

TaxAlert

STATE AND LOCAL TAX

August 2009

Subject:

New York City tax legislation, enacted on July 16, 2009, significantly revised the City's tax structure to conform to New York State and made a number of other changes as well.

Summary:

During the most recent legislative session, New York City made various changes to the General Corporation Tax, Banking Corporation Tax, sales and use tax, Unincorporated Business Tax, and several administrative procedures. Most notably, the changes conform to New York State's latest tax changes. With respect to the General Corporation Tax, New York City revised the combined reporting requirements, apportionment requirements, broker/dealer receipts sourcing rules, and fixed-dollar minimums. With respect to the Banking Corporation Tax, New York City made changes to the net operating loss provisions, the alternative minimum tax base, and the apportionment factor methodology, and added an economic nexus provision for banks with credit card operations. With respect to the sales and use tax, New York City increased its overall sales tax rate and repealed the exemption for clothing with a sales price of \$110 or more. With respect to the Unincorporated Business Tax, New York City increased the credit offset for businesses with tax liabilities of less than \$5,400. New York City also increased the income threshold for filing Unincorporated Business Tax returns.

Details:

General Corporation Tax

Combined Reporting Requirements

New York City enacted legislation that conforms to the State's current requirements for combined report purposes. Effective for taxable years beginning after 2008, any taxpayer that directly or indirectly owns or controls substantially all of the capital stock of one or more corporations (hereinafter, "related corporations") is required to make a combined report covering any related corporations if there are substantial intercorporate transactions among the related corporations, regardless of arm's-length transfer pricing. "Substantially all" means ownership or control of 80% or more of the stock that entitles the holder thereof to vote for the election of directors or to receive dividends.

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Further, the legislation provides that it is not necessary for any one corporation to have substantial transactions with each related corporation; it is sufficient that such transactions occur “between the taxpayer and a related corporation or collectively, a group of such related corporations.” In determining whether there are substantial intercorporate transactions, the Commissioner of the New York State Department of Taxation and Finance, which administers the City tax, will consider and evaluate all activities and transactions of the taxpayer and its related corporations. Activities and transactions that will be considered include, but are not limited to: manufacturing, acquiring goods or property, or performing services, for related corporations; selling goods acquired from related corporations; financing sales of related corporations; performing related customer services using common facilities and employees for related corporations; incurring expenses that benefit, directly or indirectly, one or more related corporations; and transferring assets, including such assets as accounts receivable, patents, or trademarks from one or more related corporations.

Prior to the legislation, New York City required (and permitted) combined reporting where it was necessary to eliminate distortion, *i.e.*, non-arm’s length transactions among related corporations.

Captive REITs and RICs

A captive real estate investment trust (“REIT”) or captive regulated investment company (“RIC”) is now required to be included in a combined report with a related New York City taxpayer if it meets a greater-than-50% ownership test. A captive REIT means a REIT a) that is not regularly traded on an established securities market and b) more than 50% of the voting stock of which is owned or controlled, directly or indirectly, by a single corporation that is not exempt from federal income tax and is not a REIT. A captive RIC means a RIC a) that is not regularly traded on an established securities market, and b) more than 50% of the voting stock of which is owned or controlled, directly or indirectly, by a single corporation that is not exempt from federal income tax and is not a RIC.

Apportionment

Conforming to New York State Single-Factor Sales Apportionment Formula: As part of the overall legislative package, New York City has adopted a single-factor sales apportionment formula. The new single sales-factor apportionment formula will be phased in over a period of several years, increasing the weight of the sales factor each year, while decreasing the weight given to the property and payroll factors. This revision, which conforms to New York State law, will be completely phased in for taxable years beginning after 2017. Prior to the legislation, New York City utilized a three-factor, evenly-weighted apportionment formula consisting of property, payroll, and sales.

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To ensure compliance with Treasury Department regulations, we wish to inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

Material discussed in this tax alert is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.

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Broker/Dealer Receipts: New York City revised its sourcing rules with regard to certain broker/dealer receipts for the purpose of computing the General Corporation Tax. Under the new legislation, receipts from certain services of registered brokers and dealers of securities and commodities must now be sourced using the customer's mailing address. For taxable years beginning after 2008, receipts from the following services of registered brokers and dealers are now sourced using the customer's mailing address:

1. Receipts constituting brokerage commissions derived from the execution of securities or commodities purchase or sale orders for the accounts of customers;
2. Receipts constituting margin interest earned on behalf of brokerage accounts;
3. Gross income, including any accrued interest or dividends, from principal transactions for the purchase or sale of stocks, bonds, foreign exchange, and other securities or commodities;
4. Receipts constituting fees earned by the taxpayer for advisory services to a customer in connection with the underwriting of securities for such customer;
5. Receipts constituting interest earned by the taxpayer on loans and advances made by the taxpayer to a corporation affiliated with the taxpayer but with which the taxpayer is not permitted or required to file a combined report;
6. Receipts constituting the primary spread or selling concession from underwritten securities;
7. Receipts constituting account maintenance fees; and
8. Receipts constituting fees for management or advisory services.

