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State Tax Return

New York Governor's Proposed Budget Bill Includes Some Significant Tax Increases

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In a theme that has recurred over past budget cycles, the recently released, 250-page New York State Budget Bill[1] does not officially raise taxes. Instead, it "Closes Loopholes."[2] "Closing Loopholes" says to the average taxpayer that the State is out there chasing down tax avoiders -- the types who exploit the system with their high-priced lawyers and accountants. Unfortunately, it appears that in actual application, "Closing Loopholes" proves to be a loophole in itself, allowing the State to increase taxes without admitting that the proposals are, in fact, raising taxes.

Provisions to expand nexus for the sales tax, corporate income taxes, and personal income tax; to decouple from Internal Revenue Code § 199; and to remove the cap on the alternative Article 9-A tax on capital, for example, are not responses to abuse. They represent instead simply decisions to tax more people, on more.

The Bill's proposed tax increases may be attributable to the current strained economic situation. The Governor just released "21-Day Amendments" to the original budget proposal, which revise his original proposals to take "significant savings actions necessary in the worsening economic climate."[3] In further tightening New York's belt the Governor noted that Wall Street accounts for 20% of the State's revenues, and that since the initial budget computations were prepared last December, the S&P 500 has fallen 9%, and sub-prime write-downs have increased by more than $30 billion.

These comments by Governor Spitzer may well mean that more tax trouble is on its way. Whatever the situation, it would be preferable for the State to address the looming and difficult tax and economic policy issues straightforwardly, rather than simply lobbing the loophole label.

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[1] S.6810, A.9810 (the "Bill"). The Bill is divided into Parts, noted below. Another tax bill has been passed by the New York State Senate (S. 5953), but at this point its prospects appear dim.

[2] See the Memorandum in Support of the Revenue Article VII Legislation (the "Memorandum"), at Parts P, T, and U, for example.

[3] See the Governor's February 11, 2008 Press Release available at http://www.ny.gov/governor/press/0211082.html.

More troubling is the Bill's 800-pound-gorilla approach to criminalizing tax positions that prove to be inconsistent with the views of the State. Much of what we struggle with is complex laws in shades of gray, where all too often there is very little guidance. Unfortunately, the prosecutorial bent of this administration seems to have led to the conclusion that things are always black or white, and that taxpayers who differ in their interpretation of the tax laws are bad actors. As a result, the Bill includes an arresting array of punitive new provisions.

State Capital Tax: Rates Go Down, But the $1 Million Cap Goes Away!

Currently, New York State imposes an alternative Article 9-A corporate tax on capital allocated to New York, at the rate of 0.178 percent. Under the Bill,[4] the rate would be reduced to 0.15 percent.

Significantly, the Bill also would eliminate the $1 million cap that currently applies to this capital base tax, except in the case of corporations qualifying as "qualified New York manufacturers," to which a cap of $350,000 would continue to apply. The elimination of the cap for non-manufacturers would constitute a significant tax increase for large corporations, especially those with net losses, and could more than offset any benefit from the rate reduction.

A "qualified New York manufacturer" is a taxpayer (1) with qualifying property that has an adjusted basis for federal income tax purposes at the close of the taxable year of at least $1 million; or (2) a taxpayer all of whose real and personal property is located entirely in New York. The definition of qualified manufacturer continues to raise constitutional questions, in that it excludes small businesses that have *any* non-New York assets.

Note that the $1 million adjusted basis requirement will not apply to qualified emerging technology companies.

The Bill would also change the definition of "manufacturer" to exclude the generation and distribution of electricity, the distribution of natural gas, and the production of steam associated with the generation of electricity. These taxpayers would thus move from a $350,000 capped tax to an unlimited capital-based tax.

This provision would apply to taxable years beginning on or after January 1, 2008.

Federal § 199 Deduction for Qualifying Production Activities Disallowed

Under the Bill,[5] New York would decouple from the federal I.R.C. § 199 deduction for "qualifying production activities income" or "QPAI." Decoupling is achieved by adding back the amount that is deducted federally when computing New York entire net income.

