

State TAX & ACCOUNTING

New York

New York Tax Department's Draft Bill Overhauls Corporate Taxes, Including Banks

ALBANY, N.Y.—The New York State Department of Taxation and Finance is drafting a bill to overhaul the state's business taxes, with the goal of having a revenue-neutral proposal included in the governor's proposed budget for the 2010-11 fiscal year.

The corporate tax reform proposal would merge the state's current tax on banks (Article 32) into the state's corporate income tax (Article 9-A), eliminating an entire article of the tax law. It would also make changes in several key sections of the law affecting combined reporting, net operating losses, apportionment of business income, and how companies determine their net income base.

The outline of a tax reform bill has been written by the tax department and circulated to various stakeholders for comments. The department's goal is to have the new provisions take effect in the tax year beginning Jan. 1, 2011.

"Base broadening and new sourcing rules would be coupled with a rate reduction to maintain revenue neutrality," the outline says. "The rate reduction will be dependent on the fiscal implications of the structural reform decisions made."

Thomas Bergin, a spokesman for the Department of Taxation and Finance, told BNA the outline is "a working document" and emphasized that "nothing is set in concrete."

Business tax experts interviewed by BNA said the potential overhaul of corporate taxes would be the most significant in some years.

"We've done some major shifts, but not a major restructuring," Ken Pokalsky, senior director of government affairs for the Business Council of New York State, told BNA.

"We're eliminating an entire article that affects one of our largest economic sectors."

Broad Principles for Reform. The department has established six broad principles for reform, including equity, simplicity, ease of compliance and administration, economic competitiveness, and reliability-stability. The department is aiming for a corporate tax regime "with a broad base at the lowest rates possible consistent with revenue needs," according to the outline.

The bill would make dozens of changes in the tax law affecting businesses, but keep some of the existing provisions. The entire net income starting point in New York would continue to be federal taxable income, with most of the current Article 9-A modifications in place.

Tax credits would remain essentially unchanged by the bill, except for a clarification of how they would work in the case of combined reporting and a possible expansion of the Financial Services Investment Tax

Credit to apply to certain investment management activities.

Among the major changes proposed are:

- A single tax rate for all corporations subject to tax.
- Elimination of the current exemption for income from subsidiary capital.
- Apportionment of business income based on a single receipts factor, using customer sourcing rules.
- Net operating losses would not be carried back and the state would conform to the federal carryforward period. The net operating loss deduction (NOLD) would no longer be limited by the federal NOLD source year or amount.
- The current deduction for bad debt under the Bank Tax would be eliminated, with the state re-coupling with the federal bad debt deduction.
- The current deduction under the Bank Tax for interest income from government obligations and income and net gains from subsidiary capital would be eliminated.

"In the context of business taxes, the central concern is for horizontal equity, that is, that similarly situated taxpayers receive equivalent tax treatment," according to the outline. "This principle is often described in shorthand as providing 'a level playing field.'"

Reaction From Business Groups. The state's leading business groups are analyzing the outline of the bill, and have not taken a firm position yet. They said it is difficult to measure the impact of the bill until the department establishes an income tax rate.

Michael P. Smith, president and chief executive officer of the New York Bankers Association (NYBA), told BNA the bill "would dramatically change the way banks are taxed" in New York.

Smith said NYBA would like the move from the Article 32 Bank Tax to the Article 9-A Corporate Franchise Tax to be revenue-neutral, but "that's a very difficult objective to attain," particularly since the banking industry in New York includes large multinational banks, small community banks, multibank holding companies, and others.

"You could have a class of companies," Smith said. "For the class, it could be revenue-neutral, but for individual taxpayers, there could be a hardship."

Pokalsky said it is difficult to determine the impact of the bill on individual companies or the business community overall. It is unclear, he said, how the Department will determine revenue neutrality, particularly which base years will be used. Pokalsky said the state, for example, collected \$4.2 billion from its Article 9-A tax in 2007, but only \$1.7 billion in 2004. Likewise, \$1.2 billion was collected from the Article 32 Bank Tax in 2007, but only \$342 million in 2004.

"The jury is still out if, overall, this is beneficial," Pokalsky said. "We're still reserving judgment on it."

Reaction From Labor. Frank Mauro, executive director of the Fiscal Policy Institute, a labor union-backed think tank located in Albany, said he is opposed to extending

the single sales factor rule. He told BNA the impact of the single sales factor rule, combined with Pub. L. No. 86-272, is it “greatly increases the amount of nowhere income.”

Pub. L. No. 86-272 provides that a state may not impose a net income tax on a foreign corporation on income derived within the state from interstate commerce if the corporation’s only business activities within the state are the solicitation of orders in the state for sales of tangible personal property, if the orders are sent outside the state for approval or rejection, and if approved, they are filled by shipment from a point outside the state.

