

**THE CITY OF NEW YORK
DEPARTMENT OF FINANCE**

NOTICE OF RULEMAKING

Pursuant to the power vested in me as Commissioner of Finance by sections 389(b) and 1043 of the New York New York City Charter and section 11-687(1) of the Administrative Code of the City of New York, I hereby promulgate the within amendment to the Rules Relating to the New York City General Corporation Tax.

Section 1. Subdivision (c) of section 11-63 of Title 19 of the Rules of the City of New York Relating to the General Corporation Tax, promulgated August 15, 1968 and last amended March 9, 2001, is amended to add a new paragraph (4) to read as follows:

(4) Double-weighted receipts factor for manufacturing businesses. (i) For taxable years beginning on or after July 1, 1996, a corporation that is a manufacturing corporation as defined in subparagraph (ii) may elect to determine its business allocation percentage by adding together the percentages determined under §§11-64 and 11-66 of these rules and adding to that sum two times the percentage determined in §11-65 of these rules and dividing the total by the number of percentages. See paragraph (2) of this subdivision (c) for the determination of the business allocation percentage where one or more factors is missing.

(ii) Manufacturing corporation. For purposes of this paragraph, a manufacturing corporation is defined as a corporation engaged primarily in the manufacturing and sale of tangible personal property.

(A) (1) Manufacturing. Manufacturing means the process, including assembly, of working raw materials into wares suitable for use or that, by the use of machinery, tools, appliances and other similar equipment, gives new shapes, qualities or new combinations to matter that already has gone through some artificial process.

(2) To qualify as manufacturing, a process, including assembly, must result in a significant change in the raw materials or component parts such that the end product of the process is substantially different in nature or form from the raw materials or component parts.

(3) Manufacturing includes finishing partially finished goods only if the partially finished goods are not usable for their intended purpose in their unfinished state and does not include the mere packaging or labeling of goods.

(4) Manufacturing includes printing in circumstances under which the taxpayer receives any combination of graphic or textual content from a customer, the taxpayer produces a tangible representation of that content, whether in print or other tangible form, through a series of processes using raw materials owned by the taxpayer and the taxpayer delivers that tangible product to the customer or one or more designees of the customer. Manufacturing also includes printing in circumstances under which the taxpayer uses any combination of graphic or textual content prepared by its own employees to

produce a tangible representation of the content in print or other tangible form using raw materials owned by the taxpayer and the taxpayer delivers that tangible product to its customers or subscribers.

(5) Manufacturing does not include furnishing information services subject to the tax imposed by section 1105(c)(1) of the tax law regardless of whether the information is provided in tangible form.

(6) Manufacturing includes the design and development of pre-written computer software as defined in section 1101(b)(14) of the tax law to the extent that such pre-written computer software constitutes tangible personal property under section 1101(b)(6) of the tax law.

(7) A corporation that performs services for a customer, including manufacturing services, on property or raw materials belonging to the customer will not be considered a manufacturing corporation.

(B) To qualify as a manufacturing corporation, a corporation must be engaged in both the manufacture of tangible personal property and the sale of such property that it manufactures. Therefore, a corporation that manufactures tangible personal property but does not engage in the sale of such tangible personal property will not be considered a manufacturing corporation. Similarly, a corporation that sells tangible personal property but does not engage in the manufacture of tangible personal property will not be considered a manufacturing corporation. For purposes of this paragraph, the lease of tangible personal property will be considered a sale of tangible personal property.

(C) For purposes of this paragraph, a corporation engaged in the manufacture and sale of tangible personal property will be considered to be primarily engaged in that activity if more than 50 percent of its gross receipts for the taxable year are derived from the sale of tangible personal property manufactured by the taxpayer.

(1) For purposes of this subparagraph (ii)(C), gross receipts include only amounts treated as business receipts for purposes of §11-65 of these rules earned in the ordinary course of the taxpayer's trade or business.

(2) For purposes of this subparagraph (ii)(C), gross receipts derived from the sale of tangible personal property shall mean the sale price of such tangible personal property valued in money, whether received in money or otherwise, without any deduction for expenses or early payment discounts, and including;

(i) any amount for which credit is allowed to the purchaser,

(ii) any charges to the purchaser for shipping or delivery regardless of whether such charges are separately stated in the written contract, if any, or on the bill rendered to such purchaser and regardless of whether such shipping or delivery is provided by the taxpayer or a third party, and

(iii) any charges for services provided by the taxpayer relating to the sale of the tangible personal property provided that such services are subordinate to the sale of the tangible property and provided that such charges are not separately stated in a written contract or bill.