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[4] Part J.

[5] Part I.

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This add-back would apply under the state corporate, bank, insurance, and personal income taxes; the state tax on UBTI; and the City corporate, bank, and resident income tax. (The City's tax on unincorporated business was not mentioned.)

New York would not be alone in decoupling from this federal deduction. The Memorandum states that 18 other states have already decoupled from the QPAI deduction. The impetus for decoupling at the state level is that, while the deduction at the federal level is designed to, and does, benefit U.S. domestic manufacturers, permitting the flow-through of the deduction at the state and local levels does not necessarily benefit *in-state* manufacturers. New York taxpayers with little in-state manufacturing activity receive the same benefit as taxpayers with substantial in-state manufacturing activity. New York therefore prefers more targeted manufacturing incentives.

Decoupling would apply to taxable years beginning on or after January 1, 2008.

Economic Presence Nexus – the Camel's Nose?

New York has long been a physical presence state, but the Bill would change that for Article 32 credit card companies.[6] Under the Bill, a banking corporation would be treated as doing business in New York if (i) it has issued credit cards to 1,000 or more customers with a New York mailing address; (ii) it has 1,000 or more customers who are merchants located in New York to whom the banking corporation remits payments for credit card transactions; (iii) it has receipts of $1 million or more from customers with a New York mailing address; (iv) it has receipts of $1 million or more from credit card transactions with New York merchants (including merchant discount fees); or (v) it has 1,000 or more customers described in (i) and (ii), or $1 million or more receipts described in (iii) or (iv). The Bill also would source interest, penalties, service charges, and fees on credit cards by reference to the cardholder's mailing address (in lieu of domicile, the current rule).

These changes would be effective in taxable years beginning on or after January 1, 2008.

REIT Redux

Last year's budget legislation included two sets of amendments addressed to "captive" REITs and RICs.[7] The first set of provisions applied to REITs 80% or more owned by

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[6] Part Y.

[7] The Bill's proposed tax increases may be attributable to the current strained economic situation. The Governor has just released "21-Day Amendments" to the original budget proposal, which have changed his original proposals to take "significant savings actions necessary in the worsening economic climate." In further tightening New York's belt the Governor noted that Wall Street accounts for 20% of the State's revenues, and that since the initial budget computations were prepared last December, the S&P 500 has fallen 9%, and sub-prime write-downs have increased by more than $30 billion. These

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(non-REIT) Article 9-A taxpayers. These rules required the REIT/RIC to join in a combined report with such corporations, and disallowed the deduction for dividends paid by the combined REIT. The combined report of such group was then to include the REIT's capital in calculating the tax on combined capital, even though a stand-alone REIT is not subject to the capital tax.

The second set of 2007 amendments was targeted to REIT subsidiaries of banks taxed under Article 32. In this circumstance, the 2007 legislation denied the bank shareholder the 60% deduction otherwise allowed in respect of dividends from subsidiaries, and included some rather complex tracing rules to identify dividends and gains indirectly attributable to REIT subsidiaries.

The 2007 REIT legislation was soon perceived by the State to have fallen short of their intended goal of ending the benefits available when REITs, with their deductions for dividends paid, were paired with New York corporations that enjoyed a 100% (under Article 9-A) or 60% (under Article 32) deduction for dividends received. Right through to the end of the 2007 legislative session last June, the Department and the banking industry (in particular) did battle over the scope and effects of the State's efforts to curtail the use of REITs. That battle has now been joined once again.[8]

The 2008 Bill first defines a "captive REIT" and "captive RIC" as a REIT or RIC (i) that is not publicly traded, and (ii) more than 50% of the voting stock of which is owned or controlled by a single corporation that is not exempt from tax and is not itself a REIT. By lowering the threshold from 80% to 50%, and focusing on direct ownership by a single corporation, this amendment would make the definition of a captive REIT coincident with the definition of a "subsidiary" the dividends from which are entitled to full or partial exclusion from income.

