

New York State & New York City Business Tax Updates



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Chris Doyle, Dan Kelly & Brandon Bourg



Topics

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1. 2024 – 2025 New York State Budget Bill Updates

2024 – 2025 New York State Budget Bill Updates



- Relatively light revenue budget in terms of new / changed taxes, credits, and updates. Huge amount of spending approved at \$237 billion.
- Key business tax takeaways include:
 - **Commercial Security Tax Credit:** For 2024 – 2025 an eligible business entity may claim a security tax credit of \$3,000 for each business retail location located in New York, with a total credit cap of \$5 million annually. Designed to support retail security enhancement and costs.
 - **Cannabis Tax:** THC potency-based wholesale / distribution tax replaced with a flat wholesale 9% excise tax. Retail NY tax rate of 9% excise tax + 4% local excise tax remain. Excise tax on medical cannabis reduced from 7% to 3.15%, along with other modest adjustments.

2024 – 2025 New York State Budget Bill Updates



- Continued:
 - **Metropolitan Commuter Transportation Mobility Tax Technical Adjustments:** Certain counties saw an inadvertent repeal of the .34% MCTMT self-employment tax through the 2023 – 2024 budget bill. Those counties were added back this year (including Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester).
 - **Limitation on Itemized Deductions:** Since 2010, itemized deductions for taxpayers with New York adjusted gross income of more than \$10 million have been limited to 25% of the allowed federal charitable contribution deduction. The Executive Budget permanently extends this long-standing limit. Tax shelter provisions were also permanently extended.
 - **Adjustments Related to Amended Tax Returns:** Tax Law Sections 689 and 1089 amended to close perceived “amended return” loophole for income and corporate tax purposes. Limitation on subsequent deficiency assessments no longer restricted to “taxable year,” but now restricted to “tax return.” New provision of Tax Law Section 1136 related to amended sales tax returns.

2024 – 2025 New York State Budget Bill, Further Legislation



- ***Update on Short Term Rentals:*** Regulating and taxing short-term rentals in upstate New York, like Airbnb and VRBO stays, was contemplated in the initial 2024 – 2025 budget bill but did not pass. Certain taxes were already imposed on short-term rentals in New York City.
- On June 10, 2024, new legislation was passed addressing short-term rentals. Short term rental hosts will be required to register with the New York State Department of Housing, and local sales tax / occupancy taxes will be imposed on short-term rentals.
- The legislation is now pending at Governor Hochul's desk. What happens next, whether it is passed, vetoed, or changed is still to be determined. There is a clear and concerted effort to impose common hotel-type taxes on the short-term rental industry in the New York legislature.



2. Final New York State Corporate / Article 9-A Regulations

Final New York State Corporate / Article 9-A Regulations



- Key Areas of Change / Updates:
 - Apportionment Rules & Updates
 - Nexus
 - Combined Reports
 - Foreign Corporations + Foreign Affiliates

Final New York State Corporate / Article 9-A Regulations – Applicability



- The final corporate tax regulations, which saw several draft versions, adjustments within the drafts, and comments from taxpayers and industry groups, are technically effective the date they were published—December 27, 2023.
- However, the NY Tax Department indicated that the final regulations apply to tax years beginning January 1, 2015, given that the new regulations are designed to implement NY's corporate tax overhaul effective on January 1, 2015.
- The NY Tax Department has discretion, “based on a totality of the circumstances,” to waive penalties if a taxpayer took a filing position before December 27, 2023, in reliance on the prior existing regulations or an earlier draft version of the final regulations. But should penalties be imposed based on a reasonable interpretation of the statute(s), and is nearly 10 years of retroactivity too long?



The New Apportionment Regulations

- Adopted in December, the new apportionment regulations are intended to amplify and clarify the “new” (as of 2015) Tax Law § 210-A.
- Do they?



The General Approach Per The Law

- Tax Law § 210-A.1
 - 1. General. Business income and capital shall be apportioned to the state by the apportionment factor determined pursuant to this section. The apportionment factor is a fraction, determined by including **only those receipts, net income, net gains, and other items described in this section that are included in the computation of the taxpayer's business income...for the taxable year.**
 - Seems like the Legislature intended to have those items that were included in business income represented in the factor.