(iii) If a group of corporations is permitted or required to file a combined report and the group, including all corporations in the group whether or not taxpayers, would qualify as a manufacturing corporation if it were a single corporation, excluding all intercompany transactions, the combined group may make an election under this paragraph. If a combined group would not qualify as a manufacturing corporation if it were a single corporation, neither the group nor any of its members may make the election under this paragraph even if one or more member corporations would qualify as manufacturing corporations if they were not included in the combined group. In order for the combined group to qualify as a manufacturing corporation it is not necessary that there be any individual member of the group that would qualify if it were not included in the combined group. See examples 7 and 8.

(iv) An election to use the double-weighted receipts factor must be made on a timely filed original return (including extensions) for the taxable year. A separate election must be made for each taxable year. The election is irrevocable and cannot be made or revoked on an amended return except with the permission of the Commissioner upon such terms and as the Commissioner may specify where the Commissioner concludes that such permission should be granted in the interests of fairness due to changes in circumstances resulting from an audit adjustment. Except as otherwise provided in the preceding sentence, if a taxpayer fails to make an election to use the double-weighted receipts factor, its business allocation percentage must be determined under the provisions of paragraph (2) of this subdivision (c).

(v) The provisions of this paragraph are illustrated by the following examples:

Example 1: X Corporation is engaged in printing pamphlets, brochures, catalogues and business reports. Under an agreement with customer A, X Corporation receives graphic material and text from customer A that X uses to produce print plates, which are used to print multiple copies of a catalogue. X Corporation uses its own raw materials, including paper and ink, and its own equipment to produce the plates and the catalogue. X Corporation employees advise A with regard to the layout and typeface of the catalogue. In the course of performing the contract, X Corporation delivers a master print to A for its review and final approval. In addition, under the agreement with A, X Corporation prepares an electronic version of the catalogue for incorporation into a Web page maintained by A. X Corporation mails the print version of the catalogue to A's customers and delivers the electronic version of the catalogue to A on a disk. X Corporation receives \$500X under the agreement with no breakdown of the price among the various services and products provided.

Under an agreement with customer B, X Corporation receives the text of an annual financial statement required to be filed electronically with the SEC by B. B also requires print copies of the statement. X prints the report in hard copy, using its own ink and equipment but using paper belonging to the customer, delivers the hard copies to B and transmits the statement electronically to the SEC. X Corporation receives \$200X under the agreement with B with no breakdown of the price among the various services and products provided.

X Corporation's activities under the agreement with A are considered the manufacture and sale of tangible personal property. (Note: if X Corporation delivers the electronic version of the catalogue to A by means of the Internet the result would not change. The \$500X received by X Corporation under the contract with A would be considered receipts from the manufacture and sale of tangible personal property provided that the provision of the electronic version is subordinate to the sale of the print version of the catalogue.) No part of X Corporation's activities under the agreement with B are considered the manufacture and sale of tangible personal property because under the agreement with B, X Corporation is merely performing services on property owned by

B. (Note: if X Corporation used its own paper for the print copies, X Corporation's activities under the agreement with B would be considered the manufacture and sale of tangible personal property.) Of X Corporation's total business receipts of \$700X, \$500X are from the manufacture and sale of tangible personal property. Therefore, X Corporation is considered to be a manufacturing corporation.

Example 2: Corporation X is engaged in compiling, printing and distributing a daily newspaper using material received from news services, its own reporters and editorial staff, its own paper and ink and printing equipment and its own technicians. Corporation X is considered engaged in manufacturing. Corporation X receives \$100X in receipts from the sale of newspapers and \$400X in receipts from the sale of advertising. Because less than 50 percent of Corporation X's receipts are from the manufacture and sale of tangible personal property, X is not considered a manufacturing corporation.

Example 3: Corporation A is engaged in film processing whereby it receives undeveloped film from its customers and, using its own chemicals, paper and equipment, develops the film and makes print or slide copies for customers. Corporation A is engaged in manufacturing. If instead of using its own materials and equipment, Corporation A contracts with Corporation B to develop the film and make prints, Corporation A is not engaged in manufacturing.