The Bill then breaks its REIT/RIC provisions into three pieces, one for each of Articles 9-A (general corporations), 32 (banks), and 33 (insurance companies).

Turning first to the Article 9-A amendments, these basic provisions generally would require the combination of a captive REIT with its affiliates that file in New York, and disallow a combined captive REIT or RIC deductions for dividends paid to its 50% shareholder or to any affiliate thereof (as defined in I.R.C. § 1504). The Bill would produce unusual and perhaps unanticipated results in certain ownership structures. If the direct 50% owner of the REIT is a New York filer, then the REIT is included in a combined report with that corporation, and with any other corporations properly combining with that shareholder. If the direct shareholder is not a New York filer (in its

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(continued…)

comments by Governor Spitzer may well mean that more tax trouble is on its way. Whatever the situation, however, it would be preferable for the State to address the looming and difficult tax and economic policy issues straightforwardly, rather than simply lobbing the loophole label.

[8] Part U.

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own right or as a member of a New York group), then the REIT/RIC is combined with the “closest controlling stockholder.” That is defined as the corporation that indirectly owns or controls more than 50% of the REIT’s or RIC’s voting stock, and is “the fewest tiers of corporation away in the ownership structure.” If that corporation is not a New York filer, or is ineligible for inclusion in a New York combined report (for example because it is an alien corporation), then the search proceeds up the chain until a corporation is identified with whom the captive REIT or RIC can be included in a combined New York report. (If a captive REIT owns a qualified REIT subsidiary, the QRS must also be included in the combined report.)

The disallowance of a dividends paid deduction for dividends paid to affiliates is phased in, beginning with a 50% disallowance for 2008, a 75% disallowance for 2009 and 2010, and a 100% disallowance for taxable years beginning on or after January 1, 2011.

A REIT or RIC that is not required to be included in a combined report by virtue of the special REIT/RIC rules could still be included in a combined report under the general Article 9-A provisions that require/permit combined reporting where there is 80% ownership, a unitary business, and either substantial intercompany transactions or distortion. In applying those rules, however, the ownership interest required to include a REIT or RIC in the group is reduced from 80% to 50% of voting stock.

Under Article 32, the Bill first allows a 100% dividends received deduction for dividends from subsidiaries “if that dividend income is directly attributable to a dividend from a captive REIT or captive RIC… included in a combined report or return” under Article 9-A or 33. Thus, combination under Article 9-A or 33, and the attendant loss of the dividends paid deduction at the REIT level, earns a higher-tier bank shareholder a full deduction for the related dividends.

Where a captive REIT is not combined under Articles 9-A or 33, the Bill proposes Article 32 combination that, as with the 9-A or 33 proposal, requires combination with the direct 50% shareholder or the closest eligible controlling stockholder. (There is, however, a special carve-out for bank groups with assets not exceeding $8 billion.) And as with the Article 9-A proposals, where a captive REIT or RIC is combined under Article 32, its assets are included in measuring the alternative tax on assets; and its income is calculated by disallowing the deduction for dividends paid to an affiliate, on a phased-out basis.

The changes affecting captive REITs and RICs are all proposed to be effective for taxable years beginning on or after January 1, 2008.

Affiliate Nexus Is Baaaaack

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As recently reported,[9] a State Technical Services Bureau Memorandum[10] directed at e-commerce retailers was issued last November. That TSB-M imputed nexus to out-of-state vendors who utilized in-state “affiliates” to solicit sales. The holiday season timing of this announcement received significant negative press coverage, and as a result the TSB-M was withdrawn on November 15, 2007.[11]

Well, it’s back.[12] Under the Bill, a seller of tangible personal property or taxable services would be presumed to be a “vendor” with nexus to New York for sales tax purposes if the following conditions are satisfied:

1. The seller enters into an agreement with a New York resident whereby the resident receives a commission or other consideration for directly or indirectly referring potential customers to the seller, whether by posting an internet web site link or otherwise; and

2. The cumulative gross receipts of the vendor from sales to New York customers that result from New York resident referrals are in excess of $10,000 during the preceding four quarters ending on the last day of February, May, August, and November.

