



2010-2011 NEW YORK STATE BUDGET



On August 4, 2010, the New York State legislature finally finished its work on the 2010-2011 New York State budget, making this the second latest budget in history. The following is a summary of the most significant tax changes:

Personal Income Tax

NEW YORK CITY RATE HIKE FOR HIGH EARNERS

The basic tax rate on incomes over \$500,000 for all filing statuses would increase from 3.2% to 3.4%. With the “temporary” 14% New York City surcharge running through the 2011 tax year, the effective rate for those earning more than \$500,000 would be 3.876%. *Effective: tax years beginning on or after January 1, 2010.*

CHARITABLE DEDUCTIONS FOR HIGH EARNERS

The bill would slash the amount of charitable contributions allowed as New York itemized deductions from 50% to 25% for taxpayers with New York AGIs over \$10 million. New York City would have the option of adopting the charitable deduction limitation for the City personal income tax. This provision would be effective taxable years beginning on or after 2010 and would sunset for tax years after 2012. *Effective: tax years beginning on or after January 1, 2010.*

TREATMENT OF TERMINATION PAY TO NONRESIDENTS

The bill expands the definition of “New York Source income” for nonresidents to include income from a termination agreement, a covenant-not-to-compete, or other (non-retirement) income “related to a business, trade, profession or occupation previously carried on” in New York, whether or not by an employee. Past tax rulings had held that certain post-termination income received by a nonresident from a New York employer represented payments in exchange for a nontaxable, intangible right (i.e., a right to future employment), rather than taxable compensation for services performed for the employer in New York. *Effective: tax years beginning on or after January 1, 2010.*

NONRESIDENT HEDGE FUND MANAGERS

As a result of a last-minute amendment, nonresident managers of New York-based hedge funds and investment partnerships can still treat a large portion of their compensation as non-New York source income under the bill. Prior versions of the bill would have classified the “carried interest” managers receive as part of their compensation (essentially a share of the fund’s investment profits) as compensation for services rendered to the partnership, rather than as nontaxable capital gain from intangible investments. This proposal was dropped when Connecticut rolled out the “red carpet” for New York-based hedge funds.

SALES OF S CORPORATION SHARES BY A NONRESIDENT

The bill provides that nonresident shareholders of S corporations who sell their shares pursuant to an IRC § 338(h)(10) election must calculate their New York source incomes as if the deemed asset sale had actually occurred. The amendment effectively reverses a 2009 Tax Appeals Tribunal decision (*Matter of Baum*, Tax Appeals Tribunal, February 12, 2009) which held that, for New York tax purposes, such a transaction represents a sale of an intangible stock interest only and should be treated as such for determining New York source income for a nonresident. The budget bill would require that the asset-sale-followed-by-complete liquidation “fiction” of a § 338(h)(10) election be treated as it is for federal purposes—that is, as if all steps had actually occurred. Thus, the gain on the *deemed* asset sale would be treated as New York Source income to a nonresident shareholder (i.e. taxable sale of assets in New York), with no offset for loss or adjustment on the deemed liquidation in exchange for stock (i.e. nontaxable sale of intangible property). The amendment would also affect IRC §453(H)(1)(A) elections, requiring nonresident S corporations to treat payments received under an installment obligation as New York source income. *Effective: immediately, and the changes apply to all open tax years.*

ADD-BACK FOR FEDERAL ITEMIZED DEDUCTION FOR SALES TAX

The bill would require that taxpayers who elect to take an itemized deduction on their federal returns for state and local sales taxes paid must add such amounts back when determining their New York itemized deductions. *Effective: tax Years beginning on or after January 1, 2010.*

Sales Tax

ELIMINATION OF CLOTHING AND FOOTWEAR EXEMPTION

The bill would eliminate the statewide sales and use tax exemption for clothing and footwear sold for less than \$110, effective October 1, 2010 and lasting through March 31, 2011. A limited exemption for clothing and footwear under \$55 would be reinstated between April 1, 2011 through March 31, 2012, after which, the original (\$110) exemption would be reinstated indefinitely. *Effective: October 1, 2010.*

