

TAX SECTION

New York State Bar Association

MEMORANDUM IN SUPPORT

Table of Contents

Cover Letter: i

MEMORANDUM IN SUPPORT..... 1

SUMMARY OF PROVISIONS..... 1

 Introduction..... 1

 Purchase and Sale of Property For One's Own Account/Investment Income..... 2

 Holding, Leasing or Managing Real Property 7

 Avoidance of Multiple, Entity-Level Taxation of Partnership Income..... 8

REASONS FOR SUPPORT 11

The People of the State of New York, represented in Senate and Assembly, do
enact as follows: 15

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May 24, 1993

Mr. William Thomas
Deputy Commissioner for Policy
Department of Finance
Room 509, Municipal Building
1 Centre Street
New York, NY 10007

Dear Mr. Thomas:

We have reviewed the final version of the unincorporated business tax legislation which you distributed May 14, 1993. The bill represents a substantial improvement over present law in the areas it deals with, namely, replacing the additional exemption with a credit, liberalizing the exemptions for trading for one's own account and for holding, leasing or managing real property, and changing the method of allocating investment income where such income does not qualify for exemption.

The bill does not meet all of the concerns expressed in our letter to you of March 18, 1993. In particular, it fails to clarify the language describing the activities eligible for the trading for one's own account exemption by adding express references to activities commonly engaged in by investment firms.

Nevertheless, on balance, we believe that the proposed legislation will accomplish a significant reform from present law and we support its enactment into law.

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If the bill is enacted, we would hope to work with you to reach agreement on future legislation or changes in rules that would accomplish the additional objectives referred to in our March 18 letter and also in our letter of April 14, 1993.

Very truly yours,

Peter C. Canellos
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MEMORANDUM IN SUPPORT

TITLE

AN ACT to amend the administrative code of the city of New York, in relation to revising provisions of the unincorporated business tax imposed by chapter 5 of title 11 thereof relating to the taxation of investment income, the taxation of income from real property, and the additional exemption allowed thereunder in certain cases; and in relation to providing for a credit against such tax and the city general and banking corporation taxes imposed by chapter 6 of such title 11 for unincorporated business taxes paid in certain cases

SUMMARY OF PROVISIONS

Introduction

Since 1966, New York City has imposed a four percent unincorporated business income tax (UBT) on the allocated net income of every individual and unincorporated entity carrying on a trade or business wholly or partly in the City. This bill will substantially revise UBT provisions dealing with the following subjects: (1) the treatment of individuals and unincorporated entities engaged both in the purchase and sale of property for their own account and in other business activities, as well as the method of taxing income from certain investment activities; (2) the treatment of real property owners, lessees or fiduciaries engaged both in the holding, leasing or managing of real property and in other business activities; and (3) the treatment of income from partnerships subject to the UBT in the hands of other partnerships or individuals subject to the UBT or corporations

subject to the City general corporation tax (GCT) or the banking corporation tax (BCT).

Purchase and Sale of Property For One's Own Account/Investment Income

This portion of the bill is designed to provide greater certainty regarding the circumstances in which the UBT will apply to certain investors who also carry on business activities in the City. It also liberalizes the rules for allocating income from taxable investment activities to the City, which will produce for many taxpayers with investment income a lower tax liability than under current law.

Subdivision (c) of section 11-502 of the New York City Administrative Code provides that individuals or unincorporated entities, except dealers holding property primarily for sale to customers in the ordinary course of business, will not be subject to the UBT solely by reason of the purchase and sale of property, or the purchase, sale or writing of stock option contracts, for their own account. If the person purchasing and selling property for his or her own account also engages in a business activity in the City, the business activity may "taint" the purchase-and-sale- for-own-account activity, resulting in the application of the UBT to both the business activity and the purchase-and-sale-for-own- account activity. Section 2 of the bill amends subdivision (c) to clarify the circumstances in which a person engaged in the purchase and sale of property for his or her own account will become subject to the UBT by virtue of additional business activity. The amendment provides, in substance, that the UBT will not apply if the person who purchases and sells property for his or her own account does not receive more than \$25,000 of gross receipts during the taxable year (determined without regard

to any deductions) from the conduct of an unincorporated business in whole or in part in the City. Twenty-five thousand dollars was chosen as the threshold because that is the level below which no unincorporated business will incur liability for the UBT due to the availability of certain statutory deductions and credits. The bill does not address the question of under what circumstances receipts from activities other than those specifically exempted by section 11-502(c) will constitute receipts from an unincorporated business conducted by an individual or unincorporated entity. However, the bill makes it clear that if a taxpayer receives more than \$25,000 in gross receipts from an activity that clearly constitutes an unincorporated business carried on by that taxpayer wholly or partly in the City, that taxpayer is not engaged solely in the purchase and sale of property for his or her own account.

The bill also revises the rules under which taxable income from corporate and governmental stocks, bonds and other securities is to be allocated to the City for purposes of the UBT. Currently, if investment income is subject to the UBT, it is allocated to the City under the same rules as apply to business income. Those rules call for the allocation of income to the City on the basis of the taxpayer's books if they fairly and equitably reflect the income from the City, or on the basis of a three-factor formula containing property, payroll and receipts factors. If the taxpayer does not have a regular place of business outside the City, no allocation is permitted.

The bill retains the current rules for allocating business income. However, a new set of rules is prescribed for allocating income from "investment capital," and such income is eligible for allocation whether or not the taxpayer has a regular place of

business outside the City. These new investment income allocation provisions are patterned after those contained in the GCT, and are similar to the provisions applicable to the New York State franchise tax imposed by Article 9-A of the Tax Law. The new UBT provisions will be interpreted and applied in the same manner as their GCT counterparts. The changes are consistent with the general policy of reducing the differences between the UBT and the GCT. The NYC Department of Finance will promulgate rules promptly upon enactment of the bill to provide guidance as to the application of these new provisions. Among other things, those rules are expected to provide that a partner's distributive share of income of an unincorporated entity qualifying as investment income will retain that character in the hands of that partner regardless of how the interest in the unincorporated entity was acquired and regardless of whether that partner is a general or limited partner.