The presumption is rebuttable where the seller demonstrates that, notwithstanding the affiliate agreement(s), the New York resident(s) did not in fact engage in solicitation in the State at a level that creates nexus under the Constitution. Interestingly, while the original TSB-M described activities by New York affiliates that went well beyond the maintenance of a web site link, the proposed statute would draw a much more expansive line.

The Bill states that the amended definition of nexus will apply to sales and uses on or after the date of enactment. The Bill further provides, however, essentially for an amnesty for qualified unregistered vendors. If they register by June 1, 2008, the State will be precluded from assessing tax, interest, or penalties for periods commencing before June 1, 2008. If the Bill survives the legislative process, affected sellers who meet the conditions of this amnesty may need to act quickly to avoid the retroactive application of this new nexus rule. Those who do not will be left to wonder whether retroactive assessment of sales taxes lies ahead.

Lenders Lose Sales Tax Refunds for Bad Debts

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[9] See Maryann B. Gall, Carolyn Joy Lee, and Laura A. Kulwicki, *Nexus and Web-Related Activities: How the New York “Grinch” Tried to Ruin the Holiday Spirit*, STATE TAX RETURN (Dec. 2007), *available at* JonesDay.com/pubs/pubs.aspx (Keyword: Grinch).

[10] TSB-M-07(6)S (the “TSB-M”).

[11] TSB-M-07(6.1)S.

[12] Part X.

A 2006 amendment to the sales tax added Section 1132(e-1) to expand the definition of "vendors" entitled to offset sales tax remittances with credits for sales taxes previously remitted in respect of accounts that became uncollectible. This provision was of particular importance to lenders purchasing private label credit card accounts. Prior to the 2006 amendment, lenders who loaned against credit card sales were precluded from seeking a refund or credit with respect to sales taxes remitted on uncollectible debts, because they were not the "vendor" in the underlying retail transaction.[13] The 2006 amendment reversed that unfavorable rule, effective January 1, 2007.

Under the Bill,[14] Section 1132(e-1) would be repealed effective June 1, 2008. The Memorandum explains that repeal by stating that the existing refund provisions are "contrary to the transactional nature of the sales tax."[15] This repeal would apply to all accounts charged or written off after that date. Therefore, refunds would be available only for debts deemed uncollectible between January 1, 2007 and June 1, 2008. Affected lenders should consider whether accounts should be charged or written off prior to the June 1, 2008 effective date.

Tax My Ride

Currently, corporate aircraft can, in various circumstances, qualify as commercial aircraft that is used to transport people for hire and thus is exempt from sales tax. Under the Bill,[16] the sales tax is amended to exclude from that exemption aircraft used for the transportation of agents, employees, officers, and directors of "affiliated persons." Affiliated persons are defined as persons with direct, indirect ,or common ownership of more than 5%.

The Bill would also narrow the "welcome stranger" exemption, and exclude the use of aircraft, vessels, and vehicles to carry employees, officers, directors, shareholders, members, or partners (i) of the owner, where such individuals are New York residents; or (ii) of any 5% affiliate that was a New York resident when the property was purchased.

This provision would take effect June 1, 2008.

FIRPTA Comes to the Empire State

Nonresidents of New York have historically not been subject to tax on gains derived from the sale of intangibles (except where used in a New York business). This is

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[13] *See* New York State Regulation Section 534.7(b)(3), and *General Electric Capital Corp. v. N.Y.S. Div. of Tax Appeals*, 2 N.Y. 3d 239 (2004).

[14] Part F.

[15] Memorandum discussion of Part F.

[16] Part EE.

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explicitly provided in the statute, and may indeed be required under New York's Constitution.[17]

The treatment of income from intangibles as non-New York sourced means that nonresidents can receive dividends from C corporations, and derive gain on the sale of interests in pass-through entities, without incurring New York income tax, even where the entity derives its income or value from assets or activities located in New York. Thus, for example, a nonresident could sell her interest in a partnership owning New York real property and pay no New York income tax, whereas if the entity sold the real property, she would be subject to tax on her distributive share of the partnership's gain.