The General Approach Per The Regs.

- 4-1.2(b) The following amounts shall **not** be included in either New York receipts or everywhere receipts:
 - (1) **gross income from investment capital, even if such income is included in business income** pursuant to the 8% of entire net income (ENI) limitation on gross investment income.
 - (2) any portion of gross other exempt income generated by stock that is not marked to market.
 - (3) any portion of gross other exempt income generated by stock that is marked to market in instances where the taxpayer did not make the fixed percentage election for qualified financial instruments.
 - (4) amounts specified in section 208(9)(a) to be subtracted from federal taxable income in the computation of ENI (other than the subtractions for qualified banks provided for in section 208(9)(a)(19)).
 - (5) amounts specified in section 208(9)(b) to be added back to federal taxable income in the computation of ENI (other than the addition modification for alien corporations not deemed domestic under any provision of the IRC provided for in section 208(9)(b)(1) and the addition modification for dividends or interest provided for in section 208(9)(b)(2)).



The General Approach Per The Regs (Cont.)

- And then there is this conflict:
 - 4-1.2(b)(6) **certain reimbursements of expenses** paid for by the corporation on behalf of a customer ... [**shall not be included in receipts**].

VS.

- 4-1.2(d) **All business receipts** for the period covered by the report, computed on a cash or accrual basis according to the method of accounting **used in the computation of its ENI, must be taken into account.**



Sales of TPP and RP Per The Law

- § 210-A.2. (a) **Receipts** from sales of tangible personal property where shipments are made to points within the state or the destination of the property is a point in the state shall be included in the numerator of the apportionment fraction. Receipts from sales of tangible personal property where shipments are made to points within and without the state or the destination is within and without the state shall be included in the denominator of the apportionment fraction.
- (b) **Receipts** from sales of electricity delivered to points within the state shall be included in the numerator of the apportionment fraction. Receipts from sales of electricity delivered to points within and without the state shall be included in the denominator of the apportionment fraction.
- (c) **Receipts** from sales of tangible personal property and electricity that are traded as commodities, as the term “commodity” is defined in section 475 of the internal revenue code, are included in the apportionment fraction in accordance with clause (l) of subparagraph two of paragraph (a) of subdivision five of this section.
- (d) **Net gains** (not less than zero) from the sales of **real property** located within the state shall be included in the numerator of the apportionment fraction. Net gains (not less than zero) from the sales of real property located within and without the state shall be included in the denominator of the apportionment fraction



Sales of TPP and RP Per The Regs

4-2.1(a) **Receipts and net gains** (not less than zero) from the sale of tangible personal property are included in New York receipts if paragraph (1), (2), or (3) of this subdivision applies. All receipts and net gains (not less than zero) from the sale of tangible personal property are included in everywhere receipts.

* * *

(e) (example 2): Corporation A operates a car rental business in New York State and elsewhere in the United States. To keep its inventory up-to-date and make room for newer models, Corporation A sells some of its fleet of cars every year. The **net gain** (not less than zero) from these sales, which is properly reported as business income, shall be apportioned to New York State to the extent that the final destination of the cars sold is in New York.

Are net gains to be used to calculate the BAF for all out-of-the-ordinary-course-of-business sales of TPP?



Sales of TPP and RP Per The Regs (Cont.)

Section 4-2.2. (a) Net gains (not less than zero) from the sales of real property located in New York are included in New York receipts. Net gains (not less than zero) from sales of real property located within and without New York State are included in everywhere receipts.

* * *

(c) To determine the amount of net gains from sales of real property to be included in the numerator and denominator of the BAF, the corporation first must subtract the sum of all losses... . *If the result is equal to or less than zero, no amount is included in New York receipts and everywhere receipts. If the total amount of net gains (not less than zero) from sales of real property located in New York exceeds the net gains (not less than zero) from sales of real property located within and without New York State, the amount included in New York receipts is limited to the amount included in everywhere receipts.*

So, the BAF input from RP sales can't exceed 100%. This makes perfect sense.



Rents and Royalties Per The Law

Tax Law § 210-A.3. Rentals and royalties. (a) Receipts from rentals of real and tangible personal property located within the state are included in the numerator of the apportionment fraction. Receipts from rentals of real and tangible personal property located within and without the state shall be included in the denominator of the apportionment fraction.