Under section 1 of the bill, "investment capital" is defined as investments in corporate and governmental stocks, bonds and other securities, not held for sale to customers in the regular course of business. A governmental security, the interest on which is exempt from the UBT, is included in investment capital only in the taxable year in which it is sold or otherwise disposed of in a transaction which results in a gain or loss includable in the calculation of UBT income. Bill section 1 also defines "investment income" as income, gains and losses from investment capital, less those deductions of the unincorporated business directly or indirectly attributable to investment capital or investment income. It is expected that the audit guidelines contained in the NYC Department of Finance's Audit Procedure SAP 93-1-GCT, 3/1/93, will be extended to UBT audits on the issue of

attribution of expenses. Bill section 4 provides that, in calculating its income, an unincorporated business can exclude 50 percent of the dividends it receives, other than dividends associated with certain highly leveraged merger or acquisition transactions, or dividends from certain short-term stock holdings.

Section 8 of the bill provides that investment income is to be allocated to the City by multiplying it by an investment allocation percentage, determined, in general, on the basis of the presence in the City of the issuers of the stocks, bonds and other securities comprising the taxpayer's investment capital. An issuer determines the extent of its presence in the City by calculating an issuer's allocation percentage on the return it files under the City's GCT, BCT or utility tax.

Since investment income is to be allocated separately from business income, the bill makes various amendments to the UBT law to effect this bifurcated allocation scheme. Bill section 1 adds a new term--"unincorporated business entire net income"--which is defined as the excess of the unincorporated business' gross income over its deductions. Another newly added term--"business income"-- is defined as the amount arrived at by subtracting investment income from unincorporated business entire net income. Sections 6 and 7 of the bill amend subdivisions (a) and (c) of section 11-508 of the Administrative Code, which contain the current allocation rules, to specify that these rules will now apply to the allocation of business income. Finally, bill section 3 amends the definition of the term "unincorporated business taxable income" found in section 11-505 of the Administrative Code, in order to make it clear that taxable income is to be

determined by taking the sum of allocated business income and allocated investment income and subtracting certain deductions not subject to allocation.

Section 5 of the bill makes technical amendments to subdivisions (5) and (8) of section 11-507 of the Administrative Code, relating to the treatment of expenses attributable to obligations that are subject to the UBT but exempt from federal income taxation or obligations that are subject to federal income taxation but exempt from the UBT. The amendments clarify the descriptions of the types of obligations covered by these provisions by referring to them as obligations "the interest on which" is exempt, rather than obligations "the income from which" is exempt. These clarifying changes conform to amendments made to comparable provisions of the New York State and New York City personal income taxes by Chapter 406 of the Laws of 1990.

Section 9 of the bill makes technical amendments to paragraphs (1) and (2) of subdivision (b) of section 11-509 of the Administrative Code, which allow special deductions for depreciation and certain research and development expenditures, in order to reflect the fact that business income and investment income will be separately allocated under the terms of the bill.

The new rules concerning the purchase and sale of property for one's own account and the classification and allocation of investment income will apply to taxable years beginning after 1993.

Holding, Leasing or Managing Real Property

Under subdivision (d) of section 11-502 of the Administrative Code, an owner of real property, a lessee or a fiduciary will not be subject to the UBT solely by reason of holding, leasing or managing real property. However, if that person engages in any additional business activity, both the business activity and the real estate activity may be subject to the UBT.

Section 10 of the bill amends subdivision (d) of section 11-502 to preserve the existing exemption for real estate operations even though other business activity is also carried on. It does this by providing that if an owner, lessee or fiduciary (except a real estate dealer) who is holding, leasing or managing real property is also carrying on an unincorporated business, whether or not at the location of the property, the real estate operation will not be subject to the UBT if, and only to the extent that, the real property is held, leased or managed for the purpose of producing rental income or gain on the sale of the property. If the owner, lessee or fiduciary carries on a business at the property, including, for example, a garage, restaurant, laundry or health club, that business will be deemed an incident to the holding, leasing or managing of the real property, and will not be subject to the tax, if it is conducted solely for the benefit of tenants at the property, as an incidental service to such tenants, and is not open or available to the general public.

Section 11 of the bill amends subdivision (c) of section 11-506 of the Administrative Code, relating to the calculation of unincorporated business gross income, to exclude from the calculation income or gain from the holding, leasing or managing

of real property if, and to the extent that, such activity is exempted from the tax under section 10 of the bill. Section 12 of the bill amends section 11-507 of the Administrative Code, relating to unincorporated business deductions, to disallow deductions for any expenses directly or indirectly attributable to the holding, leasing or managing of real property to the extent that such activity is exempted from the tax. Section 13 of the bill makes a technical amendment to subdivision (e) of section 11-508 of the Administrative Code, concerning allocation rules applicable to real property, to make it clear that these rules are subordinate to the newly adopted rules on the taxation of real estate activity.

These new rules concerning the tax treatment of real estate activity will apply to taxable years beginning after 1992.

Avoidance of Multiple, Entity-Level Taxation of Partnership Income

Subdivision (2) of section 11-510 of the Administrative Code is designed to minimize double taxation in cases in which the income of a partnership subject to the UBT is taxed in the hands of its partners who are themselves subject to the UBT or to the GCT or BCT. Subdivision (2) allows a partnership, in calculating its taxable income, to claim a deduction for amounts included in income by partners who are subject to the UBT, GCT or BCT; however, with respect to each such partner, the deduction cannot exceed the taxable income of that partner allocable to the City on its City business tax return. If a corporate partner subject to the GCT is liable for the alternative tax measured by income plus compensation paid to officers and certain shareholders, the Department of Finance takes the position that the partnership cannot claim the deduction based upon that alternative tax base.

(However, litigation on this issue is now pending in the Appellate Division of the New York Supreme Court.) If a partnership has multiple tiers of direct partners and indirect investors that are themselves partnerships, the Department of Finance takes the position that the deduction is available only to alternate partnerships in the chain. (Litigation is also now pending on this issue.)

Section 15 of the bill amends subdivision (2) of section 11-510 to eliminate this deduction for income taxable to partners. In its place, the bill provides for credits which the partners can claim on their business tax returns.

