

# SLT | NY's New Investment Capital and Income Rules

Corey Rosenthal, JD, and Arvinder Kaur, CPA

New York State's recent corporate tax reform resulted in many changes to its statutes and regulations, including some significant changes to the investment capital and income rules. Under the new rules, investment income is exempt from tax, but the law significantly narrows the definition of investment capital and investment income. In addition, New York City reforms substantially conform to the state tax law changes for investment capital and income for C corporations.

Pursuant to the new rules, the definition of investment capital has been narrowed to investment in stock. Investment income is income from investment capital reduced by an expense attribution of either 1) total direct or indirect interest expenses attributable to investment income or 2) 40% of total investment income. This expense election cannot be overridden by the state and can be made on an amended return.

The New York State Department of Taxation and Finance (DTF) also issued TSB-M-15(4)C, (5)I on July 7, 2015, which provides information on the classification of investment capital and income as it relates to the five criteria that must be met in order for an investment in stock to qualify as investment capital. The five criteria are as follows:

- The stock must satisfy the definition of a capital asset under Internal Revenue Code (IRC) section 1221 at all times the taxpayer owned such stock during the taxable year;
- The stock must be held for more than one year;
- Any disposition of the stock must be treated by the taxpayer as generating a long-term capital gain or loss under the IRC;
- If a stock is acquired on or after January 1, 2015, the stock must never have been held for sale to customers in the regular course of business at any time after the close of the day on which it was acquired; and
- Before the close of the day the stock is purchased, the stock must be clearly identified in the taxpayer's books and records as stock held for investment in the same manner as under IRC section 1236(a)(1) for the stock of a dealer in securities.

The fifth criterion has raised important questions and required further clarification; DTF has therefore provided guidance on determining the appropriate way to identify stock as investment capital for different types of taxpayers.

## Identification by Dealers

For corporations that are dealers and subject to IRC section 1236, any stock acquired before or after October 1, 2015, must be clearly identified in the corporation's records as stock held for investment under section 1236(a)(1). As long as a federal identification under section 1236 is made, New York will not require dealers to make a separate identification. A section 475 identification for stock as held for investment is not sufficient.

## Identification by Nondealers

Nondealer corporations that are subject to IRC section 1236 were required to clearly identify any stock acquired prior to October 1, 2015, in their records before October 1, 2015, in order to satisfy the investment capital identification requirement. For stock acquired after October 1, 2015, the identification requirements are as follows:

- The stock must be recorded in an account maintained for investment capital purposes only, separate from any other account with stock held for sale to customers. The account can be maintained in the corporation's books and records or in a separate depository account maintained by a clearing company as nominee for the corporation.
- The investment capital account must disclose the name of the issuer of the stock, the Committee for Uniform Securities Identification Procedures (CUSIP) number of the stock [or

CUSIP International Numbering System (CINS) for international securities], the date of purchase, the number of shares purchased, and the purchase price. If stock is sold, the account must disclose the date of sale, number of shares sold, and sale price. The account must readily identify the length of time the stock is owned by the corporation.

If stock is not clearly identified, it will not qualify as investment capital, even if it meets the above requirements.

### **Identification Procedures for Stock Acquired Pursuant to Options**

Stock acquired through the exercise of an option will be considered investment capital if it meets the other four criteria and if, before the close of the day on which it is acquired, it is clearly identified in the corporation's records that the option is held for investment. For nondealers, any stock purchased on or after October 1, 2015, pursuant to an option acquired prior to October 1, 2015, may not be identified as investment capital unless the corporation clearly identified such option in its records as held for investment prior to October 1, 2015.

### **Identification by a Partnership with a Corporate Partner**

A partnership with a corporation that has investment capital must follow the identification rules in order for the corporate partner to be allowed to treat such stocks as investment capital. If a corporation becomes a partner after October 1, 2015, only stock acquired by the partnership after October 1, 2015, may qualify as investment capital.

### **Identification on Combined Reports**

Each corporation included in a combined report must separately follow the applicable identification requirements for investments in stock owned by that particular corporation. On January 7, 2016, the DTF issued TSB-M-15(4.1)C, (5.1)I, which provides extended identification periods applicable on or after October 1, 2015, for stock held by certain nondealers. These identification periods are summarized below, and all entities impacted by these rules should be mindful of identifying the stock they own in a timely manner. In general, the extended period of time to identify stock as investment capital begins on the later of the measurement date discussed below or January 7, 2016, and ends on the close of business on the ninetieth day thereafter.

### **Corporations**

For a corporation that becomes subject to tax under Article 9-A of the New York Tax Law on or after October 1, 2015, the measurement date is the date the corporation begins doing business, employing capital, owning or leasing property, or maintaining an office in New York. For a corporation subject to tax under Article 9-A on or after October 1, 2015, solely due to receipts within New York in excess of \$1 million, the measurement date is the date on which the corporation first had receipts within the state above this threshold. For a unitary group subject to tax under Article 9-A on or after October 1, 2015, solely due to receipts within New York in excess of \$1 million, the measurement date of every corporation in the unitary group is the date on which the unitary group first had aggregate receipts above this threshold in the state.

For a corporation that is not a New York taxpayer, has not previously been included as part of a combined report, and first meets the capital stock requirement to be included in a combined report on or after October 1, 2015, the measurement date is the first day the corporation meets the capital stock requirement to be included in a combined report.

### **Partnerships with Corporate Partners**

For a partnership that has nexus with New York on or after October 1, 2015, the measurement date is the date the partnership establishes itself, as described above, in New York. For a partnership that has nexus solely because of deriving receipts in excess of \$1 million within New York on or after October 1, 2015, the measurement date is the date on which the corporate partner first had receipts above this threshold.

For a partnership that does not itself have nexus in New York, but has one or more corporate partners subject to tax under Article 9-A for the first time on or after October 1, 2015, the measurement date is the first date the partnership has a corporate partner that is otherwise subject to tax in the state.

For a partnership that does not itself have nexus in New York and had one or more corporate partners that also did not have nexus prior to October 1, 2015, but does have one or more partners with nexus on or after October 1, 2015, the measurement date is the first date that one of its existing corporate partners becomes subject to tax in New York.

### **Stock Acquired Pursuant to Options**

With respect to nondealer corporations or partnerships that purchase options to which the additional identification period applies, any stock purchased on or after the end date of the additional identification period pursuant to an option acquired before that date may not be identified as investment capital unless the corporation or partnership clearly identified the option in its records as held for investment within the additional identification period.

The above information is a significant part of the corporate reform and very important to understand for those impacted. Although New York's new rules governing investment capital and investment income exempt such capital and income from tax, these rules are much more stringent and burdensome on the taxpayer than under prior law. It is important to make sure that the necessary identifications are timely made, as untimely identifications may result in additional taxes. Affected taxpayers should discuss these reforms with their tax advisors, and tax advisors should familiarize themselves with these important changes.

*Corey Rosenthal, JD is a principal, at CohnReznick LLP, New York, N.Y.*

*Arvinder Kaur, CPA is a state and local tax manager, at CohnReznick LLP, New York, N.Y.*

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