The New York City Department of Finance
Business Corporation Tax Regulations

The New York City Department of Finance (the "Department") is in the process of developing regulations implementing the Business Corporation Tax ("BCT"), added by Chapter 60 of the Laws of 2015. The City is developing these regulations in light of significant State regulatory action. On December 27, 2023, the New York State Department of Taxation and Finance issued a Notice of Adoption for corporate tax reform regulations in the State Register. These state corporate tax reform regulations implemented significant statutory changes made by Chapter 59 of the Laws of 2014 (as well as technical amendments made by Chapter 59 of the Laws of 2015 and Chapter 60 of the Laws of 2016). The Department is planning to promulgate regulations implementing the BCT. The Department's regulations would substantially parallel the State's corporate tax reform regulations. However, in several respects, the City is considering departing from the policies contemplated in the State's regulations. The following sections describe the major areas in which the Department's regulations would depart from the policies adopted by the State.

Allocation of Flow-Through Income from Partnerships

The Department is considering a departure from the allocation approach used by New York State. New York Tax Law Section 210(3) and New York Codes, Rules and Regulations Title 20, Section 9-2.2 require the use of the "aggregate method" in circumstances where there are sufficient contacts between the partnership and the corporate partner. Under this method, the income is treated as if it is earned directly by the corporate partner and gets apportioned using the procedures set forth in New York Codes, Rules and Regulations Title 20 and Tax Law Article 9-A. If there is insufficient contact or information from the partnership, the fallback method of apportionment under state regulations is the "entity method." Under the entity method, in order to apportion the partnerships' distributive share, a corporate partner must multiply the income from the partnership by the corporation's Apportionment Factor, which is determined without regard to the partnership's income or activity.

Unlike the New York Tax Law, the New York City Administrative Code ("Ad Code") gives the commissioner of the Department a high degree of flexibility regarding how to include a partnership's distributive share in the corporate partner's income. Ad Code Section 11-654(4-a) states that a corporation that is a partner in a partnership will compute its BCT using any method required or permitted by the regulations. Additionally, 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. Any items of income or gain from a partnership will be allocated under the statutory and regulatory rules of the UBT and will not be included in the receipts factor of a corporate partner. The corporation's other income will be allocated under the Business Allocation Percentage ("BAP") calculated pursuant to Ad Code Section 11-654.2. The sum of the separately allocated partnership income and the business income allocated using the BAP will be the corporate partner's taxable income for the purposes of the BCT. The UBT paid credit will continue to be available to all corporate partners.

Clear and Convincing Evidence

The Department is considering departing from the evidentiary standards imposed by New York Codes, Rules and Regulations Title 20, Sections 4-1.6(d), 4-3.2(e), 4-4.2(e), and 6-2.3(c), which relate to overcoming presumptions related to certain allocation provisions and determining the existence of a unitary business. These New York State regulations state that to overcome the presumptions contained in these sections, either the taxpayer or the Department must meet the "clear and convincing" evidence standard.

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.

Allocation of Income from Passive Investment Customers

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 provision in question is New York Codes, Rules and Regulations Title 20, Section 4-4.4(c), which dictates how to determine where the taxpayer's customers receive the benefit of the services performed by the taxpayer that are not otherwise enumerated within the regulations ("other business receipts"). A passive investment customer is defined in Section 4-4.1(b)(3) as an entity that pools capital from passive investors for the purpose of trading or making investments in stock, bonds, securities, commodities, loans, or other financials assets, but that does not otherwise conduct a trade or business. Pursuant to Section 4-4.4(c), income from passive investment customers constituting receipts from management, distribution, and administration services are to be apportioned based on the location of the investors that contribute to the pooled capital. If the taxpayer does not have this information, then the taxpayer may apportion the receipts based on the location where the contract for the services is managed by the passive investment customer.

The Department proposes to replace the second method with one that is more closely related to the primary method of investor location. The place where the contract is managed is a singular location and the potential for the manipulation of that location is a concern for the City. 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.

Billing Address Safe Harbor

The Department proposes to increase the number of customers needed to meet the requirements of the billing address safe harbor over the threshold of 250 found in New York Codes, Rules and Regulations Title 20, Sections 4-3.2(d)(1)(ii) and 4-4.2(d)(1)(ii).

The billing address safe harbor is a way to simplify the determination of where the benefit of a product or service is received in the case of other business receipts, or, in the case of receipts from digital products, the determination of the primary use location of a digital product or service. New York State regulations provide that if a taxpayer has 250 business customers purchasing substantially similar products or services and no more than 5% of receipts from such products or services are from any particular customer, then there is a presumption that the primary use location (for digital products or services) or the location where benefit is received (for other business receipts) is the customer's billing address.

The Department is considering adopting this same policy, however, with the threshold as low as 250 customers, the safe harbor would apply to nearly every taxpayer that is not a small business, effectively becoming the default rule. The Department seeks to increase the number of customers needed to meet the safe harbor requirements to 1,000, as it would relieve the burden on the large taxpayers but not replace the default rule by being too widely applicable.

Real Estate Mortgage Investment Conduits

The Department proposes to depart from New York Codes, Rules and Regulations Title 20, Section 3-3.1(a)(2)(v), which excludes from entire net income ("ENI") the amount of excess inclusion required to be reported for federal income tax purposes by Internal Revenue Code ("IRC") Section 860E.

IRC Section 860E applies to taxpayers that are holders of a residual interest in Real Estate Mortgage Investment Conduits and requires that the taxable income of such interest holders be no less than the amount of the excess inclusion defined by IRC Section 860E(c).

New York City Administrative Code Subchapter 3-A contains no statutory requirement that the excess inclusion be deducted from federal taxable income. The Department aims to maintain conformity with federal taxable income and retain the excess inclusion when calculating ENI, as has been historically done under the General Corporation Tax.