Fixed-Dollar Minimum

For taxable years beginning after 2008, the City's \$300 fixed-dollar minimum tax has been replaced with a graduated minimum tax based on gross receipts. The amount of the graduated dollar minimum tax for taxable years beginning after 2008 will be determined as follows:

New York City Fixed Dollar Receipts	Graduated Dollar Minimum
Not more than \$100,000	\$25
\$100,001-\$250,000	\$75
\$250,001-\$500,000	\$175
\$500,001-\$1,000,000	\$500
\$1,000,001-\$5,000,000	\$1,500
\$5,000,001-\$25,000,000	\$3,500
More than \$25,000,000	\$5,000

Alternative General Corporation Tax

For taxable years beginning after 2008, the maximum amount under the alternative General Corporation Tax measured by business or investment capital has been increased from \$350,000 to \$1 million.

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Banking Corporation Tax

Net Operating Losses

Under the new legislation, New York City allows banks that are taxable under the Banking Corporation Tax to carry forward net operating losses (“NOLs”) to future taxable years, for losses incurred in taxable years beginning after 2008. NOLs may still not be carried back to prior taxable years. This change conforms to the New York State rules, which have allowed banks to deduct NOLs carried forward since 2000, to the extent deductible under section 172 of the Internal Revenue Code. Under prior New York City law, any NOLs allowable for federal tax purposes were required to be added back in computing New York City taxable income.

Alternative Minimum Tax

For taxable years beginning after 2010, foreign banks will be required to use “taxable assets” as the tax base in computing the alternative tax, conforming to the tax base used by domestic banks. Prior to the change, foreign banks computed the alternative tax using the par value of issued common stock.

Apportionment Factor

A single sales-factor apportionment formula will be phased in over a period of several years, in a manner similar to the General Corporation Tax, for banking corporations that provide substantial management, administrative, or distributive services to investment companies. This formula will replace the current apportionment factor, which consists of a double-weighted receipts factor, a double-weighted deposits factor, and a single-weighted payroll factor. During the applicable phase-in period, the weight given to the deposits and payroll factors will be decreased each year, while the weight given to the receipts factor will be increased each year, until it is ultimately a single sales factor for taxable years beginning after 2017.

Credit Card Companies Nexus and Receipts Sourcing

Effective for taxable years beginning after 2010, a credit card company will be deemed to be doing business in the City in a corporate or organized capacity if any one of the following four conditions is satisfied:

- 1) It has issued credit cards to 1,000 or more customers who have a mailing address within the City as of the last day of the taxable year;
- 2) It has merchant contracts and the total number of locations within the City covered by those contracts is 1,000 or more;
- 3) It has receipts of \$1 million or more during the taxable year from its credit card customers who have a mailing address within the City; or
- 4) It has receipts of \$1 million or more arising from merchant customer contracts relating to locations in the City.

In addition, interest, and fees and penalties in the nature of interest, from bank, credit, travel and entertainment card receivables are earned and sourced within New York City if the mailing address (in the taxpayer’s records) of the card holder is in the City. Prior to the new legislation, these receipts were sourced to the commercial domicile of the banking corporation.

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“Grandfathered” Bank Holding Company Subsidiary Changes

The New York City Administrative Code was also amended to conform to New York State rules determining when corporations are subject to the General Corporation Tax and when they should be treated as banks and thus be subject to the Banking Corporation Tax. Prior to the amendment, a corporation was allowed to be taxed under the General Corporation Tax if it was treated as a general corporation prior to the Gramm-Leach-Bliley Act. These taxpayers were considered to be “grandfathered” filers. Under the new law, certain companies that are owned by bank holding companies can no longer rely on the “grandfathered” filing status provided by the Gramm-Leach-Bliley Act transitional provisions and must now file a Banking Corporation Tax return.