HOTEL ROOM REMARKETERS

The bill would impose sales tax on sales of hotel rooms by hotel room remarketers, such as online travel companies. Currently, room remarketers that have agreements with hotels to buy and remarket rooms pay tax on the rooms they purchase from hotels; however, they are not required to collect tax on their charges to customers for booking the room, nor the markup they charge. The bill would require room remarketers to collect tax on the full, marked-up price of any room booked for a customer. In return, the remarketer could apply for a credit for the tax paid on its purchase of the (non-marked-up) room from the hotel—that is, if the remarketer registers with New York for sales tax purposes. The amendment would apply to New York’s hotel occupancy tax as well as the statewide sales tax. *Effective: September 1, 2010*

AFFILIATE NEXUS

The bill would narrow the “affiliate nexus” provisions adopted in 2009 by specifying that a New York vendor will not create sales tax nexus for an affiliated out-of-state company merely by providing advice, accounting or legal services to the out-of-state entity, or by overseeing strategic planning, marketing, inventory, staffing, distribution or cash management for the non-New York entity. *Effective: deemed to have been in effect and applicable to sales on or after June 1, 2009.*

TIMELY FILING CREDIT ELIMINATED

The \$200 maximum credit available to vendors who timely file their returns would be eliminated for vendors required to file quarterly and part-quarterly returns (i.e. those reporting \$300,000 or more in gross receipts in any quarter). *Effective: tax periods beginning on or after June 1, 2010*

BAD-DEBT CREDITS ON “PRIVATE LABEL” CREDIT CARDS

The bill repeals the sales tax deduction allowed to vendors and/or lenders for uncollectible amounts charged on “private label credit cards.” Under the current law, either a vendor who has issued its own “in-house” credit card or the lender that holds the vendor’s card accounts may claim a credit for sales tax previously remitted on an uncollectible or worthless account. *Effective: for credits or refunds claimed after July 1, 2010.*

Corporate Taxes and Credits

DEFERRAL OF BUSINESS TAX CREDITS

For tax years 2010, 2011 and 2012, taxpayers with more than \$2 million in aggregated business tax credits would be required to defer the amounts above \$2 million until 2013. The total amount of credits deferred under this proposal would be paid back to taxpayers (without interest) over tax years 2013, 2014 and 2015. The deferral would affect dozens of business tax credits available, including Empire Zone and QETC credits and credits for low-income housing, fuel-cell generating equipment, biofuel production, rehabilitation of historic structures, employment and transportation of people with disabilities and other credits. *Effective: 2010, 2011, and 2012 tax years.*

CAPTIVE REAL ESTATE INVESTMENT TRUSTS (REITS)

The bill extends, indefinitely, the tightened combined reporting rules adopted in 2008 for “captive” REITs and regulated investment companies (RICs). When adopted, these rules applied only to tax years beginning on or before January 1, 2011, and portions would have sunset in 2011. The 2008 rules establish a 50% stock ownership threshold for defining a “captive” REIT or RIC and require all captive REITs and RICs to file a combined return with the closest New York taxpaying corporation that directly or indirectly owns or controls them. The law also eliminated dividend-deduction rules that allowed banking and insurance corporations to accumulate and distribute dividends from out-of-state REITs and RICs without paying tax at the parent level. *Effective: immediately.*

REPLACEMENT OF THE EMPIRE ZONES PROGRAM

On June 22, 2010, Governor Paterson signed into law the Excelsior Jobs Program Act to replace the Empire Zones program, which officially expired on June 30, 2010 (see below). The still-outstanding provisions in the budget bill address issues relating to retroactive decertification of existing Empire Zone business, the treatment and timing of applications into the program and eligible credits during the transition.

- **Decertification:** The bill clarifies that any decertification of an existing Empire Zone business that occurred based on the 2009 changes to the eligibility criteria and review of all existing Empire Zone certifications was intended to be retroactive to tax years beginning January 1, 2008. Although some provisions in the 2009 legislation indicated a 2008 effective date, the actual decertification provisions contained no such designation. A State Supreme Court judge recently held there was no statutory authority to make an Empire Zone decertification retroactive to 2008 (*James Square Associates LP et al v. Mullen*, NY Supreme Court, June 11, 2010). The current budget bill contains the language to do so.
- **Transition Provisions:** The bill addresses various issues relating to events occurring before the June 30, 2010 expiration date. The bill provides that:
 - If a local Zone Administrative Board had applied before June 30 to revise the borders of a particular Zone in order to accommodate a new project or had applied to the Department of Economic Development (DED) for approval of “a regionally significant project,” the DED can revise the effective date of the project to be before June 30 to allow entry into the program.
 - Investment tax credit: If a taxpayer was certified as a “qualified investment project” (QIP) prior to the June 30 expiration, it would retain such status for the remainder of 2010 and for the next nine years for the purposes of the Empire Zone investment tax credit. A taxpayer certified as an Empire Zone project before June 30 would continue to be designated as such for investment tax credits until April 1, 2014, as would the areas in which the taxpayer was certified.
 - Capital tax credit: If an area is no longer designated an Empire Zone because of the expiration of the program, a taxpayer who made a contribution of money before June 30 to a community development project approved by the DED in that area, could continue to claim the Empire Zone capital tax credit for additional contributions to the project up until April 1, 2014.

