

## FINANCE MEMORANDUM

### Reporting Federal and New York State Changes

### INTRODUCTION

The New York City (“City”) Business Corporation Tax, General Corporation Tax, Banking Corporation Tax and Unincorporated Business Tax all require taxpayers to report any change or correction to taxable income or other basis of tax by the Internal Revenue Service or the New York State Department of Taxation and Finance (in each case, a “Tax Adjustment”) for any tax period. This Finance Memorandum explains how taxpayers should report Tax Adjustments to the Department of Finance (“DOF”), including adjustments that impact income, receipts, or capital allocation. This memorandum supersedes SAP-PP-2008-10, 3/20/08.

### GENERAL REQUIREMENTS

For tax periods beginning on or after January 1, 2015, taxpayers must report all applicable Tax Adjustments on amended returns and state any additional tax or refund that is due as a result of their revised calculations. A Tax Adjustment includes a settlement with the IRS or DTF in which the taxpayer agrees (or an owner agrees with respect to his, her or its pass-through share of the taxpayer’s income or loss) to a specific amount of additional tax without agreeing to a designation of the payment to any of the specific issues raised by the authority issuing the assessment (also known as a “lump sum” settlement). The following procedures apply to the reporting requirement:

- *Timing.* Taxpayers have 90 days to amend separate tax returns and 120 days to amend combined group tax returns. This period generally begins when the United States Internal Revenue Service (“IRS”) or New York State Department of Taxation and Finance (“DTF”) makes a final determination.<sup>2</sup>
- *Tax Periods.* Taxpayers must amend their returns for all tax periods that are the subject of Tax Adjustments, even if DOF is currently auditing, or previously audited, those periods.
- *Contents.* The amended returns must show the Tax Adjustments, the recalculations required to incorporate the Tax Adjustments into the City tax calculation, and the new City tax due. For this purpose, taxpayers should attach the following to the amended returns:

- a. a copy of the IRS and/or DTF final determination, audit report, waiver, or notice of carry-back allowance, and all underlying data and schedules that explain or support the federal or state adjustments;
- b. a DOF worksheet that identifies each Tax Adjustment (including any adjustments with which the taxpayer disagrees) and shows how each change affects the taxpayer's calculation of its City tax;<sup>3</sup>
  - if a lump sum settlement is supported by IRS or DTF schedules or workpapers that attribute portions of the settlement amount to particular items of income or capital, the information provided in the schedules or workpapers should be reflected in the taxpayer's income adjustments at the City level;
  - if the IRS provides no supporting schedules or workpapers in connection with a lump sum settlement, taxpayers must use the amount of the settlement to determine the amount of additional federal taxable income that corresponds to the settlement (please see the attached addendum for further instructions);
  - a worksheet for each tax type is available on the DOF website at [nyc.gov/finance](http://nyc.gov/finance), under the "Forms" banner.
- c. if a taxpayer disagrees with the applicability of any Tax Adjustment, the taxpayer should not incorporate that Tax Adjustment into its City tax calculation on its amended return, but the taxpayer must file an amended return and attach a statement that describes the adjustment and explains why it is erroneous or inapplicable.
  - *Overlapping Federal and State Adjustments.* A single amended return may be used to report IRS and DTF determinations for the same tax period on the condition that the taxpayer attach separate explanatory worksheets for the IRS and DTF Tax Adjustments.
  - *Self-Assessment.* Each amended return is a self-assessment, that is deemed assessed on the filing date. If a taxpayer believes that a Tax Adjustment is erroneous or inapplicable, but does not attach a statement to its amended return that explains why the adjustment is erroneous or inapplicable, any additional City tax that it owes as a result of the Tax Adjustment will be considered a self-assessment, and collection activity can begin when the amended return is filed.<sup>4</sup>
  - *Failure to File.* An unreported Tax Adjustment may give rise to a deficiency assessment at any time through a Notice of Tax Due after the due date for the report has passed.<sup>5</sup> The date of the Notice will become the date of the assessment unless the taxpayer properly reports the Tax Adjustment within 30 days of the Notice and attaches a statement that explains why its Tax Adjustment and the Notice are erroneous.<sup>6</sup>

If a taxpayer must report a Tax Adjustment but it cannot properly compute its corrected City tax liability within the statutory period, the taxpayer may request, by letter, within the statutory period, an accelerated audit so that DOF can determine the correct liability. A taxpayer might make this request if the IRS re-determined its income for a tax period in which it was a consolidated

group member for federal tax purposes and a separate filer for City tax purposes, and it cannot properly compute the changes that would have been made if it had filed on a separate basis for federal tax purposes. The letter should be sent to the official address of the offices of the New York City Department of Finance, Tax Audit and Enforcement Division, Attention: Assistant Commissioner of Tax Audit, and should include the basis for the request.

