SUBSTANCE OF THE PROPOSED RULE

DEPARTMENT OF TAXATION AND FINANCE

The proposed rule implements the sweeping reform of New York State's corporate tax framework effected by Part A of Chapter 59 of the Laws of 2014, together with related, primarily technical and conforming amendments enacted by Part T of Chapter 59 of the Laws of 2015 and Part P of Chapter 60 of the Laws of 2016 (hereinafter referred to collectively as "Tax Reform"). The proposed rule provides detailed guidance relating to Tax Reform, updating the regulations to conform with the new law. The proposed rule also would interpret and integrate other related provisions of the Tax Law regarding business models that have developed since these regulations were last comprehensively updated, such as the emergence of limited liability companies. The resulting rule provides regulated parties with detailed direction regarding the computation of tax under Tax Law article 9-A, as revised by Tax Reform.

The existing Business Corporation Franchise Tax regulations provide extensive guidance on the computation of the Tax Law article 9-A franchise tax on general business corporations. Following the enactment of Tax Reform, the department undertook a rigorous review and update of these provisions. Given the magnitude of changes required, this rule repeals existing 20 NYCRR Subchapter A, Parts 1 through 9, the Business Corporation Franchise Tax, and adds new Parts 1 through 9 to replace them.

The rule also repeals 20 NYCRR Subchapter B, the Franchise Tax on Banking Corporations Regulations, and makes necessary changes to 20 NYCRR Subchapter C, the Franchise Taxes on Insurance Corporations.

The 2014 Tax Reform legislation represents the most extensive restructuring of New York State's corporate tax framework since the 1940s. In particular, the new Tax Law article 9-A structure modernized and simplified the Tax Law, enhanced certainty and clarity, and addressed the most common areas of dispute between taxpayers and the department. The amendments to Tax Law article 9-A established an economic nexus standard (deriving receipts from activity in this state), changed the apportionment scheme from one based generally on the location where services were performed to a market-based approach, changed the rules for mandatory and permissive combined reporting, eliminated the separate taxation of subsidiary capital, established new definitions of investment capital and income, and changed how investment capital and income are taxed.

Part 1 of the new Business Corporation Franchise Tax regulations pertains generally to the imposition of tax. Subpart 1-1 provides definitions of terms used throughout the regulations. Subpart 1-2 sets forth the rules for nexus to be used in determining whether a corporation is subject to tax. While largely modeled after the existing nexus regulations, the more notable changes include rules for the new economic nexus standard, as well as guidance for corporations invested in partnerships and limited liability companies and corporations seeking protection under Public Law 86-272.

Part 2 addresses accounting periods and methods and is largely unchanged from its predecessor regulations.

Part 3 provides guidelines for the computation of tax on the business income base, capital base and the fixed dollar minimum tax. This Part is substantially revised from the existing regulations due to statutory changes to the various types of income, capital, and losses.

Subpart 3-1 generally defines these tax bases and provides rules for the computation of tax measured by each. Subpart 3-2 delineates the commissioner’s authority to correct distortions of income or capital in specified circumstances, provides rules for adjusting the tax base to the period covered by the report where the entire net income (ENI) to be reported under article 9-A is for a period that is less than 12 months, and describes how the fair market value and average value of assets is computed.

Subpart 3-3 defines ENI and details rules relating to the taxable year in which income or deductions are included in ENI, the new subtraction modifications for community banks and thrifts, and the royalty modification.

Subpart 3-4 defines investment capital, investment income and other exempt income, and addresses the attribution of interest expenses to various types of income and capital. Subpart 3-5 defines business capital and capital base, as well as business income and business income base. Subpart 3-6 provides illustrative examples of income and capital.

Subparts 3-7 through 3-9 address the rules for the various types of losses. In addition, detailed examples are included that illustrate the rules contained in the new regulations.

Subpart 3-7 concerns the treatment of capital losses and the rules for the application of such losses.

The current Subpart 3-8 concerns the treatment of net operating losses (NOLs) generated for taxable years prior to 2015. While that Subpart is repealed in this proposed rule, NOLs generated for taxable years prior to 2015 would remain subject to Part 3-8 as it existed prior to its repeal by the proposed rule. The new Subpart 3-8 provides detailed guidance for computing the prior net operating loss conversion (PNOLC) subtraction that converts pre-reform NOLs into a new subtraction in the computation of the business income base to be used in post-reform years. This new subtraction was necessitated by the significant changes to the rules for NOLs in post-reform years.

Subpart 3-9 delineates the rules for net operating loss deductions (NOLD) for taxable years beginning on or after January 1, 2015, as Tax Reform significantly altered the rules for computing and deducting a corporation's New York State NOL prospectively. Post reform, NOLs are computed on an apportioned basis and are no longer limited to the allowed federal NOL amount.

