Updated as of September 12th, 2024

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 also 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 has considered potentially departing from the policies contemplated in the State's regulations. In order to receive tax practitioners' and policy advocates' perspectives regarding these points of departure –or any other concerns relating to these regulations— the Department conducted two public virtual discussion sessions on May 14 and May 15, 2024 and received comments both in writing and at the sessions themselves.

The following sections describe the major areas in which the Department considered regulations that would constitute a departure from the policies adopted by the State, the comments that the Department received and the Department's intended policies in light of these comments. Other areas of the City's rules may ultimately deviate from the State's rules in order to implement differences in administrative procedures, existing differences in tax policy or to account for differences in the mechanics of the City's and State's tax statutes.

Neither the discussion sessions nor this summary constitute steps in the City Administrative Procedures Act ("CAPA") process. *See* Charter ch. 45. Ultimately, promulgation of the City's BCT regulations will follow the standard CAPA process, which will include a public hearing. The City intends to provide additional updates on its progress towards formal initiation of CAPA; however, a precise timeline for rulemaking is not available as of the date of this writing.

Allocation of Flow-Through Income from Partnerships

Initially, the Department considered diverging from the allocation approach used by New York State for partnership flow-through receipts. Pursuant to section 11-654(4-a) of the Administrative Code of the City of New York ("Administrative Code"), a corporation that is a partner in a partnership must compute its BCT using any method required or permitted under the Department's regulations. Pursuant to this broad authority, the Department had initially

considered a method of allocating a corporate partner's distributive share of partnership income using the sourcing rules of the Unincorporated Business Tax ("UBT"), which applies to partnerships doing business in New York City. Under this initially contemplated approach, the allocation of partnership income would have been conducted separately from the allocation of the corporation's non-partnership income and would not have entered the Business Allocation Percentage ("BAP") of the corporate partner.

In contrast, the law and recent rules governing the New York State Corporate Tax require the use of the "aggregate method" in circumstances where there are sufficient contacts between the partnership and the corporate partner. *See* New York Tax Law § 210(3); New York Codes, Rules and Regulations Title 20 ("20 NYCRR") § 9-2.2. Under this method, the income is treated as if it is earned directly by the corporate partner and is apportioned using the procedures applicable to other corporate income. *See generally* Tax Law art. 9-A; *See also* 20 NYCRR ch 1, subch. A. If there is insufficient contact or information from the partnership, the fallback method of apportionment under state regulations is the "entity method." *See* 20 NYCRR § 9-2.4. 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.

Commenters expressed concern about the allocation of income from partnerships not subject to the UBT under this initially contemplated approach (*e.g.*, pursuant to the self-trading or holding, leasing and managing of real property exceptions under Administrative Code § 11-502) and the integration of UBT modifications into the corporate level flowthrough income. More generally, commenters inquired whether the UBT allocation rules would be adopted for all sources of receipts or only for certain categories of receipts; what methodology would be used to avoid double-counting of partnership income; and what partnership losses would be allocated to corporate partners. Commenters also noted potential incompatibilities between the applicable statutory authorities and this initially contemplated methodology, given the different definitions of investment income between the BCT and the UBT in the Administrative Code. Similarly, these commenters also observed the potential incompatibility of this methodology with the statutory authority governing the process of determining economic nexus for the purposes of BCT applicability. Commenters also generally questioned the breadth of the City's flexibility under the BCT framework. Lastly, commenters expressed concern about the availability of certain partner level deductions under this approach and questioned whether unitary businesses involving partnerships and corporations would be distinguished from other business arrangements involving such entities.

Having reviewed the feedback and considered these questions, challenges and alternatives, the Department will not go forward with the initially considered methodology that uses the UBT sourcing rules to allocate partnership income earned by corporations. Although the City maintains that it does have considerable discretion in establishing the allocation of partnership receipts with respect to the BCT, uniformity across the State and City corporate tax regimes will streamline the process of tax administration and reduce the cost of doing business in the City of New York.

Commenters additionally inquired regarding the effective date of these regulations. These regulations will be retroactive back to the effective date of the BCT and apply to tax years beginning on after January 1, 2015 and supersede any previously issued policy guidance.

Clear and Convincing Evidence

The Department is considering diverging from the evidentiary standards imposed by 20 NYCRR §§ 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. To overcome the presumptions contained in these sections the New York State regulations require that the taxpayer or the Department meet the "clear and convincing" evidence standard. In contrast, the Department considered not including a specific standard of evidence in the City's regulations.

Commenters argued that the Department should conform to the State's standard, and that the Department is inviting challenges on audit and litigation by leaving open the standard of proof necessary to overcome a particular presumption. The Department disagrees and does not intend to propose language specifying the standard of evidence necessary to overcome presumptions. Rather, the Department intends to propose a regulatory framework under which it will continue making determinations based on the individual facts and circumstances of the taxpayer. As previously expressed in the public sessions, complying with the "clear and convincing" evidence standard would be excessively burdensome for both the City and its taxpayers. It would also inappropriately charge the Department with a judicial or quasi-judicial function that is incompatible with the Department's role in the process of tax administration.

Allocation of Income from Passive Investment Customers

The Department plans 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 20 NYCRR § 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 § 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 § 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 intends to propose rules that follow the State's regulatory framework but 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 also 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.

Several commenters challenged both the State and the City's authority to promulgate specialized allocation rules for passive investment customers and suggested that the City's fallback percentage should be reduced. However, the Department believes that the 8% figure reflects a fair estimation of the economic activity within the City relative to the nation as a whole and is appropriate to use as fallback allocation method. One commenter inquired what definition the City would use for passive investment customers. The Department plans to use the same definition of passive investment customer as is currently set forth in 20 NYCRR § 4-4.1(b)(3). Lastly, one commenter inquired whether this policy would affect UBT taxpayers. This rule relates only to BCT taxpayers; it will not affect UBT taxpayers.

Billing Address Presumption

The billing address presumption (referred to in early iterations by the State as a 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 at least 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. *See* 20 NYCRR §§ 4-3.2(d)(1)(ii), 4-4.2(d)(1)(ii). The Department initially considered increasing the number of customers needed to meet the requirements of the billing address presumption to a higher threshold of 1,000.

A commenter suggested that this change would constitute not only a departure from the State's policies but also a departure from the established tax allocation model developed by the Multistate Tax Commission. After considering the commenter's concerns regarding conformity with State Rules and taking into consideration that the State's billing address presumption is based on a Multistate Tax Commission model that is also employed by other States, the Department does not intend to alter the presumption threshold and will instead adopt the same policies set forth in 20 NYCRR §§ 4-3.2(d)(1)(ii) and 4-4.2(d)(1)(ii).

Real Estate Mortgage Investment Conduits

The Department is considering diverging from 20 NYCRR § 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 modification relating to the excess inclusion. The Department intends 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.

Commenters expressed concern about the calculation of net operating losses ("NOL") in the year in which a corporation has excess inclusion income. This would affect carry-forward NOLs for future tax years. One such commenter inquired regarding the interplay of other modifications and deductions in conjunction with the excess inclusion minimum. This feedback highlights practical concerns regarding the integration of the excess inclusion minimum into the BCT framework. The Department intends to issue further guidance on this topic as the Department continues to develop its proposed regulations.