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Highlights of the New York State 2007/2008 Budget Act

By Mark H. Levin

On April 9, 2007, Governor Spitzer signed the New York State 2007/2008 Budget Act. One of the shortest in recent history, the Act contains some major changes to the tax law.

Single Sales Factor Apportionment

In the past several years, several states have adopted a single sales factor for corporate tax purposes. The enactment of a single sales factor in the 2005/2006 Budget Act was intended to encourage out-of-state corporations to open offices and create employment in New York State. The use of a single sales factor reduces the tax burden of out-of-state corporations because neither assets nor payroll are considered in apportioning entire net income.

The 2005/2006 Budget Act provided for the conversion from a four-factor apportionment formula to a single sales factor apportionment formula, phased in over a three-year period, with the full implementation for taxable years beginning on or after January 1, 2008. The 2007/2008 Budget Act accelerates the implementation of single factor apportionment so that it is fully effective for taxable years beginning on or after January 1, 2007.

Business Tax Rate Reduction

In another step designed to entice corporations to do business in New York, the Budget Act reduced the tax rate imposed on net income from 7.5% to 7.1% for corporate franchise, bank, and life insurance taxpayers.

In addition, the tax rate imposed on manufacturers (and emerging technology companies) was further reduced to 6.5% (0.35% lower than the top personal income tax rate). The alternative minimum tax (AMT) rate was lowered from 2.5% to 1.5%. The above rate reductions are effective for taxable years beginning on or after January 1, 2007.

Corporate Combined Reporting

Corporations with substantial intercorporate transactions will be required to file combined tax returns under the New York State corporate franchise and insurance tax. New York continues to be a "separate filing" state, imposing combined reporting only when its special combined reporting provisions are applicable.

In determining whether substantial intercorporate transactions exist, the Commissioner of the Department of Taxation and Finance evaluates all activities and transactions of a taxpayer and its related corporations. Activities and transactions that will be considered include, but are not limited to, the following:

- Manufacturing, acquiring goods or property, or performing services for related corporations;
- Selling goods acquired from related corporations;
- Financing sales of related corporations;
- Performing related customer services using common-facilities employees for related corporations;

- Incurring expenses that benefit, directly or indirectly, one or more related corporations; and
- Transferring assets, including accounts receivable, patents, or trademarks, from one or more related corporations.

This provision is effective for taxable years beginning on or after January 1, 2007. The single factor formula does not apply to the metropolitan commuter transportation district surcharge, which will continue to use the three-factor formula.

Personal Service Corporations or S Corporations

The 2007/2008 Budget Act includes a provision for tax abuse involving personal

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service corporations or S corporations. It permits the Commissioner of the Department of Taxation and Finance to completely or partially disregard a personal service corporation formed to receive a partner's distribution from a New York State partnership if such a corporation was formed to avoid New York personal income tax.

Under this provision, the commissioner may allocate all income, deductions, credits, exclusions, and other allowances between such a personal service or S corporation (even if the corporation is taxed under Tax Law Article 9-A or is not subject to tax in New York State) and its employee-owners if such allocation is necessary to prevent avoidance or evasion of New York State personal income tax, or in order to clearly reflect the source and amount of the income of the personal service corporation or S corporation or any of its employee-owners.

These provisions are effective for taxable years beginning on or after January 1, 2007

Highway Use Tax

To comply with federal law, a highway use tax certificate of registration is replacing the highway use tax permit. The new highway use tax certificate of registration takes effect on July 1, 2007, subject to transition provisions for existing registrations.

Captive REITs and RICs

Under the Budget Act, the 60% dividend exclusion for dividends received by captive real estate investment trusts (REIT) and regulated investment companies (RIC) will be eliminated over a five-year period for banks with assets in excess of $8 billion.

Additionally, any corporate franchise Article 9-A taxpayer that has a captive REIT or RIC subsidiary will be required to include such REITs and RICs on a combined franchise tax return. These provisions are effective for taxable years beginning on or after January 1, 2007.

Provisions for Banks

The Budget Act extended for two years (through 2010) provisions related to the 1985 Bank Tax Reform Act and the transitional provisions under the bank tax related to the federal Gramm-Leach-Bliley Act of 1999.

Bank investment subsidiaries that have elected to be subject to the general business franchise tax under Article 9-A will be deemed to have revoked the election as of the first day of the taxable year in which any of the following conditions apply:

- The corporation ceases to be an Article 9-A taxpayer;
- The corporation becomes subject to the fixed-dollar minimum tax under Article 9-A;
- The corporation has no wages or receipts allocable to New York State or is otherwise inactive (this provision will not apply to a corporation actively engaged in a trade or business, or when substantially all of the assets of a corporation are stock and securities of corporations directly or indirectly controlled by it and engaged in the active conduct of a trade or business);
- 65% or more of the voting stock of the corporation becomes owned or controlled directly or indirectly by a corporation that acquired the stock in a transaction (or series of related transactions) that qualifies as a purchase within the meaning of IRC section 338(H)(3) [unless the acquired corporation and the acquiring corporation were, immediately prior to the purchase, members of the same affiliated group under IRC section 1504 without regard to the exclusions under IRC section 1504(B)]; or
- The corporation, in a transaction or series of related transactions, acquires assets, whether by contribution, purchase, or other means, having an average value [determined under New York Tax Law section 210(2)], or, if greater, a total tax basis in excess of 40% of the average value, or, if greater, the total tax basis of all the assets of the corporation immediately prior to such an acquisition; and as a result of such an acquisition, the corporation is principally engaged in a business that is different from the business immediately prior to such an acquisition, provided that such different business is described in Tax Law section 1452(a)(I), (II), or (III) (related to the business of banking).

Corporations that meet one of the above conditions will then be subject to the bank tax. This provision is effective for taxable years beginning on or after January 1, 2007. ❑

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