Section 14 of the bill adds to section 11-503 of the UBT law a credit provision under which a partner subject to the UBT, who has a distributive share from a partnership that is also subject to the UBT, can claim a credit for such partner's share of the tax paid by the partnership. The amount of the credit cannot, however, exceed the amount by which the partner's tax liability (before all credits) exceeds the tax it would have owed (before all credits) if it did not have a distributive share from the partnership. If a partner is a member of more than one partnership, the sum of such partner's credits with respect to all of the partnerships cannot exceed its tax liability, computed prior to the allowance of all credits. In a multiple-tier partnership structure, each taxable partnership below the highest level partnership is allowed to claim a credit for its share of the tax paid and credit claimed by the partnership of which it is a direct partner. (The amendment allowing the credit in multi-tier partnership situations is not intended to create any inference as to the correct method of applying the current law's additional exemption provision in such situations.) The credit

allowed under this new provision is to be taken before any other credits allowed under the UBT.

Section 16 of the bill amends section 11-604 of the Administrative Code so as to add a similar credit provision to the GCT law. A corporation will be eligible to claim the credit if it is liable for the basic tax measured by entire net income or the alternative tax measured by entire net income plus compensation paid to officers and five-percent shareholders. (The amendment allowing the credit against the alternative tax is not intended to create any inference as to the correct application of the current law's additional exemption provision in the case of income of a partnership taxable to a corporation subject to the alternative tax.) The amount of the credit is equal to the corporation's distributive share of the tax paid and credit claimed by the partnership in which it is a direct partner. However, the credit cannot exceed the amount by which the corporation's tax (before all credits) exceeds the tax it would have owed (before all credits) if it did not have a distributive share from the partnership. If related corporations file a combined GCT return, the credit is computed as if the combined group were the partner in each partnership from which any of its members has a distributive share. Under the GCT, a corporation is required to calculate its tax under four alternative bases and pay whichever is the highest; the bill provides that application of the new credit provision is not to result in a shift from one tax base to another.

Section 17 of the bill adds to the BCT law a new section 11-643.8, which establishes a credit similar to the GCT credit. A banking corporation will be eligible to claim the credit if it is liable for the basic tax measured by entire net income or the alternative tax measured by alternative entire net income. Like

the GCT, the BCT requires payment of whichever of four alternative tax calculations produces the highest tax; again, application of the credit provisions cannot produce a shift among the tax bases.

In determining the amounts of these newly allowable credits, the credit provisions described in the preceding paragraphs require additional calculations in certain cases to reflect various tax rate differentials among the UBT, GCT and BCT.

Sections 14 through 17 of the bill will apply to taxable years beginning after 1992.

REASONS FOR SUPPORT

This bill is an important step toward bringing New York City's unincorporated business tax into closer conformity with the general corporation tax, and improves the administration of certain UBT exemptions. The changes proposed in this legislation were developed in response to concerns that have been expressed over the years by the private sector, particularly the State Bar Association, CPAs, and firms in the real estate and financial sectors. The specific provisions are the result of extensive consultations with these groups.

The UBT is a City income tax on proprietorships and partnerships. Since its inception in 1966, the UBT tax rate has been 4 percent. An enriched UBT tax credit was added in 1987 which eliminated tax liability for nearly 30,000 small businesses. The UBT is expected to generate approximately \$400 million in FY 1993.

The UBT includes the following exemptions which are the focus of this bill. The "additional exemption" allows partnerships to

claim an exemption for distributions to partners who are themselves subject to the UBT or to the city general corporation tax or to the banking corporation tax. The "solely purchasing and selling property for one's own account exemption" provides a full exemption to individuals or entities engaged solely in trading or investing in property or stock option contracts for their own benefit. The "real property exemption" also provides a full exemption for individuals or firms engaged solely in holding, leasing or managing their real property. This bill addresses issues raised by taxpayers with regard to these exemptions and clarifies and simplifies the administration of these exemptions. In addition, the bill changes the method of taxation of investment income under the UBT to bring it closer to the method used in the City general corporation tax.

With respect to the specific provisions, we urge the Legislature to enact this bill for the following reasons.

The issue of whether the additional exemption can be claimed with respect to a corporate partner that is subject to the GCT alternative tax measured by income plus compensation paid to officers and certain shareholders is currently the subject of litigation. One of the important features of the new credit provision is that it will eliminate this controversy for future periods by allowing the credit to be claimed by a corporate partner subject to the alternative tax. Also before the courts at the present time is the issue of how the additional exemption applies in the case of multi-tier partnership structures. Here, too, the new credit provision will resolve this issue for the future in favor of taxpayers by allowing each partnership in a multi-tier partnership structure to claim a credit for the tax paid and credit claimed by the partnership in which it is a direct partner.

The substitution of a credit for the additional exemption will also eliminate compliance problems that exist under the current provision. These problems arise mainly from the fact that, in order to determine the correct amount of the exemption, the partnership must know the amount of allocable net income reported on its partners' City business tax returns. In some cases, this information may not be readily available to the partnership; in other cases, the partnership and the partner may have different taxable years, so that the partnership's return may be due before the partner's tax year has even closed. Replacing the exemption at the partnership level with a credit at the partner level will eliminate these problems because the partner will always know what its share of the partnership's tax is, and the return on which the partner claims the credit will always be due either at the same time as, or subsequent to, the partnership's return.

The amendment to the "solely purchasing and selling property for one's own account exemption" will create a "safe harbor" for investors and provide more detailed guidance regarding the circumstances in which the UBT will apply. In those cases in which investment income as defined in the bill is subject to the UBT, it will be allocated within and without the City under provisions that are much more favorable to taxpayers than the current provisions. The new rules are the same as the GCT's investment income allocation rules, and therefore represent a significant step toward the goal of greater conformity between the two taxes. The extensive body of interpretive material which already exists for the GCT provisions will be drawn on in implementing these new provisions, so UBT taxpayers should have no difficulty in complying with these provisions.

The amendment to the "real property exemption" will eliminate the prospect of loss of the exemption due to the presence of business activity which "taints" the real estate activity. This change is expected to improve the rate of voluntary reporting and payment of tax on other businesses conducted by real estate operators who now fail to file or pay because that will expose their real estate activities to taxation. The amendment will also promote compliance by clarifying the rules for determining when the tax will apply to certain services or facilities offered by a landlord at the real property, which are available both to tenants and to the general public.