Part 4 provides guidance for the rules for computing a business apportionment factor (BAF) pursuant to Tax Law section 210-A, that are used to apportion business income and capital to New York. Prior to reform, the Tax Law included four general categories of receipts for apportionment purposes. Post-reform, there are apportionment rules for over 50 categories of items to be included in the BAF. Many of these rules are based on the location of the taxpayer's customer. This Part includes regulation sections only for those receipts categories where additional guidance is needed. As such, there is not a section for each receipt category contained in section 210-A.

Subpart 4-1 sets forth definitions and general rules for computing the BAF. In addition, it addresses lump sum payments, installment sales, apportionment on combined reports, discretionary adjustments, and rules for the impact of Federal changes on the BAF. Specific sourcing rules are contained in Subparts 4-2 through 4-4. Subpart 4-2 covers a majority of the receipt categories contained in Tax Law section 210-A. Subpart 4-3 provides detailed guidance on the hierarchy of methods used to source receipts from digital products and services. Subpart 4-4 provides similar detailed guidance on the separate hierarchy of methods used to source receipts from other services and other business receipts. All of these Subparts contain illustrative examples within the various sections.

Part 5 addresses credits against tax, in particular the investment tax credit (Subpart 5-1), employment incentive credit (Subpart 5-2), and security training tax credit (Subpart 5-3). The rule incorporates statutory changes since Tax Reform and otherwise makes only minimal changes to the pre-reform credit regulations by eliminating expired credits and provisions that essentially restate the statute and retaining only those regulations that contain information not in the statute or have ongoing application. This Part does not create any new regulations to address credits not previously addressed. However, it is possible the Department may propose regulations in the future to address these and other credits.

Part 6 concerns reporting requirements. Subpart 6-1 sets forth general reporting requirements, identifying those corporations required to file reports and providing guidance for filing reports under specific circumstances. Subpart 6-2 delineates the conditions under which taxpayers are required or may elect to file combined reports. Subpart 6-3 concerns the form of reports filed both on an individual and a combined basis. Subpart 6-4 addresses the time, including extensions of time, and place for filing reports. Substantial changes to this Part were made in Subpart 6-2 dealing with combined reports. Tax Reform altered the rules for combined reporting by moving to a system that requires combination when a more than 50 percent ownership test is met and the corporations are engaged in a unitary business. In addition, taxpayers may elect combined reporting if the requisite ownership test is met, whether or not the corporations are engaged in a unitary business. Subpart 6-2 implements these changes, defining terms, providing explicit guidance, and presenting illustrative examples of the application of the new combined reporting rules in specific circumstances.

Part 7 relates to payment of tax, declaration and payment of estimated tax and collection. This Part generally is the same as the predecessor provisions, with changes generally limited to technical and conforming changes and the elimination of regulations that merely reiterated the applicable statutes.

Part 8 is dedicated to the computation of the Metropolitan Transportation Business Tax Surcharge. The surcharge is based on New York State franchise tax before credits that is apportioned to the Metropolitan Commuter Transportation District (MCTD), using a three-factor formula based on property, payroll, and receipts. The rules contained in this Part for the property and payroll factor generally are based on existing rules that were applicable to the obsolete article 9-A property and payroll factors, whereas the receipts factor generally uses the principles contained in Part 4 to apportion receipts to the MCTD. In addition, this Part contains the Surcharge rate for tax years beginning on or after January 1, 2015, and before January 1, 2024.

Part 9 provides definitions of terms and rules pertaining to the following special entities: qualified New York manufacturers (Subpart 9-1), corporate partners (Subpart 9-2), New York S corporations (Subpart 9-3), real estate investment trusts and regulated investment companies (Subpart 9-4), and domestic international sales corporations (Subpart 9-5).

Tax Reform also merged the bank tax imposed under Tax Law article 32 into the corporate franchise tax imposed under article 9-A. Federal changes relating to what banks and bank holding companies were allowed to do blurred the distinctions between corporations taxed under article 32 and those taxed under article 9-A and made the different taxing schemes for substantially similar corporations increasingly untenable. The repeal of the bank tax crucially eliminated the differing schemes of taxation of taxpayers involved in essentially the same activities, thereby removing the opportunity to exploit differences in the rules of the two articles of the Tax Law. The proposed rule repeals the now obsolete 20 NYCRR Subchapter B, Parts 16-23, Franchise Tax on Banking Corporations regulations, consistent with Tax Reform.

The proposed rule also repeals Subchapter C, Parts 32 and 33 of the Franchise Taxes on Insurance Corporations regulations and adds a new Part 32. The repeal of existing Part 32 eliminates obsolete tax credits. New Part 32 updates the combined reporting requirements for insurance corporations, previously set forth in Part 33. The guidance provided in the now repealed Part 33 was minimal and directed insurance companies to use the pre-reform combination rules contained in Subpart 6-2, which was applicable to article 9-A corporations. Because the Tax Reform changes to the combined reporting rules in article 9-A were not incorporated into article 33, insurance corporations still rely on the old article 9-A rules. Therefore, new Part 32 specifically incorporates the pre-reform combination rules that are in the current Subpart 6-2 and makes them applicable specifically to insurance corporations.