“EXCELSIOR JOBS PROGRAM ACT”

The New York State Legislature recently passed, and the Governor signed into law, the “Excelsior Jobs Program Act.” The Excelsior Program (“Program”) was created to replace the Empire Zones program, which expired on June 30, 2010. The Program essentially contains four components:

- **The Excelsior Jobs Tax Credit** – for increasing employment in the State;
- **The Excelsior Investment Tax Credit** – for investments in property in the State;
- **The Excelsior Research and Development Tax Credit** – for research and development expenditures in the State (this is based on the federal R&D Credit);
- **The Excelsior Real Property Tax Credit** – allows real property credits for regionally significant projects (as defined by statute) or for businesses located in economically depressed areas.

In general, a business must be predominantly engaged in one of the following categories and meet certain employment growth thresholds in order to participate in the program (though there are some exceptions): (1) as a financial services data center or a financial services back office operation, (2) in manufacturing, (3) in software development and new media, (4) in scientific research and development, (5) in agriculture, (6) in the creation or expansion of back office operations, or (7) in a distribution center. Each of these terms is specifically defined by the statute.

A general overview of the program is available on Empire State Development’s website at:

<http://www.empire.state.ny.us/BusinessPrograms/Excelsior.html>

Compliance and Enforcement

FELONY FOR THREE YEARS’ FAILURE TO FILE

A person who, with the intent to evade tax, fails to file either personal income tax or corporate tax returns (Articles 9, 9-A, 13, 32, 33, or 33-A) for three consecutive years would be guilty of a class E felony under the bill, provided that the person indeed had an unpaid liability with respect to each of those three years. For corporate taxes, the unpaid liability in each of the three years would have to exceed a \$250 threshold. *Effective: immediately (for offenses after effective date).*

REPORTING REQUIREMENTS FOR IDAS

The bill would require Industrial Development Agencies (IDAs) to file an informational statement with the Tax Department each time an IDA designates a new project operator or agent who will benefit from the sales and use tax exemption applicable to IDA projects. Additionally, every designated agent and project operator making purchases for an IDA project would be required to file an annual statement with the Tax Department stating the value of all sales and use tax exemptions claimed during the year. *Effective: immediately.*

Miscellaneous

ELECTRONIC FILING:

- **Preparer Penalties:** Tax return preparers subject to penalties for failing to file or pay electronically (i.e. those preparing more than 100 returns during any calendar year) could no longer claim the *taxpayer's election* not to file electronically as a basis for reasonable cause to abate penalties.
- **Charging for Electronic Filing:** Tax preparers and tax software companies would be prohibited from charging a separate fee for electronic filing of authorized tax documents. Violators would be subject to a \$500 penalty for each violation.
- **Timely Filing and Payment:** The bill sets forth definitions and provisions to determine when an electronic filing, payment, or electronic funds withdrawal is "postmarked" and sets forth reasonable correction periods for electronic filings. *Effective: applicable to tax returns and other filings on or after December 30, 2010.*

ABANDONED PROPERTY

The bill would allow the State to declare uncashed travelers checks, money orders, and similar instruments to be declared abandoned property within five years rather than seven years. A new category of abandoned property would also be established for unclaimed funds held by a public utility for at least three years or unclaimed amounts held for three years by a person for services not rendered or for goods not delivered. *Effective: immediately.*

CONCLUSION

If you would like to learn more about these or any other recent changes to the tax law, or if you would like to learn more about what our State & Local Tax Practice Group can do for you, please call or e-mail a member of our group.

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