The new investment allocation provisions are expected to cost the City about \$8 million in FY94 and \$15 million annually thereafter. Allowing the new credit to be claimed by a corporate partner subject to the GCT alternative tax is expected to produce an annual revenue loss of about \$10 million. As previously mentioned, this issue is currently being litigated. The real estate proposal is expected to be revenue neutral.

AN ACT to amend the administrative code of the city of New York, in relation to revising provisions of the unincorporated business tax imposed by chapter 5 of title 11 thereof relating to the taxation of investment income, the taxation of income from real property, and the additional exemption allowed thereunder in certain cases; and in relation to providing for a credit against such tax and the city general and banking corporation taxes imposed by chapter 6 of such title 11 for unincorporated business taxes paid in certain cases

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Section 11-501 of the administrative code of the city of New York is amended by adding five new subdivisions (f), (g), (h), (i) and (j) to read as follows:

(f) "Unincorporated business entire net income" when used in this chapter shall mean the excess of the unincorporated business gross income of an unincorporated business over its unincorporated business deductions.

(a) "Investment capital" when used in this chapter shall mean investments of the unincorporated business in stocks, bonds and other securities, corporate and governmental (excluding governmental stocks, bonds and other securities the interest or dividends from which are fully exempt from tax under this chapter, other than any such governmental stock, bond or other

security which is sold or otherwise disposed of during the taxable year in a transaction which results in a gain or loss which is included in computing unincorporated business entire net income for the taxable year) not held for sale to customers in the regular course of business, provided, however, that in the discretion of the commissioner of finance, there shall be deducted from investment capital any liabilities of the unincorporated business which are directly or indirectly attributable to Investment capital.

(h) "Investment income" when used in this chapter shall mean income, gains and losses from investment capital, to the extent included in computing unincorporated business entire net income, less, in the discretion of the commissioner of finance, any deductions allowable in computing unincorporated business entire net income which are directly or indirectly attributable to investment capital or investment income, provided, however, that in no case shall investment income exceed unincorporated business entire net income.

(i) "Business capital" when used in this chapter shall mean all assets of the unincorporated business other than investment capital, less liabilities of the unincorporated business not deducted from Investment capital, except that cash on hand and on deposit shall be treated as investment capital or as business capital as the taxpayer may elect.

(j) "Business income" when used in this chapter shall mean unincorporated business entire net income minus investment income.

§2. Subdivision (c) of section 11-502 of the administrative code of the city of New York is amended to read as follows:

(c) Purchase and sale for own account. An individual or other unincorporated entity, except a dealer holding property primarily for sale to customers in the ordinary course of his or her trade or business, shall not be deemed engaged in an unincorporated business solely by reason of (1) the purchase and sale of property or the purchase, sale or writing of stock option contracts, or both, for his or her own account, or (2) any combination of the activities described in clause (1) and any other activity not otherwise subject to the tax imposed by this chapter, but this subdivision shall not apply if the unincorporated entity is taxable as a corporation for federal income tax purposes. Notwithstanding anything to the contrary, the receipt by an individual or other unincorporated entity of twenty-five thousand dollars or less of gross receipts during the taxable year (determined without regard to any deductions) from an unincorporated business wholly or partly carried on within the city by such individual or unincorporated entity shall not cause such individual or other unincorporated entity to be treated as not engaged solely in the activities described in clause (1) or (2) of the preceding sentence.

§3. Section 11-505 of the administrative code of the city of New York is amended to read as follows:

§11-505 Unincorporated business taxable income. The unincorporated business taxable income of an unincorporated business shall be [the excess of] its unincorporated business [gross] entire net income [over its unincorporated business deductions], allocated to the city, less the amount of:

(1) Its deductions under section 11-509 of this chapter not subject to allocation; and

(2) Its unincorporated business [exemptions] exemption under section 11-510 of this chapter.

§4. Subdivision (c) of section 11-506 of the administrative code of the city of New York is amended by adding a new paragraph 3-a to read as follows:

(3-a) Fifty percent of dividends to the extent includible in gross income for federal income tax purposes and not subtracted under paragraph two or three of this subdivision, other than (A) the amounts described in subparagraphs thirteen and fifteen of paragraph (b) of subdivision eight of section 11-602 of this title, and (B) dividends from stock described in paragraphs (b) and (c) of subdivision three of section 11-602 of this title; provided, however, that, there shall be no subtraction pursuant to this paragraph for any portion of a dividend from stock with respect to which a dividend deduction would be disallowed by subsection (c) of section two hundred forty-six of the internal revenue code if the unincorporated business were a corporation. (in applying subparagraphs (A) and (B) of this paragraph, references in subchapter two of chapter six of this title to "acquiring person" or "acquiring corporation" shall be deemed to refer to the unincorporated business.);

§5. Subdivisions 5 and 8 of section 11-507 of the administrative code of the city of New York are amended to read as follows:

(5) No deduction shall be allowed for (A) interest on indebtedness incurred or continued to purchase or carry obligations or securities the [income from] interest on which is exempt from tax under this chapter; (B) expenses paid or incurred for the production or collection of such income or the management, conservation or maintenance of property held for the production of such income; or (C) the amortizable bond premium on any bond the interest income from which is so exempt.

(8) A deduction shall be allowed (to the extent not allowable for federal income tax purposes) for (A) interest on indebtedness incurred or continued to purchase or carry obligations or securities the [income from] interest on which is subject to tax under this chapter but exempt from federal income tax; (B) ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of such income or the management, conservation or maintenance of property held for the production of such income; and (C) the amortizable bond premium for the taxable year on any bond the interest on which is subject to tax under this chapter but exempt from federal income tax.

§6. Subdivision (a) of section 11-508 of the administrative code of the city of New York is amended to read as follows:

(a) General; allocation of business income. If an unincorporated business is carried on both within and without the city, as determined under regulations of the commissioner of finance, there shall be allocated to the city, in the manner provided in subdivision (b), (c) or (d) of this section, a fair and equitable portion of [the excess of] its [unincorporated]

business [gross] income [over its unincorporated business deductions]. If the unincorporated business has no regular place of business outside the city, all of such [excess] business income shall be allocated to the city.