The Bill seeks to change that.[18] The Bill would redefine the term "real property located in this state" to include a non resident's interest in a partnership (which includes limited liability companies that are classified as partnerships or disregarded entities), a limited liability corporation, an S corporation, or a non publicly traded C corporation with 100 or fewer shareholders, if such entity owned New York real property with a fair market value equal to 50% or more of all of the entity's assets on the date the interest is sold. An "ant--abuse" rule would prevent stuffing, by counting only those assets held for at least two years prior to the sale.

Where this definitional standard is met ,the nonresident would be treated as having New York source income from the sale or exchange of the entity interest, determined by allocating the total gain between the real property and the other assets of the entity based on their relative values on the date of sale. This allocation of course may or may not reflect the actual source of the gain.

The recharacterization of gain on affected interests is proposed to apply to sales of entity interests made 30 days or more after enactment of this amendment.

There's a New Sheriff in Gotham

Under a Part labeled the "Tax Enforcement and Compliance Initiative of 2008,"[19] the Bill proposes a number of significant enforcement initiatives.

Voluntary Disclosure May Provide More Limited Benefits

The first initiative would establish a new procedure for voluntary disclosure agreements ("VDAs"). Currently, New York's VDA program is administered informally by the Department, with no specifically prescribed parameters. Under the Bill, a new statutory VDA procedure would be enacted.

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[17] See N.Y.Const. Article XVI, Section 3.

[18] Part T.

[19] Part Z.

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A VDA would not be available to any taxpayer currently under criminal investigation; nor to a taxpayer that has "ever been the subject of any criminal tax investigation, tax prosecution, audit, inquiry, prior VDA or civil tax proceeding" relating to the tax in question, whether by the State Department of Taxation and Finance, the City Department of Finance, or the IRS; nor for taxes that are the subject of any State tax assessment or warrant.

A VDA also would not be available to taxpayers participating in a federal or New York listed or reportable transaction. In addition, a taxpayer could not enter into a VDA if he or she had ever been convicted of a tax crime by New York, or granted amnesty under one of New York's tax amnesties or voluntary compliance initiatives. In a departure from the existing VDA procedure, the taxpayer could request a VDA even if the tax delinquency was the result of willful or fraudulent conduct.

Once executed, the VDA would result in a waiver of applicable penalties for failure to pay tax liability, failure to file a return, and failure to pay estimated tax. It is not explicitly stated whether negligence or fraud penalties would be waived as well; however, such penalties may be included in the phrase "applicable penalties." The statute also would specifically provide that the VDA could not be used to initiate a criminal proceeding against the taxpayer -- something that is generally assumed but not assured under the existing procedures.

New York may audit the returns filed under the VDA. The statute of limitations on such audits is extended by five years following the execution of the VDA.

In a rather striking departure from usual VDA procedures, the proposed statutory scheme does not provide any limit on how far back the taxpayer must report tax liability. New York (like many other jurisdictions) currently generally applies a three-year look back to taxes disclosed under a VDA. Department officials have informally indicated, however, that the proposed statute was intended to provide no limit on the years for which the disclosing taxpayer would be required to file.

Currently, a taxpayer desiring to enter into a VDA can contact the Department anonymously and if the Department, on the presented facts, agrees to enter into a VDA, only then would a taxpayer reveal its identity. Under the Bill, a taxpayer would apply for a VDA on a form prescribed by Commissioner, with the accuracy of the information thereon sworn to under penalties of perjury. It is therefore unclear whether the new statutory scheme permits anonymous applications. Moreover, under the new rules a VDA and any other documents filed with the VDA are deemed to be "reports and returns," which may implicate the newly proposed penalties discussed below.

The tax liability under a VDA could be paid in installments, but the Department could require financial disclosure statement regarding assets, liabilities, and earnings of the taxpayer prior to consenting to installment payments.