Mauro said he realizes it would be unrealistic to eliminate the single sales factor, so he recommends that the state have “a throwback rule.” In addition, he said the tax department should produce an annual report on the revenues and impact of the rule and the state should appoint a commission to study the measure.

Mauro also said the proposed bill should include tax credit reform. He said there are \$1 billion to \$2 billion in unused tax credits because the state’s investment tax credit rate is so generous relative to the income tax rate. The amount of investment tax credits earned far exceeds what can be used, according to Mauro.

“There’s a huge and growing bank of unused credits,” Mauro said. “That’s too dangerous a phenomenon.”

Combined Reporting Law Changes. The bill would make a number of changes in the state’s 2007 combined reporting law. The state would adopt “a full unitary water’s-edge method” for combined reporting, according to the outline.

The existing test, based on whether there is “substantial inter-corporate transactions,” would be eliminated. The requirements to be combined would be a unitary business test and a 50 percent stock ownership test.

“The unitary business would be treated as if it were a single entity,” the outline says. “Each taxpayer member of the combined group would be liable for the group’s whole tax, not just its pro rata share of the combined group’s tax. The combined group would designate one taxpayer member to be the agent for administrative purposes.”

The bill would take a broad approach to the issue of nexus. According to the outline, “jurisdiction to tax would be asserted over corporations without a physical presence in New York where economic nexus is present.”

The state would use “a de minimis economic nexus standard based on receipts from customers located in New York,” according to the outline. The bill would repeal the current rule that excludes the use by out-of-state corporations of fulfillment services located in the state as a factor in determining whether the corporation is subject to the corporate income tax.

If the bill were enacted, New York would be “joining a lot of other states that have taken a very aggressive view of how they can impose business activity taxes,” Robert E. Brown, a partner in the Rochester, N.Y., law firm Boylan, Brown, Code, Vigdor & Wilson, told BNA.

Brown said the state should consider “harmonizing the New York scheme with other states” since many companies are multinational or multistate.

Brian Strahle, a tax consultant in Minneapolis who maintains a blog on state and local taxes called Lever-

ageSALT, described the proposed nexus standard this way on his blog: “If you think about breathing in New York, you probably have a taxable presence in New York.”

Chances of Passage. The prospects of the tax proposal passing the state Legislature are uncertain at best, particularly when the state is under enormous fiscal pressure, according to those interviewed by BNA. Moreover, the question is: Can a Legislature notorious for its political dysfunction and gridlock pass a highly complex tax bill?

Pokalsky said one of his concerns is that the Legislature could keep the base-broadening aspects of the plan and leave the current rate unchanged, thereby raising business taxes.

Brown said the tax department will have “a Herculean task” of getting it through the Legislature. “If the legislature starts to pick and choose,” he said, “you could end up with a statute that really didn’t have the kind of integrity that the department intends.”

He said there are sure to be winners and losers, when the dust settles. “That’s not the big news,” he said. “The big news is that this is so comprehensive that they need to make sure they give people a fighting chance to get in line.”

BY GERALD B. SILVERMAN

Text of an outline for proposal is in TaxCore.

State Taxes

States Hiked Taxes, Fees by \$23.9 Billion To Close FY 2010 Shortfalls, Study Shows

Facing the “worst fiscal crisis since the Great Depression,” states raised taxes and fees by \$23.9 billion in fiscal year 2010, but most held the line on corporate income taxes, according to a Dec. 2 report by the National Governors Association and the National Association of State Budget Officers.

Thirty-seven states enacted net tax and fee changes, the study showed, but only six states increased the corporate income tax—and 12 actually cut the tax. The result was an overall net decline of \$202.2 million in the corporate income tax, while the personal income tax increased by \$10.7 billion overall and the sales tax was increased by \$6.1 billion.

States also relied on hikes in the old standbys, alcohol and tobacco taxes, to raise needed revenues.

Those tax increases helped to close massive budget gaps caused by falling tax collections, according to *Fiscal Survey of States, December 2009*. Issued by the NGA and NASBO twice a year, the survey reports on trends in revenues, expenditures, and taxation.

A preliminary summary from the December report, issued Nov. 12, revealed that state finances had worsened in 2009 and were expected to deteriorate further in 2010 (217 DTR H-2, 11/13/09). Declining state fiscal health is evidenced by \$256 billion in budget gaps between fiscal 2009 and fiscal 2011, the report said.

To close these gaps, “43 states cut their enacted fiscal 2009 budgets by \$31.3 billion and 36 states cut their fiscal 2010 expenditures by \$55.7 billion,” the report said. Even with federal assistance, states were “forced to cut programs while raising taxes and fees.”