§7. The opening paragraph of subdivision (c) of section 11-508 of the administrative code of the city of New York is amended to read as follows:

Allocation by formula. If subdivision (b) does not apply to the taxpayer, the portion allocable to the city shall be determined by multiplying (A) the [excess of its unincorporated] business [gross] income [over its unincorporated business deductions,] by (B) the average of the following three percentages:

§8. section 11-508 of the administrative code of the city of New York is amended by adding a new subdivision (f) to read as follows:

(f) Allocation of investment income. (1) The investment income of an unincorporated business shall be allocated to the city by multiplying such investment income by an investment allocation percentage to be determined as follows:

(A) multiply the amount of its investment capital invested in each stock, bond or other security (other than governmental securities) during the period covered by its return by the issuer's allocation percentage (determined as provided in paragraph two of this subdivision) of the issuer or obligor thereof;

(B) add together the products so obtained; and

(C) divide the sum so obtained by the total of its investment capital invested during such period in stocks, bonds and other securities;

provided, however, that in case any investment capital is invested in any stock, bond or other security during only a portion of the period covered by the return, only such portion of such capital shall be taken into account; and provided, further, that if a taxpayer's investment allocation percentage is zero, interest received on bank accounts shall be allocated in the manner provided in subdivision (b), (c) or (d) of this section.

(2) (A) In the case of an issuer or obligor subject to tax under subchapter two of chapter six of this title, or subject to tax as a utility corporation under chapter eleven of this title, the issuer's allocation percentage shall be the percentage of the appropriate measure (as defined hereinafter) which is required to be allocated within the city on the report or reports, if any, required of the issuer or obligor under chapter six or eleven of this title for the preceding year. The appropriate measure referred to in the preceding sentence shall be: in the case of an issuer or obligor subject to subchapter two of chapter six of this title, entire capital; and in the case of an issuer or obligor subject to chapter eleven of this title as a utility corporation, gross income.

(B) In the case of an issuer or obligor subject to tax under part four of subchapter three of chapter six of this title, the issuer's allocation percentage shall be determined as follows:

(i) In the case of a banking corporation described in paragraphs one through eight of subdivision (a) of section 11-640 of this title which is organized under the laws of the United States, this state or any other state of the United States, the issuer's allocation percentage shall be its alternative entire net income allocation percentage, as defined in subdivision (c) of section 11-642 of this title, for the preceding year. In the case of such a banking corporation whose alternative entire net income for the preceding year is derived exclusively from business carried on within the city, its issuer's allocation percentage shall be one hundred percent.

(ii) In the case of a banking corporation described in paragraph two of subdivision (a) of section 11-640 of this title which is organized under the laws of a country other than the United States, the issuer's allocation percentage shall be determined by dividing (I) the amount described in clause (i) of subparagraph (A) of paragraph two of subdivision (a) of section 11-642 of this title with respect to such issuer or obligor for the preceding year, by (II) the gross income of such issuer or obligor from all sources within and without the United States, for such preceding year, whether or not included in alternative entire net income for such year.

(iii) In the case of an issuer or obligor described in paragraph nine of subdivision (a) or in paragraph two of subdivision (d) of section 11-640 of this title, the issuer's allocation percentage shall be determined by dividing the portion of the entire capital of the issuer or obligor allocable to the city for the preceding year by the entire capital, wherever located, of the issuer or obligor for the preceding year.

(C) Provided, however, that if a report or reports for the preceding year are not filed, or if filed do not contain information which would permit the determination of such issuer's allocation percentage, then the issuer's allocation percentage to be used shall, at the discretion of the commissioner of finance, be either the issuer's allocation percentage derived from the most recently filed report or reports of the issuer or obligor or (B) a percentage calculated, by the commissioner of finance, reasonably to indicate the degree of economic presence in the city of the issuer or obligor during the preceding year.

(3) For purposes of this subdivision, investment capital shall be determined by taking the average value of the gross assets included therein (less liabilities deductible therefrom pursuant to the provisions of subdivision (g) of section 11-501 of this chapter). The value of investment capital which consists of marketable securities shall be the fair market value thereof and the value of investment capital other than marketable securities shall be the value thereof shown on the books and records of the unincorporated business in accordance with generally accepted accounting principles.

(4) If it shall appear to the commissioner of finance that any investment allocation percentage determined as hereinabove provided does not properly reflect the activity, business or income of the unincorporated business within the city, the commissioner of finance shall be authorized, in his or her discretion, to adjust it by excluding one or more assets in computing such percentage, provided that the income therefrom is also excluded in determining unincorporated business entire net income. The commissioner of finance from time to time shall publish all rulings of general public interest with respect to any application of the provisions of this paragraph.

§9. Paragraphs 1 and 2 of subdivision (b) of section 11-509 of the administrative code of the city of New York are amended to read as follows:

(1) Depreciation with respect to any property such as described in paragraphs three or four of this subdivision, and subject to the conditions provided therein, not exceeding twice the depreciation allowed with respect to the same property for federal income tax purposes. Such deduction shall be allowed only upon condition that no deduction shall be allowed pursuant to section 11-507 of this chapter for depreciation of the same property, and the total of all deductions allowed pursuant to this paragraph in any taxable year or years with respect to any property shall not exceed its cost or other basis and, in the case of an unincorporated business carried on both within and without this city, with respect to property described in paragraph four of this subdivision, such total shall not exceed its cost or other basis multiplied by [a] (A) the percentage of the excess of the taxpayer's unincorporated business gross income over its unincorporated business deductions allocated to this city, or (B) the percentage of the taxpayer's business income allocated to this city, whichever is applicable, which percentage shall be determined under section 11-508 of this chapter for the first year such depreciation is deducted.