(b) **Receipts of royalties from the use of patents, copyrights, trademarks, and similar intangible personal property within the state** are included in the numerator of the apportionment fraction. Receipts of royalties from the use of patents, copyrights, trademarks and similar intangibles within and without the state are included in the denominator of the apportionment fraction. **A patent, copyright, trademark or similar intangible property is used in the state to the extent that the activities thereunder are carried on in the state.**



Rents and Royalties Per The Regs

4-2.3(a)(3) Gross receipts from real and tangible personal property that is subleased from the corporation must be included in the BAF.

(4) The amount of receipts from the rental of motor vehicles and other rolling stock, such as trucks or construction equipment, included in New York receipts is the product of such receipts and a fraction. Such fraction may be based on miles operated in New York State compared to total miles operated, time operated in New York State compared to total time operated, number of pickup and delivery locations in New York State compared to the total of such locations, or any other method that fairly apportions such receipts to New York State.



Rents and Royalties Per The Regs (Cont.)

4-2.3(b)(1) Receipts from the use in New York State of patents, copyrights, trademarks, licenses, and similar intangibles are included in New York receipts. 100% of receipts from the use of patents, copyrights, trademarks, licenses, and similar intangibles are included in everywhere receipts.

* * *

(3) A patent, copyright, trademark, license, and similar intangible is used in New York State to the extent that **the activities generating the fees paid** for the use of the patent, copyright, trademark, license, or similar intangible are carried on in New York State.



Financial Transactions Per The Law

Tax Law § 210-A.5 has different rules depending on different categories of income-producing activity.

- For QFI's, taxpayers can elect to use the fixed percentage method (8% in the numerator, 100% in the denominator) or customer-based sourcing (billing address for individuals, commercial domicile for business entities).
- Interest on mortgages sourced to the location of the real property. Interest on other loans sourced based on borrower location.
- Net gains from sales of mortgages sourced based on location of the real property. Net gains from the sale of other loans is in accordance with the location of the loan purchaser.



Financial Transactions Per The Law (Cont.)

- QFIs include the following marked-to-market instruments: certain loans; federal, state, and municipal debt; asset backed securities; and other government agency debt; corporate bonds; stock or partnership interest; other financial instruments; and commodities.
- The statute provides that taxpayers default to customer (i.e., payor)-based sourcing for QFI receipts, but may make an 8% election.
- For non-QFIs (essentially corporate equity investments), no representation in either the denominator or numerator.
- For physical commodities, the measure is net income, and the sourcing is based on delivery location receipts. If there is no physical delivery, source is based on customer location.



Financial Transactions Per The Law (Cont.)

- Tax Law § 210-A.5(a)(2)(G) Dividends and net gains from sales of stock or partnership interests. Dividends from stock, net gains (not less than zero) from sales of stock, and net gains (not less than zero) from the sale of partnership interests are not included in either the numerator or denominator of the apportionment fraction unless the commissioner determines pursuant to subdivision eleven of this section that inclusion of such dividends and net gains (not less than zero) is necessary to properly reflect the business income or capital of the taxpayer.



Financial Transactions Per The Regs

- **QFI 8% election:**

4-2.4(a)(2) (i) If a corporation has marked to market any instrument described in clause (A), (B), (C), (D), or (I) of section 210-A(5)(a)(2), then any other financial instrument described in the same clause that has not been marked to market is also a qualified financial instrument in the taxable year. Each of these clauses is one type of financial instrument.

(ii) The determination of qualified financial instrument is done separately for stocks and partnership interests described in section 210-A(5)(a)(2)(G).



Financial Transactions Per The Regs (Cont.)

4-2.4(c)(1) A taxpayer, or the designated agent in the case of a combined report, may elect the fixed percentage method to include 8% of net income from qualified financial instruments in New York receipts and 100% of all net income from qualified financial instruments in everywhere receipts (whether or not such net income would otherwise be included in the New York receipts or everywhere receipts pursuant to the provisions of section 210-A(5)(a)(2).

* * *

(2) The fixed percentage method election must be made annually and may only be made on an original, timely filed report, determined with regard to extensions of time for filing. Any fixed percentage method election made on a report that is filed late will be invalid and ineffective.