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The Bill provides that, if the Department determines that the taxpayer provided false information in connection with the VDA, or if within the following five years the taxpayer fails to file a return or to make a payment due under the VDA, or engages in any tax fraud, willful violation of any tax law, or willful failure to pay any tax, the VDA can be abrogated, and the Department can pursue criminal, civil, and administrative penalties against the taxpayer on the subject matter of the VDA.

A VDA does not allow a taxpayer to file future refund claims for years covered by the VDA, other than in respect of net operating or capital loss carrybacks, federal corrections, or changes as a result of audits of flow-through entities in which the taxpayer owns an interest. Additionally, a taxpayer may not request a refund in a VDA, although the Department is authorized to grant a refund on its own motion.

The new VDA procedures would take effect upon enactment. Inasmuch as it is unclear whether the existing (and more traditional) VDA procedures will continue to be available after this proposal is enacted, taxpayers for whom the new legislation is problematic might be well advised to file a VDA request before the legislature acts.

Preparer Penalties

The Bill also would replace the existing tax preparer penalties with more stringent rules. Under this proposal, if a preparer, for a fee, prepares, counsels, or advises in the preparation of a return with the intent to evade tax or defraud the state, or supplies fraudulent information, the preparer will be subject to a penalty equal to the greater of $15,000 or three times the underlying tax. (In some circumstances, the preparer penalties can be triggered by acts of subordinates.)

These new rules would apply to returns filed and actions taken subsequent to enactment.

Bank Data Matching

As a new collection tool, the Bill would require that any tax liability reduced to judgment, either by docketing a warrant with a court or filing with the office of the Department of State, is subject to a new “financial institution data match system.” Under this system, financial institutions (defined to correlate with federal and state child support rules) would be required to provide to the Department, on a quarterly basis, the names, addresses, Social Security numbers or EINs, account numbers, and balances for each debtor identified by the Department. The financial institutions would not be liable to any person for complying with this program. Moreover, the financial institutions would be barred from informing the identified debtor that the Department has requested information on that debtor -- on pain of a penalty equal to the greater of $1,000 or the balance in the debtor’s account.

This new disclosure rule would take effect upon enactment.

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Fraud Penalties and BCMS

Currently, taxpayers who are issued Notices asserting tax, interest, and/or penalty generally have the option of proceeding to the Bureau of Conciliation and Mediation Services ("BCMS") before beginning the (more costly) hearings process in the Division of Tax Appeals. Under the Bill, in the case of any Notice imposing a fraud penalty or a tax preparer penalty, BCMS would not be available. Moreover, these matters could not be heard by the Small Claims Unit of the Tax Appeals Tribunal. Finally, if the Tribunal upholds the asserted penalties, the pleadings and the transcript of the oral argument (and not just the Tribunal's Decision) would be made public.

These new rules apply to Notices issued on or after the date of enactment.

New Criminal Penalties

Criminal penalties would be broadly revised under the Bill. Taxpayers engaging in any "tax fraud acts" could be prosecuted in Albany county. A "tax fraud act" would include willfully engaging in an act pursuant to which a person fails to make, render, sign, certify, or file a return when required; filing any return knowing that it contains false information or omits material information; submitting false or fraudulent information in connection with an audit proceeding or failing to timely submit information required under the statute or regulations; failing to remit any tax collected when such collection is required; failing to collect any tax required to be collected; failing to pay tax, with intent to evade; or issuing an exemption certificate knowing that it is not correct.

Tax fraud by itself is a Class A misdemeanor. Where there is intent to evade and the underpayment of tax is over $1,000, that would be a Class E Felony; if over $3,000, it would be a Class D Felony; if over $50,000, it would be a Class C Felony; and if over $1 million, it would be a Class B Felony. Underpayments may be aggregated if they are pursuant to the same fraud scheme, or if they occur continuously over consecutive years.

An additional criminal penalty is imposed under the Bill if any person subpoenaed under Tax Law § 174 or the CPLR fails to appear without a lawful excuse, refuses to be sworn, or refuses to answer or produce books without legal privilege. Such person would be guilty of a misdemeanor.

These new criminal provisions would take effect upon enactment.