(2) Expenditures paid or incurred during the taxable year for the construction, reconstruction, erection or acquisition of any property such as described in paragraph three or four of this subdivision, and subject to the conditions provided therein, which is used or to be used for purposes of research or development in the experimental or laboratory sense. Such purposes shall not be deemed to include the ordinary testing

or inspection of materials or products for quality control, efficiency surveys, management studies, consumer surveys, advertising, promotions or research in connection with literary, historical or similar projects. Such deduction shall be allowed only on condition that, in the case of an unincorporated business carried on both within and without this city, with respect to property described in paragraph four of this subdivision, such deduction does not exceed the expenditures multiplied by [a] (A) the percentage of the excess of the taxpayer's unincorporated business gross income over its unincorporated business deductions allocated to this city, or (B) the percentage of the taxpayer's business income allocated to this city, whichever is applicable, which percentage shall be determined under section 11-508 of this chapter for the first year such depreciation is deducted, and that, for the taxable year and all succeeding taxable years, no deduction shall be allowed pursuant to section 11-507 of this chapter on account of such expenditures or on account of depreciation of the same property, except to the extent that its basis may be attributable to factors other than such expenditures, or in case a deduction is allowable pursuant to this paragraph for only a part of such expenditures, on condition that any deduction allowable for federal income tax purposes on account of such expenditures or on account of depreciation Of the same property shall be proportionately reduced in determining the deductions allowable pursuant to section 11-507 of this chapter for the taxable year and all succeeding taxable years. With respect to property which is used or to be used for research and development only in part, or during only part of its useful life, the deduction allowable pursuant to this paragraph shall be limited to a proportionate part of the expenditures relating thereto. If a deduction shall have been allowed pursuant to this paragraph for all or part of such expenditures with respect to

any property, and such property is used for purposes other than research and development to a greater extent than originally reported, the taxpayer shall report such use in the taxpayer's return for the first taxable year during which it occurs, and the commissioner of finance may recompute the tax for the year or years for which such deduction was allowed, and may assess any additional tax resulting from such recomputation within the time fixed by subdivision (c) of section 11-523 of this chapter.

§10. Subdivision (d) of section 11-502 of the administrative code of the city of New York is amended to read as follows:

(d) Holding, leasing or managing real property. An owner of real property, a lessee or a fiduciary shall not be deemed engaged in an unincorporated business solely by reason of holding, leasing or managing real property. If an owner of real property or lessee or fiduciary (except a dealer holding real property primarily for sale to customers in the ordinary course of his or her trade or business) who is holding, leasing or managing real property is also carrying on an unincorporated business in whole or in part in the city, whether or not such unincorporated business is carried on at or is connected with such real property, such holding, leasing or managing of real property shall not be deemed an unincorporated business if, and only to the extent that, such real property is held, leased or managed for the purpose of producing rental income from such real property or gain upon the sale or other disposition of such real property. For purposes of this subdivision, the conduct by such owner, lessee or fiduciary, at such real property, of a trade, business, profession or occupation, including, but not limited to, a garage, restaurant, laundry or health club, shall be deemed

to be an incident to the holding, leasing or managing of such real property, and shall not be deemed the conduct of an unincorporated business, if such trade, business, profession or occupation is conducted solely for the benefit of tenants at such real property, as an incidental service to such tenants, and is not open or available to the general public.

§11. Subdivision (c) of section 11-506 of the administrative code of the city of New York is amended by adding a new paragraph 8 to read as follows:

(8) Notwithstanding any other provision of this chapter to the contrary, the amount of any income or gain (to the extent includible in gross income for federal income tax purposes) realized by an owner of real property, a lessee or a fiduciary from the holding, leasing or managing of real property if. and to the extent that, such holding, leasing or managing of real property is not deemed an unincorporated business pursuant to the provisions of subdivision (d) of section 11-502 of this chapter.

§12. Section 11-507 of the administrative code of the city of New York is amended by adding a new subdivision 16 to read as follows:

(16) Notwithstanding any other provision of this chanter to the contrary, no deduction shall be allowed to an owner of real property, a lessee or a fiduciary for interest, depreciation or any other expense directly or indirectly attributable to the holding, leasing or managing of real property or to income or gain therefrom if, and to the extent that, such holding, leasing or managing of real property is not deemed an unincorporated

business pursuant to the provisions of subdivision (d) of section 11-502 of this chapter.

§13. Subdivision (e) of section 11-508 of the administrative code of the city of New York is amended to read as follows:

(e) Special rule for real estate. Income and deductions from the rental of real property, and gain and loss from the sale, exchange or other disposition of real property, shall not be subject to allocation under subdivision (b), (c) or (d) of this section, but shall be considered as entirely derived from or connected with the state, other than this state, in which such property is located or, if such property is located in this state, the political subdivision thereof. To the extent that anything in the preceding sentence is inconsistent with any provision of subdivision (d) of section 11-502, subdivision (c) of section 11-506 or subdivision sixteen of section 11-507 of this chapter, the provisions of such subdivisions shall take precedence over the provisions of the preceding sentence.

§14. Section 11-503 of the administrative code of the city of New York is amended by adding a new subdivision (j) to read as follows:

(j) If a partner in an unincorporated business is taxable under this chapter and is required to include in unincorporated business taxable income his, her or its distributive share of income, gain, loss and deductions of, or guaranteed payments from, such unincorporated business, such partner shall be allowed a credit equal to the lesser of the amounts determined in paragraphs one and two of this subdivision:

(1) The amount determined in this paragraph is the product of (A) the sum of (i) the tax imposed by this chapter on the unincorporated business for its taxable year ending within or with the taxable year of the partner and paid by the unincorporated business and (ii) the amount of any credit or credits allowed by this subdivision to the unincorporated business for its taxable year ending within or with the taxable year of the partner, and (B) a fraction, the numerator of which is the net total of the partner's distributive share of income, gain, loss and deductions of, and guaranteed payments from, the unincorporated business for such taxable year, and the denominator of which is the sum, for such taxable year, of the net total distributive shares of income, gain, loss and deductions of, and guaranteed payments to, all partners in the unincorporated business for whom or which such net total (as separately determined for each partner) is greater than zero. Provided, however, if the unincorporated business is a limited liability company and the partner is not a limited liability company, the amount determined in this paragraph shall be the product of the amount calculated in accordance with the preceding sentence and a fraction, the numerator of which is four and the denominator of which is four and thirty-five one hundredths.