Forms NYC-3360 for the General Corporation Tax, NYC-3360B for the Banking Corporation Tax, and NYC-115 for the Unincorporated Business Tax will not be processed as stand-alone reports of Tax Adjustments for tax periods beginning on or after January 1, 2015.

## **REPORTING NEW YORK STATE CHANGES TO APPORTIONMENT**

The New York State Fiscal Year 2015-16 Enacted Budget included business tax conformity measures that amend the framework for assessing tax and issuing refunds as a result of Tax Adjustments that arise from DTF franchise tax determinations (“NYS Tax Adjustments”). Specifically, the amendments provide that reallocations of income, receipts, and capital that result from NYS Tax Adjustments may be included in the calculation of assessments and refunds during the additional limitations period that applies to Tax Adjustments.<sup>7</sup> DOF will give effect to this change for tax periods beginning on or after January 1, 2015.

Under this framework for reporting NYS Tax Adjustments, taxpayers must reallocate City income, receipts, and capital consistently with any NYS Tax Adjustments that affect apportionment; and, to do so, they should replicate the methodologies that DTF applied to determine income, receipts, and capital apportionment in its adjustments, to the extent that City and State laws are the same.<sup>8</sup> The same principle applied to the same information would constitute the same methodology for this purpose. The worksheet that taxpayers must attach to their amended returns must identify each change to apportionment that DTF made, and show how it affects their City allocations and tax calculations.

A corporation that pays tax under the City’s General Corporation Tax or Banking Corporation Tax is not required to incorporate NYS Tax Adjustments to apportionment into its calculations after the standard limitations period expires, unless the apportionment rule that gives rise to the adjustment under Section 210-A of the Tax Law corresponds to an applicable allocation rule in Chapter 6 of the Administrative Code. For example, an NYS Tax Adjustment to receipts from sales of advertising under Tax Law § 210-A(8)(a) would give rise to a corresponding adjustment under Ad. Code § 11-604(3)(a)(2)(B)(i).

As before, reallocations of income, receipts, and capital that would result from IRS determinations may not be incorporated into assessments or refunds during the additional limitation period that applies to Tax Adjustments.<sup>9</sup> This prohibition applies to both DTF and IRS Tax Adjustments for tax periods that begin before January 1, 2015.<sup>10</sup>

### **Example**

For purposes of this example, Corporation X does not have investment capital or other exempt income generated by stock that is not marked to market.

Corporation X owns and marks to market unsecured loan A, corporate bond B, and stock C. In

addition, it owns unsecured loan D, unsecured loan E, corporate bond F, corporate bond G, stock H, loan I secured by real property located in the City, loan J secured by real property located in the City, and loan K secured by real property located in Nassau County, New York, but does not mark these instruments to market. In tax year 2016, Corporation X elects to use the fixed percentage method, pursuant to Tax Law § 210-A(5)(a)(1) and Ad. Code § 11-654.2(5)(a)(1), to determine the amount of receipts, net gains (not less than zero), and net income (not less than zero) from qualified financial instruments to include in the numerator of its receipts fraction. Corporation X treats all of the aforementioned instruments as qualified financial instruments for purposes of calculating the receipts fraction on its New York State and City tax returns.

Four years later, on audit, DTF determines, among other adjustments, that loans I, J, and K are not qualified financial instruments because they are secured by real property, and that Corporation X reported them incorrectly for tax purposes. These loans generate interest income and no other receipts, net income or net gains during the tax year. DTF reassess Corporation X's tax liability by correctly including the interest from loans I, J and K in Corporation X's New York receipts and everywhere receipts under the customer sourcing method prescribed in Tax Law § 201-A(5)(a)(2)(A)(i). Accordingly, DTF recalculates the apportionment fraction to include 100%, instead of 8%, of the interest from loans I, J and K in the numerator, and issues a Notice of Determination. Corporation X concedes the accuracy of this adjustment. DTF's determination constitutes a Tax Adjustment.