Example 4: Y Corporation contracts with A Corporation, an unrelated entity, to produce a line of art supplies, crayons, paper, markers, glue, etc. from raw materials purchased by Y. The finished goods are delivered to Y. Y packages two or more of those products together with paper purchased from another unrelated supplier into kits that Y sells to toy and art supply retailers. A Corporation's receipts under the contract with Y are not receipts from the manufacture and sale of tangible personal property because Y provides and owns the raw materials. Y's receipts from the sale of the kits are not receipts from the manufacture and sale of tangible personal property because Y does not manufacture the component parts itself and the packaged kits do not differ substantially in nature or form from the various component parts.

Example 5: Corporation W washes, cuts, cooks, freezes and packages vegetables for wholesale and retail sale to customers. Corporation W is considered to be engaged in manufacturing.

Example 6: Corporation M collects, sorts, shreds and compresses scrap metal into blocks that are convenient for handling, storage and shipping and sells the scrap metal blocks to companies that manufacture finished goods from them. Corporation M is considered to be engaged in manufacturing because the scrap metal sold differs substantially in nature from the components collected by M, which were not suitable for convenient handling, storage, shipping and sale in their original form.

Example 7: Corporation C purchases fabric, cuts and sews clothing for sale to a wholesale distributor, Corporation E. Corporation C is engaged in the manufacture and sale of tangible personal property. Corporation E packages and labels the clothing for resale to its retail outlet customers. Corporation E is not considered to be engaged in manufacturing. If Corporation C cuts and sews fabric provided by Corporation D where Corporation D retains title to the fabric and D sells the finished clothing, neither Corporation C nor Corporation D would be considered to be engaged in the manufacture and sale of tangible personal property. Corporation C is providing manufacturing services and Corporation D is not conducting the manufacturing activities itself. Corporation C and Corporation D viewed as a single corporation would be considered to be engaged in manufacturing and sale of tangible personal property, and, if Corporation C and Corporation D are permitted or required to file a combined report and meet the other requirements of subparagraph (iii) of this paragraph, Corporation C and Corporation D may make the election under this paragraph.

Example 8: Corporation X operates a chain of supermarkets. Corporation X sets up a subsidiary, Corporation S to produce, package and sell food products through Corporation X's markets and markets operated by third parties. Corporation X and Corporation S are required to file a combined return. Corporation S has receipts of \$100X entirely from the manufacture and sale of tangible personal property. Corporation X has receipts of \$900X

from the supermarket business. The combined group may not make the election under this paragraph, because less than 50 percent of its total receipts are from the manufacture and sale of tangible personal property.

Example 9: Corporation T purchases finished articles of clothing and using its own equipment and raw materials, imprints or embroiders its logo on each article. Corporation T sells the clothing under its own label. Corporation T is not considered engaged in manufacturing. While the presence of the logo on the clothing may increase its marketability, it does not substantially alter the nature or form of the clothing itself and the clothing is useable as such without the logo.

Example 10: Corporation P purchases fabric from a mill and, using its own equipment, dyes, and other materials, puts a pattern on the fabric through a variety of processes and sells the fabric to clothing manufacturers. Corporation P is considered to be engaged in the manufacture and sale of tangible personal property because it substantially alters the nature of the material.

Example 11: CS Corporation is exclusively engaged in the bottling and sale of soft drinks. CS maintains a factory where it mixes syrup then combines the syrup with carbonated water, places the mixture in bottles, labels the bottles and places them in cartons, then sells the cartons to retailers and wholesalers. CS is a manufacturing corporation.

Example 12: X Corporation is engaged in the design, development and sale of computer software. X Corporation's employees use computers, programming languages and a library of "pre-written" functions and routines to develop software for use by financial institutions to manage accounts. X Corporation sells the same software to several customers although the software is enhanced or modified to meet the specific needs of each customer. Some customers receive the software on a disk, others receive it electronically over the Internet. More than 50% of X Corporation's gross receipts derive from both types of sales. The software is taxable as "pre-written computer software" under section 1101(b)(14) of the tax law. Sales of the software are treated as sales of tangible personal property for purposes of section 1101 of the tax law and, therefore, for purposes

of subparagraph (ii)(C) of this paragraph. X Corporation is a manufacturing corporation.

BASIS AND PURPOSE OF AMENDMENTS

These amendments affect the portion of the Rules Relating to the New York City General Corporation Tax governing the allocation of entire net income. Specifically, these amendments reflect the enactment by Ch. 625 of the Laws of 1996 of a provision allowing manufacturing corporations to elect to use a double-weighted gross income factor in allocating income. These amendments provide a definition of "manufacturing corporation" for purposes of that election.

/S/ Andrew S. Eristoff
Commissioner of Finance