(2) The amount determined in this paragraph is the difference between (A) the tax computed pursuant to this chapter on the unincorporated business taxable income of the partner, without allowance of any credits allowed by this section, and (B) the tax so computed, determined as if the partner had no such distributive share or guaranteed payments with respect to the unincorporated business. Provided, however, if the partner is a limited liability company and the unincorporated business is not

a limited liability company, the amount determined in this paragraph shall be the product of the amount calculated in accordance with the preceding sentence and a fraction, the numerator of which is four and the denominator of which is four and thirty-five one hundredths, The amount determined in this paragraph shall not be less than zero.

(3) Notwithstanding paragraphs one and two of this subdivision, the sum of the credits allowed to a partner for a taxable year under this subdivision with respect to all unincorporated businesses in which he, she or it is a partner shall not exceed the tax imposed on the unincorporated business taxable income of such partner under this chapter without allowance of any credits allowed by this section.

(4) The credit allowed under this subdivision shall not be allowed to a partner in an unincorporated business with respect to any tax paid by the unincorporated business under this chapter for any taxable year beginning before January first, nineteen hundred ninety-three.

(5) Notwithstanding anything to the contrary, the credit allowable under this subdivision shall be taken before any other credit allowed by this section is taken.

§15. Section 11-510 of the administrative code of the city of New York is amended to read as follows:

§11-510 Unincorporated business exemptions. In computing unincorporated business taxable income, there shall be allowed (without allocation under section 11-508 of this chapter):

(1) an unincorporated business exemption of five thousand dollars, prorated for taxable years of less than twelve months under regulations of the commissioner of finance;

(2) if a partner in an unincorporated business is taxable under this chapter or under any local law imposed pursuant to section one of chapter seven hundred seventy-two of the laws of nineteen hundred sixty-six, an exemption for the amount of the partner's proportionate interest in the excess of the unincorporated business gross income over the deductions allowed under sections 11-507 and 11-509 of this chapter, but this exemption shall be limited to the amount which is included in the partner's unincorporated business taxable income allocable to the city, or included in a corporate partner's net income allocable to the city provided, however, no such exemption shall be allowed to an unincorporated business for any taxable year of the unincorporated business beginning after December thirty-first, nineteen hundred ninety-two.

§16. Section 11-604 of the administrative code of the city of New York is amended by adding a new subdivision 18 to read as follows:

(18) If a corporation is a partner in an unincorporated business taxable under chapter five of this title, and if, before the application of this subdivision or any other credit allowed by this section, the corporation is liable for the tax on entire net income under clause one of subparagraph (a) of paragraph E of subdivision one of this section, or the tax on entire net income plus certain salaries and other compensation under clause three of subparagraph (a) of paragraph E of subdivision one of this

Section, such corporation shall be allowed a credit against such tax computed as follows:

(a) The credit allowed by this subdivision shall be the lesser of the amounts determined in subparagraphs one and two of this paragraph:

(1) The amount determined in this subparagraph is the product of (A) the sum of (i) the tax imposed by chapter five of this title on the unincorporated business for its taxable year ending within or with the taxable year of the corporation and paid by the unincorporated business and (ii) the amount of any credit or credits allowed to the unincorporated business by subdivision (j) of section 11-503 of this title for its taxable year ending within or with the taxable year of the corporation, and (B) a fraction, the numerator of which is the net total of the corporation's distributive share of income, gain, loss and deductions of, and guaranteed payments from, the unincorporated business for such taxable year, and the denominator of which is the sum, for such taxable year, of the net total distributive shares of income, gain, loss and deductions of, and guaranteed payments to, all partners in the unincorporated business for whom or which such net total (as separately determined for each partner) is greater than zero. Provided, however, if the corporation is liable for the tax on entire net income plus certain salaries and other compensation under clause one of subparagraph (a) of paragraph E of subdivision one of this section, the amount determined in this subparagraph shall be the product of the amount calculated in accordance with the preceding sentence and a fraction, the numerator of which is two and six hundred fifty-five one thousandths and the denominator of which is four or, if the unincorporated business is a limited liability company, four and thirty-five one hundredths.

(2) (A) If, before the application of this subdivision or any other credit allowed by this section, such corporation is liable for the tax on entire net Income under clause one of subparagraph (a) of paragraph E of subdivision one of this section, the amount determined in this subparagraph is the product of (i) the excess of the tax computed under such clause, without allowance of any credits allowed by this section, over the tax so computed, determined as if the corporation had no such distributive share or guaranteed payments with respect to the unincorporated business, and (ii) a fraction, the numerator of which is four, or, if the unincorporated business is a limited liability company, four and thirty-five one hundredths, and the denominator of which is eight and eighty-five one hundredths.

(B) If, before the application of this subdivision or any other credit allowed by this section, such corporation is liable for the tax on entire net income plus certain salaries and other compensation under clause three of subparagraph (a) of paragraph E of subdivision one of this section, the amount determined in this subparagraph is the excess of the tax computed under such clause, without allowance of any credits allowed by this section, over the tax so computed, determined as if the corporation had no such distributive share or guaranteed payments with respect to the unincorporated business.

(C) The amount determined in this subparagraph shall not be less than zero.

(3) Notwithstanding subparagraphs one and two of this paragraph, the sum of the credits allowed to a corporation for a taxable year under this subdivision with respect to all unincorporated businesses in which the corporation is a partner

shall not exceed: (A) in the case of a corporation that, before the application of this subdivision or any other credit allowed by this section, is liable for the tax on entire net income under clause one of subparagraph (a) of paragraph E of subdivision one of this section, the tax so computed, without allowance of any credits allowed by this section, multiplied by the fraction specified in clause (A) of subparagraph two of this paragraph, and (B) in the case of a corporation that, before the application of this subdivision or any other credit allowed by this section, is liable for the tax on entire net income plus certain salaries and other compensation under clause three of subparagraph (a) of paragraph E of subdivision one of this section, the tax so computed without allowance of any credits allowed by this section.

(b) For corporations that file a report on a combined basis pursuant to subdivision four of section 11-605 of this chapter, the credit allowed by this subdivision shall be computed as if the combined group were the partner in each unincorporated business from which any of the members of such group had a distributive share or guaranteed payments, provided, however, if more than one member of the combined group is a partner in the same unincorporated business, for purposes of the calculation required in subparagraph one of paragraph (a) of this subdivision, the numerator of the fraction described in clause (B) of such subparagraph one shall be the sum of the net total distributive shares of income, gain, loss and deductions of, and guaranteed payments from, the unincorporated business of all of the partners of the unincorporated business within the combined group for which such net total (as separately determined for each partner) is greater than zero, and the denominator of such fraction shall be the sum of the net total distributive shares of

income, gain, loss and deductions of, and guaranteed payments from, the unincorporated business of all partners in the unincorporated business for whom or which such net total (as separately determined for each partner) is greater than zero.