Tax Shelter Rules

The Bill extends the tax shelter disclosure rules, including the Department's obligation to report on tax shelters.

Sales Tax Re-Registration

This Bill would institute a new registration/re-registration program for all sales tax vendors, to be completed by March 31, 2012. This is intended to make it easier for the Department to update taxpayer information, remove obsolete registrations and collect past-due taxes from vendors. It also will enable the State to collect registration fees, set at $50. The logistics of State-wide re-registration of every vendor seem daunting.

Electronic Non-Filing Penalty

Finally, under the Bill, any failure to file a return electronically when required will be subject to a $50 penalty per occurrence.

Incense, Peppermints, and Stamps

In addition to criminalizing violations of the stamp tax on cigarettes,[20] the Bill introduces a new tax on drugs.[21] Effective 90 days after enactment, New York would require stamps of $3.50 per gram of “marihuana” (yes, that’s how they spell it, circa 1937’s tax act); and $200.00 per gram of “controlled substances.” The Bill contains a 200% penalty for any nonpayment that is due to intent to evade tax, and jeopardy assessments are permitted whenever drugs are found in unstamped packages. The new drug tax may thus be less directed at closing loopholes used by dealers (which, as defined, includes consumers, except of less than two grams of marijuana) than at other governmental entities whose forfeiture provisions might otherwise have first dibs on dealers’ assets.

LLC and Partnership Fees

The Bill[22] would restructure the LLC and partnership fees and corporate minimum taxes. Under the Bill, effective for 2008, every partnership and LLC taxed as a partnership with New York source income would be subject to a new annual fee, payable within 30 days after the close of the taxable year. These LLC and partnership fees would be based on a measure of New York activity (income), rather than the current system based on the total number of members in an LLC or a partnership. Disregarded entities would be subject only to the minimum fee of $50.

The annual fee is calculated based on the LLC’s or partnership’s New York source gross income earned during the prior year. Gross income is determined pursuant to Tax Law § 631, without any allowance for cost of goods sold. If the LLC or partnership did not have any New York source gross income during the relevant period, the LLC or partnership would be subject only to the $50 minimum fee. The annual fee is capped at $2,500, once the LLC’s or partnership’s New York source gross exceeds $25 million.

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[20] Part Z, Subpart G.

[21] Part G.

[22] Part S.

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Under the Bill, New York City could also impose its own annual fees on LLCs, partnerships, and disregarded entities, as calculated above, except that "New York" source gross income would be changed to "New York City" source gross income. These changes would be effective for taxable years beginning on or after January 1, 2008.

Revised Minimum Tax

The Bill would replace the current gross payroll-based, fixed-dollar minimum tax for 9-A corporations. The new minimum tax would be calculated based on New York receipts. The minimum tax would range from $50 for corporations whose New York receipts do not exceed $100,000, to $2,500, for corporations whose New York receipts exceed $25 million.

These changes would be effective for taxable years beginning on or after January 1, 2008.

Reduction of Article 9 Taxes

The Bill would reduce the annual fee for foreign corporations subject to tax under Article 9 of the New York Tax Law, from $350 to $50. It also would repeal the annual tax on shares of Article 9 corporations, effective January 1, 2009.

Estimated Tax

For corporations subject to tax under Article 9, 9-A, 32, or 33 and having a previous year's tax liability of more than $100,000, the Bill would increase the estimated tax due with the tax return or extension request, from 25% to 30% of the prior year's tax.[23] These changes would be effective for taxable years beginning on or after January 1, 2008.

Film Credits

The Bill[24] proposes to increase the tax credits available to the film industry, from 10% to 15% of qualified production costs. The definition of production costs would also be amended to exclude deferred, leveraged, or profit participation costs for personnel or intellectual property and interest (and the like), but would otherwise include compensation for writers, directors, and actors and payments to option or purchase New York-produced IP, up to 15% of total qualified costs.

This change would take effect January 1, 2008.

[23] Part V.

[24] Part W.

