REPORT #606

TAX SECTION

New York State Bar Association

Report on 1989 Budget Related to Procedural Matters and Corporate Taxes

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NEW YORK STATE BAR ASSOCIATION

TAX SECTION REPORT #606

LETTER TO DEPUTY COMMISSIONER WILLIAM F. COLLINS DATED APRIL 4, 1989 RELATING TO PROPOSED NEW YORK STATE 1989 BUDGET BILLS S.2446/A.3646 AND S.2474/A.3674 (PROCEDURAL MATTERS AND CORPORATE TAXES).

Tax Report #606

TAX SECTION

New York State Bar Association

April 4, 1989

<u>FEDERAL EXPRESS</u>

William F. Collins, Esq.
Deputy Commissioner and Counsel
New York State Department of Taxation and Finance
State Campus - Building #9
Albany, New York 12227

Re: <u>1989 Budget Bills</u>

Dear Deputy Commissioner Collins:

Thank you for forwarding to us copies of the Governor's Budget Bills for our review. Enclosed is our memorandum drafted by James A. Locke and Sterling L. Weaver on S.2446/A.3646 and S.2474/A.3674; a memorandum relating to S.2459/A.3659, prepared by E. Parker Brown, II, is being sent to you today directly from Mr. Brown.

Although we understand that the budget process has resulted in many changes to the original bills, we hope our comments will be useful since, we assume, many of the concepts and much of the proposed statutory language of the original bills have been incorporated in later versions.

Time constraints prevented consideration o£ this memorandum by the full Executive Committee of the New York State Bar Association Tax Section, and therefore this is not a formal Report; the memorandum has, however, been unanimously approved by the Administrative Committee of the Tax Section.

Sincerely,

Wm. L. Burke

WLB/JAPP wm. “t’ Burke
Enclosure

cc: Hon. Ralph J. Marino
Senate Majority Leader
The Capitol
Albany, New York 12224

Hon. Mel Miller
Speaker of the Assembly
The Capitol
Albany, New York 12224

Hon. Tarki Lombardi
Chairman, Senate Finance Committee
The Capitol
Albany, New York 12224

Hon. Roy Goodman
Chairman, Senate Committee on Investigations,
Taxation and Government Operations The Capitol
Albany, New York 12224.

Hon. Saul Wepren
Chairman, Assembly Ways and Means Committee
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NEW YORK STATE BAR ASSOCIATION TAX

SECTION

Report On 1989 Budget Bill
Related to
Procedural Matters and Corporate Taxes

S. 2446 & 2474

A. 3646 & 3674

Report on 1989 Budget Related to Procedural Matters and Corporate Taxes[1]

I. Overall Comment

A number of proposed changes involve conforming New York law to corresponding changes already enacted at the Federal level; others do not. The Tax Section generally has endorsed conformity with federal law and this committee shares that general view. As a general comment, without either endorsing the "revenue enhancement" approach of the budget tax bills or endorsing all the changes previously made at the federal level that are adopted in the Bill, we note in the present context that adopting conformity where it generates revenues may produce less dispute than other sources of revenue enhancement.

II. Procedural Matters

A. Interest Rates on Underpayments and Overpayments

Under the provisions of current New York State Tax Law, interest rates on underpayments and overpayments are the same and are generally calculated on a semi-annual basis.

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[1] This report was prepared by James A. Locke and Sterling L. Weaver Co-chairs of the Committee on New York State Tax Matters. Helpful comments were received from William L. Burke, John A. Corry, Arthur A. Feder, James S. Peaslee and Arthur R. Rosen.

The proposed Bill would split the treatment of interest on underpayments and overpayments with respect to taxes administered by the Department of Taxation and Finance so that interest paid on overpayments will be 1 percentage point less than the interest charged on underpayments. While an earlier report by a Tax Section Committee took issue with this proposal when it appeared at the Federal level and the Committee continues to believe in the inadvisability of this bifurcation, we believe that any change in this area should be initiated at the Federal level and that New York State will be well served by conforming to the method of calculation of interest rates utilized at the Federal level. This conformity as to rates and the way they are established will alleviate the confusion that has existed because of New York's totally separate method of determining rates on underpayments and overpayments. This proposal will be applicable to income taxes, gift taxes, corporate tax, estate tax, and sales and use taxes, as well as to tax as imposed under under the New York City Administrative Code. Consistent with treating the calculation of interest rates on a standard basis, we would recommend that the minimum of 12 percent chargeable on sales tax underpayment be eliminated. Interest rates are amounts paid for the use of money and should not be utilized as a means of imposing a penalty.