(c) The credit allowed by this subdivision shall not be allowed to a partner in an unincorporated business with respect to any tax paid by the unincorporated business under chapter five of this title for any taxable year beginning before January first, nineteen hundred ninety-three.

(d) Notwithstanding any other provision of this subchapter, the credit allowable under this subdivision shall be taken prior to the taking of any other credit allowed by this section. Notwithstanding any other provision of this subchapter, the application of this subdivision shall not change the basis on which the taxpayer's tax is computed under paragraph E of subdivision one of this section.

§17. The administrative code of the city of New York is amended by adding a new section 11-643.8 to read as follows:

§ 11-643.8 Credit relating to certain distributions from partnerships. If a banking corporation is a partner in an unincorporated business taxable under chapter five of this title, and if, before the application of this section or any other credit allowed by this part, the banking corporation is liable for the basic tax under subdivision (a) of section 11-643.5 of this part, or the alternative minimum tax on alternative entire net income under paragraph three of subdivision (b) of section 11-643.5 of this part, such banking corporation shall be allowed a credit computed as follows:

(a) The credit allowed by this section shall be the lesser of the amounts determined in paragraphs one and two of this subdivision:

(1) The amount determined in this paragraph is the product of (A) the sum of (i) the tax imposed by chapter five of this title on the unincorporated business for its taxable year ending within or with the taxable year of the banking corporation and paid by the unincorporated business and (ii) the amount of any credit or credits allowed to the unincorporated business by subdivision (j) of section 11-503 of this title for its taxable year ending within or with the taxable year of the banking corporation, and (B) a fraction, the numerator of which is the net total of the banking corporation's distributive share of income, gain, loss and deductions of, and guaranteed payments from, the unincorporated business for such taxable year and the denominator of which is the sum, for such taxable year, of the net total distributive shares of income, gain, loss and deductions of, and guaranteed payments to, all partners of the unincorporated business for whom or which such net total (as separately determined for each partner) is greater than zero. Provided, however, if the banking corporation is liable for the alternative minimum tax on alternative entire net income under paragraph three of subdivision (b) of section 11-643.5 of this part, the amount determined in this paragraph shall be the product of the amount calculated in accordance with the preceding sentence and a fraction, the numerator of which is three, and the denominator of which is four or, if the unincorporated business is a limited liability company, four and thirty-five one hundredths.

(2) (A) If, before the application of this section or any other credit allowed by this part, such banking corporation

is liable for the basic tax under subdivision (a) of section 11-643.5 of this part, the amount determined in this paragraph is the product of (i) the excess of the tax computed pursuant to such subdivision, without allowance of any credits allowed by this part, over the tax so computed, determined as if the banking corporation had no such distributive share or guaranteed payments with respect to the unincorporated business, and (ii) a fraction, the numerator of which is four, or, if the unincorporated business is a limited liability company, four and thirty-five one hundredths, and the denominator of which is nine.

(B) If, before the application of this section or any other credit allowed by this part, such banking corporation is liable for the alternative minimum tax on alternative entire net income under paragraph three of subdivision (b) of section 11-643.5 of this part, the amount determined in this paragraph is the excess of the tax computed under such subdivision, without allowance of any credits allowed by this part, over the tax so computed, determined as if the banking corporation had no such distributive share or guaranteed payments with respect to the unincorporated business.

(c) The amount determined in this paragraph shall not be less than zero.

(3) Notwithstanding paragraphs one and two of this subdivision, the sum of the credits allowed to a banking corporation for a taxable year under this section with respect to all unincorporated businesses in which the banking corporation is a partner shall not exceed: (A) in the case of a banking corporation that, before the application of this section or any other credit allowed by this part, is liable for the basic tax

computed under subdivision (a) of section 11-643.5 of this part, the tax so computed, without allowance of any credits allowed by this part, multiplied by the fraction specified in subparagraph (A) of paragraph two of this subdivision, and (B) in the case of a banking corporation that, before the application of this section or any other credit allowed by this part. is liable for the alternative minimum tax on alternative entire net income under paragraph three of subdivision (b) of section 11-643.5 of this part, the tax so computed, without allowance of any credits allowed by this part.

(b) For banking corporations that file a report on a combined basis pursuant to subdivision (f) of section 11-646 of this part, the credit allowed by this section shall be computed as if the combined group were the partner in each unincorporated business from which any of the members of such group had a distributive share or guaranteed payments, provided, however, if more than one member of the combined group is a partner in the same unincorporated business, for purposes of the calculation required in paragraph one of subdivision (a) of this section, the numerator of the fraction described in subparagraph (B) of such paragraph one shall be the sum of the net total distributive shares of income, gain, loss and deductions of, and guaranteed payments from, the unincorporated business of all of the partners of the unincorporated business within the combined group for which such net total (as separately determined for each partner) is greater than zero, and the denominator of such fraction shall be the sum of the net total distributive shares of Income, gain, loss and deductions of, and guaranteed payments from, the unincorporated business of all partners in the unincorporated business for whom or which such net total (as separately determined for each partner) is greater than zero.

(c) The credit allowed by this section shall not be allowed to a partner in an unincorporated business with respect to any tax paid by the unincorporated business under chapter five of this title for any taxable year beginning before January first, nineteen hundred ninety-three.

(d) Notwithstanding any other provisions of this part, the credit allowable under this section shall be deducted prior to the deduction of any other credit allowed by this part. Notwithstanding any other provisions of this part, the application of this section shall not change the basis on which the taxpayer's tax is computed under subdivision (a) or (b) of section 11-643.5 of this part.

§18. This act shall take effect immediately, provided, however, that sections 1 through 4 and 6 through 9 of this act shall apply to taxable years beginning after 1993 and sections 10 through 13 of this act shall apply to taxable years beginning after 1992.