

New York 2017-2018 State Budget Bill Enacted

Overview

On April 10, 2017, Governor Andrew Cuomo of New York signed into law the 2017-2018 Budget Act (S2009C/A3009C) (Budget Act).¹ The Budget Act includes amendments to the Article 9-A state franchise tax on business corporations (including certain state credits and incentives), the state personal income tax, and state sales and use taxes. Note that while earlier drafts of the budget bill this past legislative session proposed to amend New York State law to automatically treat federal S corporations as S corporations for New York State franchise tax purposes (*i.e.*, without making an election), this proposal was *not* adopted in the final Budget Act.

This Alert summarizes the more significant New York State and New York City tax law changes included in the Budget Act.

Article 9-A Franchise Tax on Business Corporations

QFI for Non-Captive RICs and REITs – Part VV

The Budget Act amends New York State and New York City law to include a separate definition of qualified financial instrument (QFI) applicable only to non-captive real estate investment companies (RICs) and real estate investment trusts (REITs). In general, if a financial instrument meets the requirements to be considered a QFI, a taxpayer may elect special sourcing rules for receipts and gains from the QFI. Specifically, in determining the inclusion of receipts and net gains for apportionment purposes from QFIs, taxpayers may annually elect to use a fixed percentage method whereby 8% of all income from QFIs is treated as business income. Prior to the Budget Act, a QFI generally was defined as a type of financial instrument² that had been marked to market under Internal Revenue Code (IRC) Secs. 475 or 1256, among other requirements. For non-captive RICs and REITs, the Budget Act removes the requirement that otherwise applicable financial instruments must be marked to market under IRC Secs. 475 or 1256 to qualify as QFIs.³

- The Budget Act also amends New York State tax law to provide separate fixed dollar minimum schedules for non-captive RICs and REITs with fixed dollar minimum tax amounts ranging from \$25 to \$500 based on the amount of an entity's New York receipts. Separate fixed dollar minimum schedules for non-captive RICs and REITs do not apply for New York City purposes.⁴
 - These changes apply to tax years beginning on or after January 1, 2016.

Personal Income Tax

Nonresident Sale of Partnership Interest – Part AA

The Budget Act amends N.Y. Tax Law Sec. 632(a)(1), which establishes the type of income that is considered New York source income for nonresident partners of partnerships. As a result of this amendment, federal tax gain

¹ [Chapter 59, Laws of 2017.](#)

² See N.Y. Tax Law Sec. 210-A.5(a) and N.Y.C. Admin. Code Sec. 11-654.2(5)(a) to determine what constitutes a qualified financial instrument. Note that the New York State Department of Taxation and Finance recently has issued draft proposed regulations that may further narrow the definition of a qualified financial instrument. See [New York Business Corporation Franchise Tax Draft Proposed Reg. Sec. 4-2.4.](#)

³ Recently, the New York State Department of Taxation and Finance (Department) informally indicated it may permit non-captive RICs and REITs to apportion 8% of receipts on New York State returns as if the QFI election was made for taxable years beginning on or after January 1, 2015 and before January 1, 2016, and that if a taxpayer opts to apportion its income in this manner, the taxpayer should include 90% of the 8% amount of receipts in the numerator of the apportionment fraction for purposes of calculating the Metropolitan Transportation Business Tax Surcharge.

⁴ Pursuant to the Department's unofficial guidance referenced in Footnote 3, the Department has informally indicated that its existing processing systems are unable to accommodate these changes for purposes of processing 2016 tax returns. To this end, the Department recommends that taxpayers follow the new fixed dollar minimum schedule and then immediately contact the Department if any notice of underpayment of fixed dollar minimum tax is issued in error.

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recognized by a nonresident partner who sells or transfers a partnership interest in a transaction subject to IRC Sec. 1060 is “treated as New York source income allocated in a manner consistent with the applicable methods and rules for allocation under [the personal income tax provisions in the New York Tax Law] in the year that the assets were sold or transferred.” This amendment takes effect immediately.

Definition of Real Property Located in New York – Part Z

The Budget Act amends N.Y. Tax Law Sec. 631(b)(1)(A), which generally provides that New York source income for nonresident individuals includes income, gain, loss and deduction derived from or connected to the ownership of any interest in real or tangible personal property in New York. The new provision expands the definition of real property located in New York to include an interest in an entity (i.e., limited liability company (LLC), partnership, S corporation or non-publicly traded C corporation with fewer than 100 shareholders) that owns shares of stock in a cooperative housing corporation (coop shares) where the cooperative housing units related to the coop shares are located in New York, provided that the fair market value of the real property in the entity (including the coop shares and underlying cooperative housing units) equals or exceeds 50% of all the assets of the entity on the date of sale or exchange of the taxpayer’s interest in the entity. This provision is applicable to tax years beginning on or after January 1, 2017.