In order to meet its reporting obligation for Tax Adjustments, Corporation X must file an amended return for tax year 2016 on which it recalculates its allocation of income, receipts, and capital to the City using the same method that DTF used to adjust its apportionment. Corporation X must therefore use the customer sourcing method prescribed in Ad. Code § 11-654.2(5)(a)(2)(i)(A) to adjust its allocation of receipts from loans I, J and K. Corporation X will recalculate its receipts fraction to include 100%, instead of 8%, of the interest from loans I and J in the numerator, and then 0% of the interest from loan K in the numerator. The City recalculation is slightly different from the State recalculation because loan K is secured by real property located in a New York State county that is outside of the City; the allocation and adjustment methodology are, however, the same.

Corporation X must attach a worksheet to the amended return that identifies each NYS Tax Adjustment, including the corrected apportionment of interest from loans I, J, and K, and shows how each adjustment impacts its City tax liability. Corporation X must also attach a copy of the final DTF determination. If it believes that any NYS Tax Adjustment is erroneous or inapplicable, it should attach an additional statement that explains why that NYS Tax Adjustment is erroneous or inapplicable, and reflect the other, applicable adjustments in its new tax calculation.

Any additional City tax that Corporation X owes from its NYS Tax Adjustments on the amended return will constitute a self-assessment, and collection activity can begin upon filing, except to the extent Corporation X attaches a statement that explains why the NYS Tax Adjustments are erroneous or inapplicable. If Corporation X does not file an amended return to report its Tax Adjustments, DOF may assess a deficiency based on the NYS Tax Adjustments at any time by mailing Corporation X a Notice of Tax Due.

If Corporation X petitions for a redetermination or refund of a City assessment for tax year 2016,

it may reflect the NYS Tax Adjustments in its allocation of income, receipts and capital.

## **INTEREST AND PENALTIES**

**Interest on underpayments:** Taxpayers are liable for interest on the additional tax resulting from Tax Adjustments, and that interest compounds daily from the due date of the original return (without regard to any extension of time for payment) to the date of payment.<sup>11</sup> Please visit the DOF website at [nyc.gov/finance](http://nyc.gov/finance) for the rate of interest on underpayments.

**Interest on overpayments:** DOF pays interest on overpayments, resulting from Tax Adjustments or otherwise. Interest accrues from the date on which taxpayers file their claim for refund to a date not more than 30 days preceding the refund check, except that interest does not accrue on any overpayment that DOF refunds within three months of the taxpayer filing the refund claim.<sup>12</sup> Please visit the DOF website at [nyc.gov/finance](http://nyc.gov/finance) for the rate of interest on overpayments. If a taxpayer fails to report a Tax Adjustment within 90 days of its IRS and/or DTF notice of final determination, interest does not accrue on the overpayment.<sup>13</sup>

**Penalties:** If a taxpayer reports a Tax Adjustment after the statutory period for filing has expired, or makes payment after the statutory filing deadline, late filing and late payment penalties will apply.<sup>14</sup>

## **ADDENDUM**

If the IRS provides no supporting schedules or workpapers in connection with a lump sum settlement, taxpayers must calculate the amount of additional federal taxable income that corresponds to the settlement, and incorporate this amount into their revised City tax calculations on their amended returns.

Taxpayers that are subject to the Business Corporation Tax must begin their City tax calculations with a revised amount of “federal taxable income before net operating loss deduction and special deductions,” to be computed by: dividing the lump sum of additional federal tax, before credits, by the rate of tax originally applied on the audited return under section 11 of the Internal Revenue Code of 1986, as amended (the “IRC”) (corporate rates), and adding the result to the amount of “federal taxable income before net operating loss deduction and special deductions” that was previously reported to the City.

Taxpayers that are subject to the General Corporation Tax or Banking Corporation Tax must begin their City tax calculation with a revised amount of the “federal taxable income before net operating loss deduction and special deductions” that they would have had if they were not S corporations under Section 1361(a) of the IRC, to be computed by: dividing the total of additional federal tax before credits by the highest rate of tax in effect for the reviewed year under section 1 of the IRC (individual rates), and adding the result to the amount of “federal taxable income before net operating loss deduction and special deductions” that was previously reported to the City.

