

Tax Section

Memorandum re Recommended Technical Corrections to 2014 New York State Corporate Tax Reform Legislation.

Tax #3

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Introduction

Governor Cuomo's 2014 budget legislation, S6359-D/A8559-D (the "Act"), contained comprehensive provisions intended to simplify and rationalize New York's taxation of corporate income. The Act combined the previously separate taxes on banks and general business corporations and made major changes respecting taxable nexus, the apportionment of income and capital, combined reporting rules, and the treatment of net operating losses, among other provisions.

The corporate tax reform provisions represented the culmination of years of hard work by the Department of Taxation and Finance and private sector groups, including the Tax Section. The Act was the product of a collaborative effort in which the Department, the Tax Section, and other business and professional groups worked together to simplify and rationalize New York State's income tax system. The Tax Section submitted a report on an earlier draft of the law (the

¹ The principal drafter of this report was Peter L. Faber. Helpful comments were received from Peter J. Connors, Stephen B. Land, Alan I. Morris, Arthur R. Rosen, Michael L. Schler, Irwin M. Slomka, and Jack Trachtenberg. This report reflects solely the views of the Tax Section of the New York State Bar Association and not those of its Executive Committee or its House of Delegates.

“Report”).² We commend the Department for taking the lead in this effort and seeing it through to completion.

Any legislation of this length and complexity is bound to have some provisions that are unclear or that produce unintended results. This report contains recommendations for technical changes to the statutory language of the corporate tax reform provisions that would address some of these issues. The report does not discuss provisions of the Act other than the corporate tax reform provisions. Moreover, we focus only on changes to the statute; some issues that will arise under the Act would be better addressed by regulations or other forms of guidance.

Investment Capital Definition

Investment capital is defined in Section 208.5(a) as including investments in stocks that are held for six months or more and that “are not held for sale to customers in the regular course of business. . . .” The language is unclear as to when a stock must be held for sale to customers to be disqualified from being investment capital. If a stock is initially held for sale to customers but later becomes an investment asset that is no longer held for sale to customers, it should become investment capital at some point. On the other hand, there is a potential for abuse. A taxpayer should not be able to convert stock held for sale to customers into investment capital by removing it from inventory and placing it in an investment account five days before selling it. Conversely, a taxpayer anticipating a loss should not be able to convert a long-term investment into a business asset by offering it for sale to customers for five days before selling it. One possibility would be to provide that stock must be held as an investment for at least six months to be investment capital and that changes within thirty days of the time with respect to which its classification as “investment capital” is relevant shall be disregarded.

Section 208.5 (f) provides that in determining whether a security has been held for more than six consecutive months “the commissioner shall take into account offsetting positions the

² New York State Bar Association Tax Section, “Tax Section Comments Regarding Corporate Income Tax Reform,” March 13, 2014.

taxpayer takes in such or similar securities.” The statute is unclear as to what constitutes an “offsetting position” and what is a “similar” security. We believe that stock should be investment capital even though the taxpayer has hedged its position in the stock, but, if this view is not accepted, the provision should be limited to positions that are taken to hedge the taxpayer’s exposure with respect to the stock in question. One possibility would be to delete the references to “offsetting positions” and “similar securities” and, instead, refer to the extent to which the taxpayer’s position in the stock is hedged within the meaning of clause (ii) of Section 208.6(a).

Section 208.5 (d) provides that if a stock that is held at the end of a year is disposed of in the following year before it has been held for six months by a taxpayer the taxpayer’s business income in the second year should be increased by the income and gains attributable to that stock that had been included in investment income, less interest deductions attributable to that stock as provided in Section 208.6. Since investment income is reduced not only by interest deductions but also by hedging losses, as defined in Section 208.6(a), the add-back to business income should also be reduced by hedging losses as described in section 208.6(a)(ii).

Investment Deduction Election

Section 208.6(b) provides that, instead of subtracting from investment income the interest deductions that are attributable to investment income, the taxpayer may elect to reduce its total investment income by 40%. The provision was intended to provide a mechanism to avoid disputes over the attribution of expenses between investment and business income. The law does not indicate when the election should be made and whether it is revocable. Absent any statement to the contrary, it would be possible for the election to be made or revoked at any time, subject only to applicable statutes of limitations. We believe that this flexibility would be consistent with the provision’s purpose. It is possible that later adjustments, through carrybacks or audit adjustments to entire net income, might change the desirability of making the election and a taxpayer should be allowed to make or revoke the election under these circumstances. While in theory one could provide that the election is revocable only under specified circumstances, it

would be hard to anticipate all the circumstances under which revocation might be desirable and there would seem to be no harm in allowing it to be revocable at any time within the applicable statute of limitations. The Department presumably has the power to address these issues in regulations.

Apportionment

Section 210-A.2(c) provides that receipts from tangible personal property and electricity “that are traded as commodities as described in section 475 of the internal revenue code” are apportioned in a certain manner. Section 475 does not “describe” the trading of commodities and this reference is unclear. We think that the word “traded” may have been inserted by mistake and that the word “treated” may have been intended, in which case the statute should be amended to so provide. If the intention is to apply this provision only to traders in commodities who elect to mark their commodities to market under section 475(f) of the Code, the statute should so provide.

Section 210-B.3(a) provides that receipts from the rental of tangible personal property located within the state are included in the numerator of the apportionment fraction. The application of this provision to movable property, such as trucks, is unclear. We do not recommend that the statute be amended to provide detailed rules, as it does for many other items. This is a matter that should be left to regulations, because it would be hard to craft a statute to cover all the situations that might occur.

Combined Reporting Rules

The Act does not address the consequences or transitional effects of corporations leaving existing combined report groups or joining existing or new combined report groups, although presumably some of these transactions will be covered by the reference to deferring income within the meaning of US Treasury regulations adopted under section 1502 of the Internal Revenue Code. Many changes in composition of the combined report groups will occur as a result of the merging of Articles 32 and 9-A. In addition to corporations moving from Article 32 to Article 9-A because of the combination of the two articles, corporations may be joining

existing combined report groups for the first time because of the reduction of the stock ownership requirement from 80% under prior law to 50% under the new law and the inclusion of additional types of corporations in a combined report group (e.g., certain alien corporations and combinable captive insurance companies). The Report recommended that the statute should provide that gain or loss will not be triggered as a result of changes in the composition of a New York combined report group as a result of the legislation in the first taxable year for which the legislation is effective. A provision to this effect was included in the Senate version of the Act but it was deleted from the final version. We recommend that the language from the Senate bill be included as part of technical corrections legislation.

Investment Tax Credit

Early drafts of the Act would have repealed the investment tax credit for regulated brokers or dealers, registered investment advisors, national securities exchanges, and boards of trade. The credit was restored for these entities in the final version of the Act, but in doing so certain provisions that had been part of the statute were omitted. These included: (1) the availability of the credit if the property is not used by the taxpayer but, rather, is used by an affiliated regulated broker or dealer, registered investment advisor, national securities exchange, or board of trade, and (2) language that provided that different uses by the taxpayer should be aggregated in determining whether property was principally used in qualifying uses. Although the new law provides that property that is leased to an affiliated entity could qualify for the credit, this would not cover many situations, such as those in which the property was contributed to the capital of a related entity or distributed to a related entity as a dividend or other distribution. We understand that the Department has acknowledged that the deletion of these provisions was inadvertent. The Tax Section recommends that the language of prior law be restored to section 210-B.1(b).

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