New York State Personal Income Tax – Part R

The Budget Act amends N.Y. Tax Law Sec. 601(a)(1)(B) to extend the top personal income tax rate of 8.82% until the end of the 2019 tax year. For tax years beginning on or after January 1, 2020, the top personal income tax rate will be 6.85%.

New York City Personal Income Tax – Part C

The Budget Act increases the New York City Personal Income Tax rate and amends the New York City school tax reduction credit. These amendments are effective for tax years beginning on or after January 1, 2017.

Sales and Use Taxes

Transactions between Related Entities – Part CC

The Budget Act attempts to close perceived “tax loopholes” for transactions between related entities by revising the definition of a “retail sale.” Prior to these Budget Act amendments, for example, certain related entities may have availed themselves of New York’s resale exemption by purchasing high-value property for resale (*i.e.*, exempt from sales tax) and subsequently leasing the property to a member or owner using long-term leases or with lease payments that were a fraction of the fair market value of the purchased property. To apparently address these types of transactions, the Budget Act amends the state sales tax definition of a “retail sale” to include transfers of tangible personal property to certain entities when the property is resold to a related person or entity. Such transfers included in the Budget Act are: (1) sales to single member LLCs or subsidiaries that are disregarded for federal income tax purposes, for resale to the entity’s member or owner; (2) sales to a partnership for resale to one or more of its partners; and (3) sales to a trustee for resale to the underlying trust’s beneficiary. Sales of tangible personal property between related corporations are *not* included in the amendment to the definition of “retail sale.” In this respect, the new definition of “retail sale” may remove the incentive to artificially use or create such entities in an attempt to avoid state sales tax.

In addition, prior to these Budget Act amendments, nonresidents generally were permitted to bring property or services into New York for use within New York without incurring state use tax; this exemption may have led to circumstances where a resident person or entity would create a new entity solely to purchase high-value property outside New York and subsequently bring such property into New York in an attempt to avoid state use tax. The Budget Act provides that the use tax exemption under N.Y. Tax Law Sec. 1118(2) does *not* apply when a person (other than an individual) brings property or services into New York unless that person has been doing business outside of New York for at least six months prior to the date the property is brought into New York. These provisions are effective immediately.

Sales Tax on the Sale of Gas Service or Electric Service – Part DD

The Budget Act clarifies the imposition of state sales tax on the sale of gas service or electric service. This provision amends N.Y. Tax Law § 1105-C to clarify that sales tax is imposed on the transporting, transmitting, or delivering charges for gas or electricity when the transportation, transmission or distribution is delivered by the provider of the commodity. This provision is effective immediately.

Prepaid Sales Tax on Motor Fuel and Diesel Motor Fuel – Part UU

The Budget Act amends N.Y. Tax Law § 1111(e) by reducing the prepaid sales tax imposed on motor fuel that is imported, manufactured or sold in, or diesel motor fuel that is sold or used in localities included in the Metropolitan Commuter Transportation District, Nassau County, or Suffolk County to sixteen cents per gallon. In addition, the

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Budget Act reduces the prepaid sales tax imposed on motor fuel that is imported, manufactured or sold in, or diesel motor fuel that is sold or used in all other localities in New York State to fifteen cents per gallon. This provision is effective on September 1, 2017.

Further, the Budget Act adds two sections (Sections 4 and 5) to N.Y. Tax Law § 1111(e). Section 4 is added to authorize the Commissioner of the New York State Department of Taxation and Finance (Commissioner) to adjust the motor fuel and diesel motor prepaid tax rates imposed per region. Beginning October 2017, the Commissioner must release a rate schedule per region requiring a tentative rate of tax to be prepaid per gallon. These schedules must be reviewed on a semiannual basis in the months of April and October and if a proposed rate change is greater than two cents, the Commissioner must adjust to the tentative rate. Finally, the Commissioner must publish such rate schedules in addition to the regional average retail sales prices of motor fuel and diesel motor fuel on the Department's website, no later than ten days prior to any rate change becoming effective. Section 5 is added to allow a credit for registered distributors in the event that a rate is lowered and a registered distributor has prepaid tax on inventory at a higher rate on fuel after the effective date. In addition, Section 5 imposes the responsibility on registered distributors to pay the higher rate on fuel in the event that a rate change is higher, after the effective date. These provisions are effective on September 1, 2017.

[Sales and Use Tax Exemption on Certain Monuments – Part WW](#)

The Budget Act adds a new paragraph to N.Y. Tax Law § 1115(a) exempting monuments from New York sales and use tax. Under Section 1502(f) of New York State's not-for-profit corporation law, qualifying monuments generally are defined as "a memorial erected in a cemetery on a lot, plot or part thereof, except private mausoleums." This provision takes effect on the first day of a sales tax quarterly period, at least ninety days after April 10, 2017, and applies to sales made on or after such date.