(3) (i) Once the fixed percentage method election has been made in the manner required in paragraph (2) of this subdivision for a taxable year, it is binding on the taxpayer and the Department for that taxable year and cannot be revoked or overridden for that taxable year.

Planning opportunity? Sell in January of Year 2 after making the election in Year 1.



Financial Transactions Per The Regs (Cont.)

4-2.5(a)(1) A loan secured by real property means that real property constitutes 50% or more of the aggregate value of the collateral used to secure a loan, when valued at fair market value (FMV), as of the time the loan is originated.

(2) Interest income from loans secured by real property located within New York State shall be included in New York receipts. If one or more of the properties that secure the loan are located outside of New York, the amount of interest income from such loan included in New York receipts is the product of such interest income and a fraction, the numerator of which is the FMV of real property located in New York State used to secure the loan and the denominator of which is the FMV of all real property used to secure the loan. All interest income from loans secured by real property shall be included in everywhere receipts.

* * *

(c) The determinations of the type of loan, FMV of real property, and borrower's location are made at the time the loan is originated and will be redetermined only if the loan is refinanced.



Financial Transactions Per The Regs (Cont.)

- Be very careful. There are distinctions being made between the input in both the law and the regulations. For instance, for some instruments (e.g., corporate bonds) the BAF input is **interest** and for other instruments (e.g., federal funds) the BAF input is **net interest**.
- And for some instruments, periodic income is sourced differently than gain on sale.
 - Interest on corporate bonds is sourced to the commercial domicile of the issuer (4-2.7(a))
 - Net gain on the sale is either subject to an 8% (if sold through a registered broker) or to the location of the purchaser.



Financial Transactions Per The Regs (Cont.)

- The input for physical commodities is net income. 4-2.10
- Why is this different than other TPP?



Financial Transactions Per The Regs (Cont.)

- Can't find a specific regulation that covers your financial instrument?
See 4-2.12
 - (c) Interest income from other financial instruments is included in New York receipts if the **payor** is located in New York State. 100% of such interest income is included in everywhere receipts.
 - (1) For purposes of this section, an **individual**, as payor or purchaser, is located in New York State if its **billing address** is in New York State; and a **business entity**, as payor or purchaser, is located in New York State if its **commercial domicile** is in New York State.
 - (2) The location for a government entity, as payor or purchaser, is dependent on the type of government entity. For example, when the payor is a foreign country, the payor would be wholly located outside of New York State, and when the payor is part of a federal banking system that operates multiple banks throughout the United States, the payor would be located in New York State to the extent of the percentage of banks in New York State.



On-line Advertising Per The Law

Tax Law § 210-A.8(c) The amount of receipts from sales of **advertising**...provided or delivered to, or accessed by the viewer or listener through the use of wire, cable, fiber-optic, laser, microwave, radio wave, satellite or similar successor media or any combination thereof, included in **the numerator of the apportionment fraction is determined by multiplying the total of such receipts by a fraction, the numerator of which is the number of viewers or listeners within the state and the denominator of which is the number of viewers or listeners within and without the state.** The total of such receipts from sales of advertising described in this paragraph is included in the denominator of the apportionment fraction.

Advertising services are not specifically addressed in the statute.



On-line Advertising Per The Regs.

- 4-2.17(a)(2) For purposes of this paragraph, an advertising or marketing service includes:
- (i) consultation on and development of advertising or marketing campaigns; or
- (ii) securing placement of advertising or marketing materials in various forms of media.



On-line Advertising Per The Regs (Cont.)

4-2.17(b)(4)(ii) **If**, after exercising due diligence, **the corporation lacks sufficient information** to apply subparagraph (i) of this paragraph, **it may use a reasonable method to estimate the numbers of listeners or viewers to include in the numerator and denominator of the fraction described in subparagraph (i) of this paragraph.** Such method should be based on data available to the corporation either as part of its operations, such as metrics or information for account holders, subscribers, or page or advertisement hits, or under the terms of the contract with the entity seeking to place the ad, such as any contractual obligations to identify ad recipients or to target the ad to specific demographics.

