and maintenance fees on foreign corporations

- Addresses current contentious audit issues
  - Group composition - 10 step analysis; decombination
  - Business vs investment income
  - Expense attribution

- Generally conforms NYC General Corporation Tax (GCT) to reformed Article 9-A for C corporations
Nexus expansion (NYS only): economic nexus adopted
  • $1 million de minimis New York receipts threshold
    – All members of unitary group (except those taxable under Articles 9 or 33) with at least $10k in NY receipts aggregate receipts to determine if threshold met
      > Includes receipts from members protected by PL 86-272

Corporations protected by PL 86-272 exempt from tax under all three tax bases as separate taxpayers
Combined Reporting

- Full unitary water’s-edge with 50% ownership test
- Commonly owned group election
  - Only determination for combined group is ownership test
  - Covers 7 year period
- Activity and income of all group members included in computation of group’s tax
  - Every taxpayer member of a combined group is also subject to separate fixed dollar minimum tax
  - Nontaxpayer members, including those protected by PL 86-272, not liable for separate fixed dollar minimum tax
What is Taxable?

- Primary base is business income base
  - Business income base is remainder subject to apportionment after:
    - NY modifications
    - Subtraction for investment income
    - Subtraction for other exempt income
    - Attribution of interest expenses
  - NOLs taken against apportioned base
What is Taxable?

- **Alternative bases**
  - Tax on business capital
    - NYS tax on business capital is being phased out by 2021
  - Fixed dollar minimum (FDM) tax
    - Sliding scale based on receipts
      > NYS FDM amounts range from $22 to $200,000
Investment Capital

- Investment capital must meet 5 criteria:
  1. Satisfy capital asset definition under IRC 1221
  2. Held for investment for more than 1 year
     - Period measured across years
     - Presumed met if held at time of filing
  3. Generates long-term capital gains/losses under IRC
  4. Never been held for sale to customers\(^2\)
  5. Be identified as held for investment in same manner as required under IRC 1236(a)(1)
     - Identification required by October 1, 2015
     - See TSB-M-15(4)C, (5)I

- Investment capital also includes assets that generate income that cannot be apportioned under the U.S. Constitution

- Investment capital exempt from tax

\(^2\)For stocks acquired on/after 1/1/15
Income from investment capital is exempt from tax.

Investment income cannot exceed 8% of ENI without regard to attribution.

- Interest expense deductions related to income in excess of 8% still subject to addback.
Other Exempt Income

- Other exempt income is the sum of exempt controlled foreign corporation (CFC) income and exempt unitary dividends
  - Exempt CFC income is income received from a CFC conducting a unitary business with the taxpayer but is not included in the combined group
  - Exempt unitary dividends are dividends from unitary corporations not in the combined group
- Exempt income cannot exceed ENI
Expense Attribution for Exempt Income

- Attribution only required for interest expenses related to investment and other exempt income
  - If actual expenses exceed income, the excess must be added back to ENI

- In lieu of performing actual attribution, taxpayers can elect to reduce tax exempt income by 40%
  - If election is made, it applies to both investment income and other exempt income
  - Election applies to all members of a combined group
  - 40% safe harbor is prohibited for cross-article dividends
### Prior NOL Conversion Subtraction

- NOLs incurred before the 2015 tax year are converted into a prior NOL conversion (PNOLC) subtraction to stabilize their value for financial accounting purposes.
- The PNOLC subtraction pool is computed as follows:

<table>
<thead>
<tr>
<th>2014 BAP</th>
<th>X</th>
<th>2014 Tax Rate</th>
<th>X</th>
<th>2014 Pre-Apportionment NOL Carry forward</th>
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6.5%
Prior NOL Conversion Subtraction

- Taxpayers\(^1\) can choose to use:
  - \(\frac{1}{10}\)th of pool over next 20 years
  - \(\frac{1}{2}\) of pool over next 2 tax years
- Deducted from apportioned business income
- Only required to use an amount necessary to reduce the tax on business income to the higher of the tax on business capital or the FDM

\(^1\)Qualified small businesses not subject to limitations
New NOL Rules

- 3 year unlimited carry back, 20 year carry forward
- No longer limited by the Federal NOLD source year or amount
- Computed on an apportioned basis
- Deducted from apportioned business income after PNOLC subtraction
- Only required to use an amount necessary to reduce the tax on business income to the higher of the tax on business capital or the FDM
Sourcing Income to New York