Taxpayers that are subject to the Unincorporated Business Tax must begin their City tax calculation with a revised amount of federal income or loss, as determined for the starting point of the Unincorporated Business Tax return, to be computed by: dividing the lump sum of additional fed-



eral tax before credits by the highest rate of tax in effect for the reviewed year under section 1 of the IRC (individual rates) or section 11 of the IRC (corporate rates),<sup>15</sup> and adding the result to the amount of income or loss that was previously reported to the City.

### Example

For tax year 2018, Corporation A begins its Business Corporation Tax calculation with "federal taxable income before net operating loss and special deductions" of \$100M. Four years later, after an IRS audit, Corporation A enters into a lump sum settlement agreement with the IRS, which requires Corporation A to pay additional tax of \$2.1M. Corporation A is required to file an amended return with DOF that incorporates the additional income that corresponds to the federal change into its City tax calculation, and calculates the additional City tax due for tax year 2018. Corporation A must then pay the additional City tax due. For this purpose, Corporation A will recalculate its "federal taxable income before net operating loss deduction and special deductions," to be included on its amended Form NYC-2, Schedule B, Line 1, as follows: (\$2.1M of additional tax ÷ 21% applicable federal tax rate) + \$100M previously reported = \$110M

<sup>1</sup> When recalculating City tax based on federal or New York State Tax Adjustments, the starting point should be the amounts reported on the taxpayer's original City return, adjusted to reflect any changes that were subsequently made by the taxpayer or the City. If a taxpayer previously filed an amended City return or if the amounts shown on its original City return were changed pursuant to a DOF audit, it should attach a copy of DOF's final determination.

<sup>2</sup> The time period for filing an amended return also starts when: the taxpayer signs a waiver under Internal Revenue Code Section 6213(d) or New York Tax Law Section 681(f) or 1081(f); the IRS allows a tentative carryback adjustment based on a net operating loss carryback or net capital loss carryback; a renegotiation of a contract or sub-contract with the United States or the State of New York results in a change in taxable income or other tax base; or, the recovery of a war loss results in a computation or re-computation of any tax imposed by the United States or the State of New York. New York City Administrative Code §§ 11-655(3), 11-605(3), 11-633(2), and 11-519. Corporations that elect taxation under Subchapter S of the Internal Revenue Code of 1986, as amended, are required to report Tax Adjustments if a triggering event occurs for any one of their shareholders.

<sup>3</sup> *Template worksheets for each tax type are available on the DOF website at [nyc.gov/finance](http://nyc.gov/finance).*

<sup>4</sup> *See, Ad. Code §§ 11-673(1) and 11-522(a).*

<sup>5</sup> *See, Ad. Code §§ 11-672(5), 11-674(3), 11-521(e) and 11-523(c).*

<sup>6</sup> *See, Ad. Code §§ 11-672(5) and 11-521(e).*

<sup>7</sup> *See, Ad. Code §§ 11-674(3)(g)(2) and 11-678(3)(c)(ii) (note that these sections of the Administrative Code do not apply to the Unincorporated Business Tax ("UBT"), and that restrictions on reporting Federal and NYS Tax Adjustments to allocation do not exist under the UBT); for the various limitations periods that may apply as a result of a Tax Adjustment, see, Ad. Code §§ 11-674(3)(a)(3) and (4), 11-674(3)(c), 11-674(3)(d), 11-674(3)(i), 11-678(3)(b), and 11-678(11)(a).*

<sup>8</sup> *See, Ad. Code §§ 11-674(3)(g)(2) and 11-678(3)(c)(ii).*

<sup>9</sup> *See, Ad. Code §§ 11-674(3)(g)(1) and 11-678(3)(c)(i).*

<sup>10</sup> *See id.*

<sup>11</sup> *See, Ad. Code §§ 11-675, and 11-524.*

<sup>12</sup> *See, Ad. Code §§ 11-679, and 11-528.*

<sup>13</sup> *See, Ad. Code §§ 11-678(3)(b), and 11-527(c).*

<sup>14</sup> *See, Ad. Code §§ 11-676, and 11-525.*

<sup>15</sup> *Essentially the reverse of the calculation described under IRC § 6225(b)(1)(A).*