Along with any bifurcation of interest rates, we believe that procedures should be implemented to permit deficiencies and overpayments to be offset so that interest is calculated only on the net difference from the relevant deficiency date or refund date in the later year.

Otherwise, the interest rate differential can create an unwarrantedly harsh result, particularly where the deficiency and refund are related (for example, because of a change in the year in which an item is taken into account).

B. Electronic Funds Transfer

There is currently no provision in the tax law which requires payment of taxes by electronic funds transfer (“EFT”). Taxpayers have enjoyed the use of funds withheld from employees and customers for income tax and sales tax purposes respectively. The bill authorizes the Commissioner by regulation to require that semi-monthly and quarter-monthly withholding tax filers and monthly sales tax filers pay their tax liability by EFT on or before the prescribed due date to a financial institution designated by the Commissioner. Taxpayers subject to the new requirement can elect not to pay EFT provided that the required return and a certified check is received by the Department on or before the second business day prior to the applicable due date prescribed by law.

Various other states have already commenced requiring EFT payment of certain tax liabilities. Ultimately, it is expected that more taxes will be remitted in this fashion. Taxpayers will no longer be able to take advantage of the “float”.

Although there will be some start up costs, this proposal is a sound step in tax administration and we support it, provided that it is implemented with adequate timing and education over a reasonable period of time.

We have some technical comments on the provisions for allowing continued use of alternatives to EFT’s. First, in the interest of avoiding disputes, we suggest the substitution of a mailing date suitably longer in advance (say 5 to 7 days before the due date) in place of a time of receipt test. Second, the cutoff time may need to be different depending upon whether the check is certified by a New York or an out-of-state bank and whether the bank is a state depositary for EFT’s.

C. Repeal of Interest Free Periods

Under current law, notices of a proposed increase in tax and notices of deficiency include interest only to the date of the notice. The taxpayer has a grace period in which to pay the sum indicated without incurring further interest costs (30 days in the case of a notice of proposed increase in tax and 90 days in the case o£ a notice of deficiency). These interest free grace periods benefit the taxpayer only if the tax is paid during these periods and not contested.

The proposed change will eliminate these two interest free periods and, thereby, bring New York and Federal law into conformity in this respect. Because this change will produce increased conformity, we believe it should be enacted.

D. Interest on Refunds

Generally speaking, under current law, in the case of an overpayment resulting from an amended return or a claim for credit or refund, interest is payable from the date that the original return was due or the date it was filed, whichever is later, except for the 90-day period following the prescribed due date for filing the original return. Under the Bill, no interest would be allowed on the credit or refund for any day before the day the amended return or claim for credit or refund is filed, and no interest would be paid before the date on which an audit was commenced in the case of overpayment resulting from the audit.[2] This proposal is at variance with the provision of Federal law applicable to the payment of interest on refunds, and we oppose it for that reason. Interest is a charge for the use of the money and the provisions of current law adequately reflect fairness in the payment of such amounts.

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[2] If an audit timing adjustment results in an overpayment in one year and an underpayment in another year, the taxpayer can be paid interest on the overpayment to the extent he must pay interest on the underpayment. As indicated above, we believe the more appropriate approach would be for interest to run on only the net amount from the later year.

Aside from the need for additional funds, there is no compelling reason for the New York law not to be in conformity with Federal law on this matter.[3]

III. Corporate Taxes

A. Associations and Publicly Traded Partnerships

The Bill would amend Articles 9, 9-A and 32 of the Tax Law to define “associations” taxable as corporations under federal tax rules and “publicly traded partnerships” treated as corporations under section 7704 of the Internal Revenue Code of 1986 (“Code”) as “corporations” which are subject to franchise tax under such Articles. Under current law, only corporations, joint stock companies or associations and business trusts are subject to tax under these Articles. The effect of the change is to conform the New York rules for classifications of these entities to the federal rules, which we believe is the correct tax policy. Until such a change is made, the income earned by these entities will not be subject to tax in New York until distributed to their owners.[4]

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[3] Our experience is that clients are not inclined to take the risks and uncertainties of recovering a tax overpayment in order to invest money with a government unit even if the stated rate of interest was attractive; New York therefore runs little risk of having loans intentionally foisted on it for the investment return.