In addition, the aggregate amount of tax credits available to the film industry would be increased from $60 million to $65 million for 2008, $70 million for 2009, and $75 million for 2010 and 2011.[25]

New York Domiciliaries Living Overseas Face New Rules

New York State provides an exception to the definition of "resident" for domiciliaries who maintain a residence in New York but spend most of their time overseas. This exception permits such individuals to file as nonresidents if certain conditions are met. The Bill[26] makes a slight but important change to one of the requirements.

The law in its current form provides that, to qualify for the exception: (1) the individual must be present in a foreign country for at least 450 days in any 548-day period; (2) the individual must not be present in New York for more than 90 days during the 548-day period (with a pro-ration rule for part years); and (3) the spouse and minor children of the individual must not be present in the individual's permanent place of abode in New York for more than 90 days during the 548-day period. The third requirement is the one that would be altered.

In its current form, family members can avoid running afoul of the third test by simply staying at a hotel or at another location, other than the family residence. As revised, the spouse and minor children would be barred from being physically present in New York for more than 90 days, as the second test currently requires for the taxpayer.

Similar changes would be made to the applicable law in New York City and Yonkers.

This provision would apply to taxable years beginning on or after January 1, 2008. Taxpayers whose 548-day period includes portion of 2007 may therefore need to recalibrate their family day counts to qualify as nonresidents in 2008.

HMOs Taxed as Insurance Companies

Under the Bill,[27] for-profit health maintenance organizations ("HMOs") that are required to obtain a certificate of authority under Article 44 of the Public Health Law would be included in the definition of "insurance company" under New York's Article 33. As a result, the HMOs would be subject to a premiums tax on all gross direct premiums written on risks located in New York, less returned premiums, at a rate of 1.75%.

This provision would take effect for taxable years beginning on or after January 1, 2008.

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[25] In a somewhat related vein, the Bill would increase the statewide allotment for low-income housing credits from $16 million to $20 million. Part M.

[26] Part P.

[27] Part K.

Expanded Sales Tax Collections by Not-for-Profits

The Bill[28] would expand the obligation of nonprofit organizations to collect sales tax on activities unrelated to their nonprofit status. Specifically, Tax Law § 1116(b) would be amended to require nonprofits to collect sales tax on sales made not only directly, but also by "remote means," for example, by telephone, internet or mail order, or at auction. This would take effect September 1, 2008.

Fuel for Thought

A significant portion of the Bill[29] is devoted to a reorganization of the State's and City's taxes on fuels. Currently, New York has a State motor fuels tax (Article 12-A), a State tax on petroleum businesses (Article 12-A), a State fuel use tax (Article 21-A), State and City sales taxes on motor fuels (Article 28 and 29), and a City tax on leaded fuels. Related provisions exist in the State's criminal procedure, general business, highway, public authorities, public services, state finance, and transportation laws. The Bill includes provisions "consolidating and reforming the state and local taxes on automotive and non-automotive fuels," and revising certain rules for alternative fuels. While billed as a good-government, clean-up-type reorganization of similar statutes, it is possible that, somewhere in the ensuing 122 pages of legislation, there are some surprises.

MTA Surcharge

The Bill would extend the Metropolitan Transportation Area surcharges through 2013.[30]

Stay Tuned

As noted, Governor Eliot Spitzer has announced amendments to the 2008-09 Executive Budget in light of the worsening economic climate. To offset the anticipated revenue deficiency, on February 11th, Governor Spitzer proposed various "savings actions" to (i) improve state government efficiently, (ii) increase funds available from the Environmental Protection Fund, (iii) increase the covered lives assessment, (iv) increase assessments on insurance companies to fund public health, (v) require preauthorization of certain prescriptions and use of generic drugs in the Elderly Pharmaceutical Insurance Coverage Program, and (vi) reduce the trend factor increases for certain healthcare reimbursements. Many of these proposed savings devices will be controversial. So with the ever-present need to balance (or at least pay for) the budget, and powerful interests aligned to protect against spending cuts, expect further tax increases to be proposed.■

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[28] Part L.

[29] Part H.

[30] Part R.

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