(iii) In any case in which a corporation uses a method of estimation to determine the amounts for the numerator and denominator of the fraction described in subparagraph (i) of this paragraph and the commissioner determines that the method employed by the corporation is not reasonable, the commissioner may substitute a method that the commissioner determines is appropriate. In this instance, the corporation bears the burden of demonstrating that the method the commissioner prescribes is not reasonable.



Advertising Services per the Regs

- 4-2.17(c) Apportionment of receipts from advertising services.
- (1) The amount of receipts from the provision of advertising or marketing services (e.g., the creation and/or implementation of an advertising or marketing campaign) included in New York receipts is determined by multiplying such receipts by a fraction, the numerator of which is the number of intended targets of such advertising or marketing in New York State and the denominator of which is the total number of intended targets ("**the intended target fraction**"). 100% of such receipts are included in everywhere receipts.



Unclassified Services and Business Activities Per The Law

- Tax Law §210-A.10. (a) Receipts from other services and other business receipts. **Receipts** from services not addressed in subdivisions one through nine of this section and other business receipts not addressed in such subdivisions shall be included in the numerator of the apportionment fraction if the location of the customer is within the state.
- Customer location is determined by:
 - Location of receipt of benefit
 - Delivery destination
 - Preceding year's source percentage
 - This year's source percentage for receipts that can be sourced



Unclassified Services and Business Activities Per The Regs

- 4-4.1(c) (c) **Intermediary transaction** means a transaction where the business customer derives value from a service or other business activity at the location of the consumer rather than the location of the business customer itself.
- 4-4.8(a) In the case of intermediary transactions, in applying the where benefit received method or the delivery destination method of the hierarchy, the location where the receipt is apportioned is based on the location of the consumers, rather than the business customer.



Unclassified Services and Business Activities Per The Regs (Cont.)

4-4.3 Where the benefit is received:

- (b)(3) The benefit of **in-person services** is presumed to be received at the location where the in-person service is performed.
- (c)(3) The benefit of services related to tangible personal property is presumed to be received at the location where the property is received after the service is performed.
- (d)(2) The benefit of a service related to real property is presumed to be received where the real property is located.



Unclassified Services and Business Activities Per The Regs (Cont.)

4-4.3(e) **Sales of intangible property.** (1) With respect to the net gains (not less than zero) from the sale of intangible property not otherwise addressed in subdivisions (1) through (9) of section 210-A, **the benefit of such sale is presumed to be received at the location where the value of the intangible was accumulated.**

(2) Intangible property includes, but is not limited to, goodwill, copyrights, patents, trademarks, trade names, brand names, licenses, and trade secrets.

(3) The location where the value of goodwill is accumulated is determined using a three-year average of the business apportionment factor (BAF) or other percentage used to apportion or allocate income to New York State of the entity that is sold, unless the facts and circumstances indicate another period of time is a better measure of where the value is accumulated.

How is this indicative of the location of the customer?



Unclassified Services and Business Activities Per The Regs (Cont.)

4-4.4(c)(1) Receipts for management, distribution, and administration services provided to a **passive investment customer** are apportioned under the rules provided for in this subdivision unless a special rule for determining where the benefit is received is applicable. Such receipts include amounts received directly from a passive investment customer as well as amounts received from the investors in such passive investment customer, in their capacity as such.

(2)(i) The benefit of management, distribution, and administration services provided to a passive investment customer is presumed to be received at the location of the investors in such passive investment customer....

Nexus & Foreign Corporations



- Section 1-2.2. Foreign corporations subject to tax. Foreign corporations whose activities include one or more of the following connections in New York are subject to the Article 9-A Franchise Tax:
 - Doing business in New York State
 - Employing capital in New York State
 - Owning or leasing property in New York State
 - Maintaining an office in New York State
 - Deriving receipts from activity in New York State

Nexus & Foreign Corporations



- Corporate partners, foreign corporations.
 - General partners of partnerships under the five criteria above are subject to tax imposed by Article 9-A.
 - Limited partners may also be subject to tax, specifically when the partnership is conducting one of the five criteria in New York and the foreign corporation engaged, directly or indirectly, in the participation in or the domination or control of all or any portion of the business activities or affairs of the partnership.
 - Deemed participation or dominion + control under certain factual situations, including where a foreign corporation has a 1% or more interest as a LP in the partnership and/or the basis of its interest in the limited partnership is more than \$1 million.
 - Prior versions of the draft regulations would have increased these thresholds to 5% and \$5 million.