[4] The entity itself would not be subject to tax. Until a distribution is made, the "shareholder" has no includable income for federal income tax purposes, and there is no provision for this item in the enumerated New York adjustments for the "shareholder." Consequently, New York also would not tax the income to the "Shareholder” until the income was distributed to him.

We do suggest the following technical changes and clarifications to the Bill:

1. The new definition of a “corporation” in sections 183, 183-a, 184, 184-a and 186-a should incorporate “joint stock company or association” in a manner similar to that used to amend section 208. This would avoid the many references to “joint stock company or association” in those sections to avoid confusion.

2. It should be made clear that any such entity could also elect Subchapter S treatment if the necessary conditions are met.

3. To avoid confusion, a definition of “capital stock” and “dividend” should be incorporated into section 183 and 186 to reflect the new broader definition of “corporation”.

4. New sections 184(1)(a) and 186(4) indicate that the amount to be included in the “gross earnings” of a taxpayer which is a partner, member or associate of a publicly traded partnership or an association which is subject to tax under those sections, which is attributable to such entity, is the amount received with respect to such partnership or association “which is required to be reported as dividends to the United States treasury department.” A better phrasing might be “which is a dividend as defined in section 316(a) of the Internal Revenue Code”. Of course, the amount should also be treated for all other relevant purposes, such as whether it should be treated as passive income.

B. Net Operating Loss Deduction

Under current law, a taxpayer subject to tax under Article 9-A uses the federal rules of section 172 of the Code to determine the years to which net operating losses (“NOLs”) may be carried. The Bill would eliminate this conformity by disallowing the carry back of a NOL to the three preceding years. Such NOLs could only be carried forward. We generally do not believe that it is good tax policy to break the conformity between the New York and federal rules. For taxpayers who incur a NOL, the refund allowed from a carry back may help the taxpayer’s cash flow through a critical business period.

C. Issuer Allocation Percentage

A corporation’s “issuer allocation percentage” is used by taxpayers subject to tax under Article 9-A in determining the portion of investment income received from such issuing corporation which is allocable to New York and the corporation’s investment capital allocation percentage. Currently, the Department computes the issuer allocation percentage from information supplied by the issuing corporation on its franchise tax reports. However, many issuers do not supply complete information so that the Department is sometimes unable to prepare accurate allocation percentages. There is currently no penalty imposed upon issuers who fail to provide such information.

The Bill imposes a penalty of $500 upon an issuer who fails to supply the requested information on its franchise tax return unless such failure is due to reasonable cause and not due to willful neglect. This provision is a reasonable approach to making the cumbersome investment income allocation rules work, and

The Bill also clarifies the rules for computing the issuer allocation percentage for banking corporations and provides new rules for computing the issuer allocation percentage for utilities subject to tax under section 186. Under the Bill, the issuer allocation percentage of a utility subject to tax under section 186 is based upon the utility’s percentage of gross earnings within and without New York. Since that is the basis upon which such utilities are taxed, this method of allocation makes good sense. For all banking corporations subject to tax under Article 32, other than New York branches of foreign banks, the method for computing the issuer’s allocation percentage is unchanged - i.e. the percentage of alternative entire net income subject to tax in New York. For a foreign bank, the method of calculating the issuer allocation percentage is based on the ratio of the bank’s interest and other income earned in New York to its gross income from sources in the United States. Non-bank subsidiaries are to use the method used by corporations subject to tax under Article 9-A.

D. S Corporation Filing Fee

The Bill would increase the filing fee for S corporations from the current $100 to $250. While this is simply a “revenue enhancer” not driven by any particular tax policy, it is not inequitable since all C corporations must pay a minimum annual fee of $250. Moreover, the same reduced minimum fees that currently apply to C corporations in existence for only a portion of a year would apply for S corporations.

E. Computation of Corporate Estimated Taxes

The Bill would amend the corporate estimated tax requirements under Articles 9, 9-A, 13-A,- 32 and 33 for taxpayers who use the “annualization” method for an installment and later switch to another method, which, if used for the earlier period, would have resulted in a higher tax. The amendment would require such taxpayers to “recapture” the underpayment for prior periods when they switch from the annualization method. This rule generally conforms to the federal estimated tax rules in section 6655 of the Code, as amended by the Technical and Miscellaneous Revenue Act of 1988, and would be effective to taxable years beginning on or after January 1, 1990. We believe conformity with the federal rules is a logical approach to be used.