- Single receipts factor apportionment with full customer sourcing rules for all taxpayers
- Statute expands the type of receipts for which sourcing rules are specifically enumerated
- Creates hierarchies and safe harbors to assist with difficult to source receipts
- Current apportionment rules for trucking, railroad, transportation of gas, and aviation are used as the basis for the new receipts rules for these industries
  - No 60 percent reduction for aviation receipts in NYC
Digital Products

- Taxpayers must source receipts from digital products based on the following hierarchy:
  1. Customer’s primary use location of the product
  2. Location where the digital product is received by the customer
  3. Apportionment fraction for the preceding year for such digital product receipt
  4. The apportionment fraction for the current year for receipts from all digital products

- Taxpayers must exercise due diligence before rejecting a method and moving to the next method in the hierarchy
Other Services & Other Business Receipts

- Services are now sourced to where the benefit is received instead of where the service is performed.

- Taxpayers must source unenumerated receipts using the following hierarchy:
  1. Where the benefit is received
  2. Delivery destination
  3. Apportionment fraction for the preceding year for such receipt
  4. The apportionment fraction for the current year for receipts from all other services and other business receipts

- Taxpayers must exercise due diligence before rejecting a method and moving to the next method in the hierarchy.
Qualified Financial Instruments (QFIs)

- QFIs are financial instruments marked to market under I.R.C. §475 or §1256
  - NY follows federal rules about who can/must mark
    - traders can elect to mark to market
    - dealers can only elect for commodities

- QFIs only include the following types of instruments:
  - loans (excluding those secured by real property)
  - federal, state, municipal debt
  - asset backed securities and other government agency debt
  - corporate bonds
  - dividends and net gains from sales of stock or partnership interests
  - other financial instruments
  - physical commodities
Taxpayers can elect to source QFIs at 8% or by using the statutory customer-based rules for each income stream that is not tax-exempt
- Non-QFIs must use customer-based sourcing
- Certain items are statutorily apportioned at 8%

Election is:
- Annual
- Irrevocable
- Made on original, timely filed return
- Applicable to all members in a combined group
QFI Election

- If QFI election is made, all QFI income is business income

- Impact of election on the enumerated categories
  - Marking is done by category
  - Once an item is marked, the entire category is deemed to consist of QFIs
  - All categories containing QFIs must use the same sourcing method
MTA Surcharge (NYS Only)

- Surcharge made permanent in all articles
  - The rates and calculations under Article 9 and Article 33 remain unchanged

- Economic nexus standard also applies to the MTA Surcharge
  - Apportionment remains 3 factor, however

- Base is changed to NYS tax before credits for current year

- Surcharge rate:
  - 25.6% of MTA-allocated tax for tax year 2015
  - Subject to adjustment by the Commissioner after 2015 pursuant to statutory standards
Forms, Guidance, and Regulations

- Forms
- Dedicated Web Page
- TSB-Ms
- Regulations
Forms

- Extensive revisions being made to Article 9-A forms and instructions
  - Anticipated availability in December 2015
- CT-3 and 3-A remain main forms
  - CT-4, CT-32 obsolete

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<thead>
<tr>
<th>Form Attachment Numbers and Topic</th>
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<tbody>
<tr>
<td>3.1: exempt income</td>
<td>3.2: bank modifications</td>
</tr>
<tr>
<td>3.3: PNOLC</td>
<td>3.4: NOL</td>
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<tr>
<td>3-A/BC: details of combined group members</td>
<td>CT-60: affiliated entity information</td>
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Dedicated Corporate Tax Reform Web Page

- Contains links to all corporate tax reform related information, guidance, and draft regulations
- Includes frequently asked questions
  - Users can submit reform questions via the page
- Provides address to submit comments on draft regulations
- Links to NYC reform page

Guidance

- **Guidance Issued**
  - Summary of Tax Provisions in SFY 2014-15 Budget
    - Explanation of corporate tax reform enacted in 2014
  - Summary of Tax Provisions in SFY 2015-16 Budget
    - Explanation of technical and clarifying amendments enacted in 2015

- **Guidance Coming Soon**
  - Interest expense attribution TSB-M
Draft Regulations

Draft Regulations Available for Public Comment
- Nexus
- Digital products
- Other business receipts

Forthcoming Draft Regulations
- MTA Surcharge
- Combined reporting
- Prior net operating loss conversation subtraction