Combined Reporting

- 2015 New York tax reform altered the rules for combined reporting. New York's system for combined reporting now requires combination when a more than 50% ownership test is met, and the corporations are engaged in a unitary business.
- Substantial litigation under the pre-2015 combined reporting "distortion" rules may give way to a brighter-line approach under the new rules and regulations.
- Taxpayers may also elect combined reporting if the requisite ownership test is met, whether or not the corporations are engaged in a unitary business.

Combined Reporting, Ownership & Control



- Final regulations address, among other topics:
 - **Section 6-2.2, Capital Stock Requirement.** “A taxpayer and another corporation meet the capital stock requirement if: (1) the taxpayer owns or controls, either directly or indirectly, more than 50% of the voting power of the capital stock of another corporation; or (2) more than 50% of the voting power of the capital stock of the taxpayer is owned or controlled, either directly or indirectly, by another corporation; or (3) more than 50% of the voting power of the capital stock of the taxpayer and more than 50% of the voting power of the capital stock of one or more other corporations are owned or controlled, either directly or indirectly, by the same interests.”
 - Stock Ownership AND Control are considered.

Combined Reporting, Unitary Business



- **Section 6-2.3, Unitary Business Requirement.** “the term “unitary business” shall be construed to the broadest extent permitted under the U.S. Constitution as interpreted by the U.S. Supreme Court, the courts of this state and the New York State Tax Appeals Tribunal.”
- A unitary business is characterized by a flow of value as evidenced by functional integration, centralized management, and economies of scale. Unitary Business Presumptions, Section 6-2.3(c)(2):
 - **Horizontal Integration** – capital stock + same general line of business
 - **Vertical Integration** – capital stock + different steps in vertical enterprise
 - **Strong Centralized Management** – capital stock + strong central management, AND centralized departments or affiliates “for such functions as” financing, advertising, R&D, purchasing.
 - **Newly-acquired Corporations** – Capital stock + one of the three typical indicia of unitary business.
 - **Holding Companies** – Capital stock requirement together with one or more operating companies, will be unitary with operating / other company.



3. New York City – Areas of Divergence from NYS Regulations



A Different Course for the City?

- The City has announced where it might diverge:
 - New York City currently taxes partnerships at the entity level pursuant to the Unincorporated Business Tax (“UBT”), and any partner of a partnership that pays any New York City income taxes is entitled to a credit for their share of the UBT. (In contrast, New York State does not have a UBT and treats partnerships consistently with federal income tax as flow-through entities.) Due to these factors, **the Department proposes to continue to use the UBT provisions as the primary method for the taxation and allocation of items of partnership income flowing to corporate partners.**



A Different Course for the City (Cont)?

- The Department proposes not to include language specifying the **standard of evidence** necessary to overcome presumptions and shall continue making determinations based on the individual facts and circumstances of the taxpayer. Complying with the “clear and convincing” evidence standard would be excessively burdensome for both the City and its taxpayers.
- The Department proposes to adopt New York State’s regulations regarding the special allocation of income from **passive investment customers** but is considering departing from the state’s fallback allocation approach....The Department is considering a fallback method of an 8% flat allocation, as it is a percentage used often within the BCT to allocate financial assets to New York City.



4. Case Law Update

Case Law Update – NY Court of Appeals’ Decision in *Disney* and *IBM* Case



- ***Matter of Walt Disney Co. v. Tax Appeals Tribunal*, No. 34 (2024 WL 1724639) (N.Y. Ct. App., April 23, 2024)**
- ***Matter of International Business Machines Corp. v. Tax Appeals Tribunal*, No. 35 (2024 WL 1724639) (N.Y. Ct. App., April 23, 2024)**
- In April 2024, the New York Court of Appeals ruled that Disney and IBM were not permitted to exclude royalty payments received from foreign affiliates that were not taxable in New York.
- Former Tax Law § 208(9)(o) (in effect from 2003 – 2013) required corporations that paid royalties to affiliates within their corporate group to add back those payments to their New York net income for calculating their franchise tax. To avoid taxing both affiliates on the same royalties, the statute also allowed affiliates that received royalty payments to deduct them from their own net income “unless such royalty payments would not be required to be added back” by the affiliate that paid them.
- Disney and IBM both received royalty payments from their foreign affiliates in exchange for the right to exploit IP assets. The companies deducted the royalty payments from the foreign affiliates in calculating their New York State tax liability.
- The Court found that both Disney and IBM could not deduct royalties received from foreign affiliates because the affiliates were not New York taxpayers subject to the state’s addback provision and the royalty payments would escape taxation.
- The Court rejected the taxpayers’ Dormant Commerce Clause arguments and upheld the Third Department’s determination that any burden the statute created on interstate or foreign commerce was incidental and constitutional.