Sales and Use Tax

The New York City sales and use tax rate has been increased from 4% to 4.5%, effective August 1, 2009. The new rate applies to New York City, and makes the combined rate 8.875% for State and City. The new City rate also applies to taxes on services such as credit rating and reporting services, beauty, barbering, and certain other personal services, and provides that City taxes on these services are extended through November 30, 2011, unless they are renewed. Previously, these taxes were scheduled to expire as of December 31, 2011.

In addition, the legislation repeals the New York City sales tax exemption for purchases of clothing items priced at \$110 or more (the exemption for clothing and footwear with a sale price of less than \$110 is maintained). The new New York City sales tax rate also now applies to the transmission and distribution of electric and natural gas service, even when the electricity or natural gas services is purchased separately from the transmission and distribution service.

New York City Unincorporated Business Tax Changes**Increase in Offset Credits**

New York City made two changes to the Unincorporated Business Tax (“UBT”) as part of the new legislation. The first change provides a partial credit for UBT liabilities of less than \$5,400 annually. The credit completely offsets UBT liabilities of \$3,400 or less. Thus, New York City unincorporated businesses with incomes under \$100,000 will not be required to pay tax and unincorporated business with incomes under \$150,000 will pay a reduced tax.

Return Filing Threshold

The other revision provides that unincorporated businesses are only required to file a UBT return if their gross income exceeds \$95,000.

Apportionment

Adoption of Single Sales Factor: For taxable years beginning after [2008], New York City adopted a single sales-factor apportionment formula for taxpayers subject to the New York City UBT. The new single sales-factor apportionment formula will be phased in over a period of several years, in a manner similar to the General Corporation Tax and the Banking Corporation Tax, increasing the weight of the sales factor each year, while decreasing the weight given to the property and payroll factors. For taxable years beginning after 2017, the apportionment factor will be based on the sales factor only.

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Broker/Dealer Receipts: New York City revised its sourcing rules with regard to certain broker/dealer receipts for purposes of computing a taxpayer's UBT liability. Under the new legislation, receipts from services of registered brokers and dealers (as discussed in the General Corporation Tax section above) from securities and commodities transactions must now be sourced using the customer's mailing address.

New York City Collection and Administrative Provisions

New York City implemented adjustments to its collection and administrative process.

Financial Institution Data Matching

Financial institutions must now conduct electronic matches in order to help New York City uncover and seize non-exempt funds held in the bank accounts of debtors owing warranted tax debt to the City.

Voluntary Disclosure

A comprehensive voluntary disclosure and compliance program similar to New York State's program has been established.

In order to qualify for the New York City voluntary disclosure program, a taxpayer must be subject to tax imposed and meet the following criteria:

1. The taxpayer is not currently under audit by New York City;
2. The taxpayer voluntarily discloses a New York City tax liability that the department has not determined, calculated, researched, or identified at the time of the disclosure;
3. The taxpayer is not currently a party to any criminal investigation being conducted by an agency of the State or any political subdivision thereof; and
4. The taxpayer does not disclose participation in a "tax avoidance" plan.

Mandatory Electronic Filing

New York City now requires electronic filing of tax returns by any tax preparer that filed more than one hundred returns or other tax documents in a single calendar year and will again file more than one hundred returns or other tax documents in a succeeding year using tax software.

Interest Rates

Interest rates on underpayments and, in some cases, overpayments may now be set by the Commissioner by publication of a notice. In addition, the rate of interest on underpayments of income and excise taxes has been increased from the federal short-term rate plus five percent to the federal short-term rate plus seven percent. Finally, the default rate for underpayments has been increased from six percent to seven and one-half percent.

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Corporate Dissolution

A corporation that has engaged in business in New York City and has incurred tax liability will not be issued a certificate of dissolution by the Department of State unless the New York City Commissioner of Finance has issued a consent stating that the corporation has paid its New York City tax obligations.

Civil and Criminal Tax Enforcement Provisions

New York City implemented changes to its civil and criminal tax enforcement provisions.

Civil Penalties

Certain taxpayers and tax preparers who file using tax software may be required to file electronically, and will be subject to penalties for failure to do so. The penalty for deficiencies due to fraud applicable to the Unincorporated Business Tax, the General Corporation Tax, the Banking Corporation Tax, and the utility tax has been increased, and a new false and fraudulent penalty has been added.

Hotel Occupancy Tax Penalties

Records access requirements and penalty provisions have been revised to more closely conform to New York State sales tax provisions regarding sales tax on hotels.

Tax Crimes Sections Revised

Provisions detailing crimes applicable to specific taxes have been redefined to conform to recent New York State revisions, and now define and punish tax crimes applicable to all City taxes.