Credits & Incentives

[Excelsior Jobs Program – Part YY and Part ZZ and Part K](#)

The Budget Act amends the Excelsior Jobs Program (Program) including the following:

- A) Increases the value of the research and development credit from 3% of qualified research expenditures attributable to activities in New York to 6%. N.Y. Econ. Dev. Law Sec. 355. This provision applies to tax years beginning on or after January 1, 2018.
- B) Effective immediately, reduces certain minimum net job thresholds required to participate in the Program for some types of business operations. N.Y. Econ. Dev. Law Sec. 353.
- C) Effective immediately, amends regionally significant project provisions with new minimum net job and capital investment thresholds for some types of business operations. N.Y. Econ. Dev. Law Sec. 352.
- D) Expands eligibility requirements for the Program to include a new category for "Life Sciences Companies" that create a minimum of 5 jobs. The definition of a regionally significant project is also amended to include a life sciences company that creates 20 net new jobs in New York while making a significant capital investment in New York. N.Y. Econ. Dev. Law Secs. 352 – 354. This provision takes effect immediately and applies to tax years beginning on or after January 1, 2018.

Additionally, taxpayers under the Program may now take credits until the end of 2029, due to the amendment of N.Y. Econ. Dev. Law Sec. 354(5); this provision takes effect immediately.

[Life Sciences Research and Development Tax Credit – Part K](#)

The Budget Act creates a new Life Sciences Research and Development Tax Credit with \$10 million of funding per year for qualified life sciences companies. Under these new provisions, taxpayers must be certified as an eligible life science company and be a "new business" as defined under state statutes. Eligible taxpayers must apply to the Empire State Development Corporation for the Life Sciences Research and Development Tax Credit, which is equal to 15% of qualified research expenditures incurred in New York State (or 20%, if the eligible taxpayer employs less than ten people). The maximum Life Sciences Research and Development Tax Credit is \$500,000 per taxpayer in any tax year, with \$10 million in funding available for the credit for research and development expenses incurred from 2018 until the end of 2027. Life Sciences Research and Development Tax Credits may be available to Article 9-A and Article 22 taxpayers. Life Sciences Research and Development Tax Credits are allocated to taxpayers in the order of receipt of an application to take the credit; additional criteria may also apply. These provisions of the Budget Act take effect immediately and apply to tax years beginning on or after January 1, 2018.

[Employee Training Incentive Program – Part L](#)

N.Y. Econ. Dev. Law Sec. 441 is amended to include defined "Life Sciences Companies" as being eligible for the Employee Training Incentive Program. In addition to expanding this program to "Life Sciences Companies," the Budget Act also imposes an amended "significant capital investment" requirement and eliminates the net new job

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requirement. Under the amended law, a significant capital investment is now defined as a capital investment “in new business processes or equipment, the cost of which is equal to or exceeds ten dollars for every one dollar of tax credit allowed to an eligible business entity under this program pursuant to subdivision fifty of section two hundred ten-B or subsection (DDD) of section six hundred six of the tax law.” This program generally provides refundable tax credits of up to 50% of eligible trainings costs, up to \$10,000 per employee, or 50% of the stipend paid to an intern. This amendment to the Budget Act takes effect immediately.

[Film Credit and Film Post Production Credit – Part M](#)

The Budget Act amends New York tax law to extend the Empire State Film Production Tax Credit Program through December 31, 2022. Previously, this credit was set to expire after 2019.

[New York Youth Jobs Program Tax Credit and Empire State Apprenticeship Tax Credit Programs – Part N](#)

The Budget Act amends N.Y. Labor Law Sec. 25-a and allocates \$40 million to the New York Youth Jobs Program Tax Credit for each year from 2018 until 2022, with \$20 million being reserved for qualified employees and \$20 million being reserved for qualified individuals.

The Budget Act also adds N.Y. Labor Law Sec. 25-c, which creates a new program known as the “Empire State Apprenticeship Program,” that provides incentives to companies that employ disadvantaged youth in part-time and full-time positions. This credit amount ranges from \$2,000 - \$7,000 per apprentice, per year, with higher credits being allocated to apprentices with additional years of mentorship in this program.

[Investment Tax Credit Changes – Part P](#)

The Budget Act amends N.Y. Tax Law Sec. 31 to exclude property principally used in the production or distribution of electricity, natural gas after extraction from wells, or steam or water delivered through pipes and mains. This provision of the Budget Act takes effect immediately.

[Single Member LLCs/Disregarded Entities – Part Q](#)

The Budget Act amends N.Y. Tax Law Sec. 43 to treat a single member LLC that is disregarded as an entity separate from its owner for federal income tax purposes, as a disregarded entity for purposes of determining eligibility for New York State tax credits allowed under Articles 9, 9-A, 22, 33, and 32 (prior to its repeal). This provision of the Budget Act is effective immediately, and applies to all taxable years that are still open under the statute of limitations for purposes of seeking a refund or assessing additional tax.

[Alternative Fuels and Electric Vehicle Recharging Property Credit – Part O](#)

The Budget Act amends N.Y. Tax Law Sec. 187-b to extend the Alternative Fuels and Electric Vehicle Recharging Property Credit until 2022.

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