Case Law Refresher –

Matter of Gerson Lehrman Group v. New York City Tax Appeals Tribunal (193 A.D.3d 452)



- This New York City apportionment case dealt with the proper method for calculating a corporation's receipts factor for General Corporation Tax ("GCT") purposes.
- Gerson Lehrman Group ("GLG") offered a subscription-based service that allowed its clients to access experts and consultants in a broad variety of disciplines.
- GLG took the position that **only** services rendered by the experts and consultants it contracted with should be included in GLG's receipts factor. GLG argued that the services performed by its other employees, such as salespeople, IT personnel, and consultant managers, should be omitted.
- The Appellate Division rejected GLG's argument and sided with the NYC Tax Appeals Tribunal in holding that the compensation for GLG's other employees (i.e., sales staff, IT staff, and consulting managers) must be accounted for in determining the corporation's receipts factor.

Matter of Gerson Lehrman (continued)– A cautionary tale



- NYC Admin. Code § 11-604.3(a)(2)(B) provides that receipts from “services performed within the city” are allocated to the city – but is silent when services are considered performed in the city, whose services count toward the formula, etc.
- The regulations (19 RCNY § 11-65(b)(3)(i)) stated that receipts from services performed in the city were allocable to the city “irrespective of whether such services were performed by employees or agents of the taxpayer, by subcontractors, or by any other persons. It is immaterial where such amounts were payable or where they actually were received.”
- The *Gerson Lehrman* decision shows how difficult it is to apply the “services performed” rule when you have a variety of employees performing different functions.
- These rules are still applicable for S corporations and for Unincorporated Business Tax (“UBT”) purposes!

Case Law Update – *Matter of E. & J. Gallo Winery* (ALJ Behuniak, February 15, 2024)



- Recent matter involving whether Petitioner, a multinational beverage manufacturing, distributing, and marketing company whose products included wines, spirits, and grape concentrates, was a “qualified New York manufacturer” (“QNYM”) under Tax Law § 210(1)(a)(vi).
- Petitioner owned vineyards and in 2016 expanded into New York by purchasing Nutt Road Vineyard. Petitioner did not use its own employees to operate the Nutt Road Vineyard. Instead, Petitioner entered into a service agreement with Martini Vineyards, Inc., which undertook the management, control, and operation of the Vineyard from 2016 through 2019 (the years at issue).
- When filing New York returns and determining its New York tax rate, Petitioner took the position it was a QNYM (0% rate on business income base).

Case Law Update – *Matter of E. & J. Gallo Winery* (ALJ Behuniak, February 15, 2024)



- Petitioner took the position that it was a QNYM, and the Audit Division disagreed. The ALJ sided with Gallo Winery, finding it met the three statutory requirements in Tax Law Section 210(1)(a)(vi) to be considered a QNYM, specifically Petitioner:
 1. Was “principally engaged” in (*i.e.*, derived more than 50% of its gross receipts from) the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing.
 2. Owned property located in New York that had an adjusted basis of at least \$1,000,000 at the close of each taxable year; and
 3. Principally used such property in the production of goods by the same list of activities noted in (1) above, including manufacturing and viticulture.
- Credit ALJ Behuniak for recognizing that: the QNYM requirements were in a provision imposing a tax, the Division’s interpretation was entitled to no deference, and the statute was “*to be construed most strongly against the government and in favor of the taxpayer.*”

Case Law Update – Appeal of Microsoft Corp. and Subsidiaries, California Office of Tax Appeals, No. 21037336 (7/27/23)



- Swing out West for a moment, for a potentially impactful decision from the California Office of Tax Appeals (“OTA”).
- After losing a substantial decision to Microsoft in July 2023 (resulting in a \$94M refund claim), the California Franchise Tax Board made a request for rehearing with the OTA. Rehearing was denied in February 2024, leaving the July 2023 opinion as final, and potentially precedential (to be determined).
- The primary issue in this case involved whether Microsoft, which elected to file California corporate income tax returns on a “Water’s Edge” basis, could include foreign dividends in its California sales apportionment factor. Based on a 2006 California ruling, taxpayers were generally not permitted to include receipts in the apportionment factor if those receipts are unrelated to activities that do not result in net business income.

Case Law Update – Appeal of Microsoft Corp. and Subsidiaries, California Office of Tax Appeals, No. 21037336 (7/27/23)



- Under California's tax code, Microsoft was entitled to a dividend received deduction for a large portion of its foreign dividends for "water's edge" filing purposes. Microsoft filed its original 2019 return under the 2006 legal ruling position, then filed for a refund claim.
- Microsoft's position was that no California statute or case law barred Microsoft from including the foreign dividends in its receipts factor computation, despite the 2006 ruling. The OTA agreed with Microsoft and allowed the inclusion of the foreign dividends in Microsoft's receipts factor.
- Microsoft also had to avoid other FTB arguments, including an argument that the foreign receipts were excludable "occasional sales," a request for alternative apportionment, and arguments regarding distortion.
- Potential for the opinion to become precedential. How would the apportionment factor work for New York Article 9-A purposes by comparison?



5. Case Studies

Article 9-A: Nexus & Foreign Companies



- X Corporation was formed in Delaware and maintains its principal office location in Houston, Texas.
- X Corporation develops and licenses software services for clients in the food and beverage industry. X Corporation owns 100% of the voting stock in Y Corporation, which develops and licenses similar software services for clients in the agriculture industry.
- X Corporation and Y Corporation do not maintain any employees, offices, property, or other tangible connections with New York State or New York City.
- During 2024, X Corporation received \$950,000 in receipts from business customers with New York addresses listed on license agreements and invoices.
- During 2024, Y Corporation—a unitary corporation wholly owned by X Corporation—had \$100,000 in receipts from business customers with New York addresses listed on license agreements and invoices.

Article 9-A: Nexus & Foreign Companies, Continued



- ***Is X Corporation Required to File in New York?*** Yes, under New York's foreign entity filing requirements, foreign businesses "deriving receipts" from New York sources more than \$1,000,000 annually, considering X Corporation and members of its combined unitary group (Y Corporation), are doing business and required to file in New York.
- ***Is Y Corporation Required to File in New York?*** Yes, X Corporation and Y Corporation meet the ownership and unitary tests and should be included on a combined report with X Corporation.
- After January 1, 2022, what is the NYC BCT outcome for both entities?



Article 9-A: Combined Reporting

- X Corporation owns 40% of the capital stock with voting rights of Y Corporation.
- Three X Corporation employees own a combined 15% of the capital stock with voting rights of Y Corporation. The employees have pledged their voting rights by Proxy to X Corporation, and when they leave, they will sell the stock to X Corporation.
- X Corporation and Y Corporation are engaged in separate lines of business. X Corporation primarily owns and operates hotels, while Y Corporation owns bakeries across the United States.
- Management for X Corporation and Y Corporation use the purchasing power and scale of both corporate entities to secure favorable pricing, and some back-office functions are shared for each corporation.

Article 9-A: Combined Reporting, Continued



- **Ownership test met?** Yes, the combined 40% of Corporation X + 15% of the three employees, who allow X Corporation to vote their shares by proxy, satisfy the ownership test. This test was satisfied through a combination of ownership (40%) and control (15%).
- **Unitary business test met?** Likely yes, considering the indicia of a unitary business between X Corporation and Y Corporation, including economics of scale and centralized management / business functions.

Questions?



HODGSON RUSS
Contact Us



Christopher Doyle

Partner

716.848.1458

cdoyle@hodgsonruss.com



Daniel Kelly

Partner

716.848.1561

dpkelly@hodgsonruss.com



Brandon Bourg

Associate

716.848.1607

bbourg@hodgsonruss.com



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