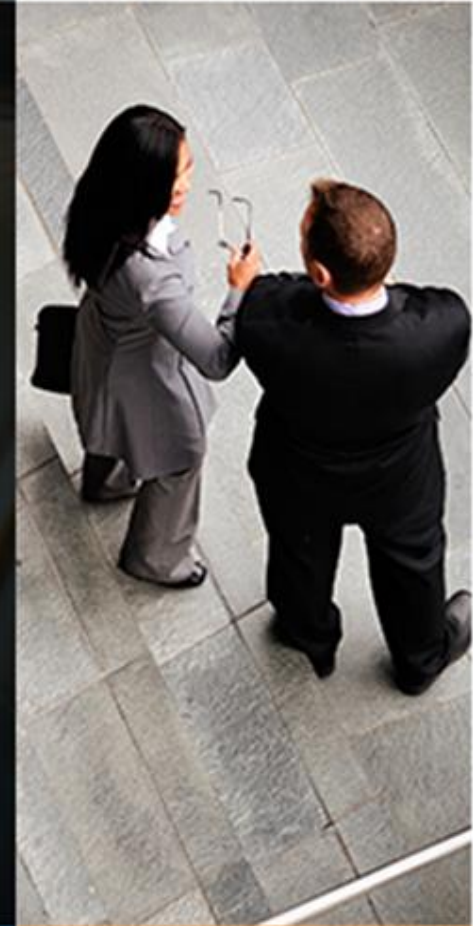


New York Tax Update

Presented by

Timothy P. Noonan
tnoonan@hodgsonruss.com



Closely Held and Flow Through Entities Conference
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Introduction

- New York State and City Taxation of S Corporations and their owners
- New York State and City Taxation of Partnerships/LLCs and other owners
- Other Personal Income Tax Issues for Owners
- Sales Tax Issues, Nexus and Other Special Situations
- Answering Questions



Part 1: New York State and City Taxation of S Corporations

New York State Taxation of S Corporations

- Taxation of Entity
 - Each S corporation pays a fixed-dollar minimum tax in New York State as follows:

New York Receipts	Tax
$X < \$100,000$	\$25
$\$100,000 < X < \$250,000$	\$50
$\$250,000 < X < \$500,000$	\$175
$\$500,000 < X < \$1,000,000$	\$300
$\$1,000,000 < X < \$5,000,000$	\$1,000
$\$5,000,000 < X < \$25,000,000$	\$3,000
$X > \$25,000,000$	\$4,500

New York State Taxation of S Corporations

- Taxation of Resident Individual Owners
 - Easy! Residents are taxed on one thing.
 - Resident owners are taxed on federal taxable income with state modifications.

New York State Taxation of S Corporations

- Taxation of Nonresident Individual Owners
 - Allocation and Apportionment
 - Use Article 9-A rules to determine source of income. Single-factor, receipts-only apportionment.
 - Comparison with LLC/Partnership Rules: More on this below
 - S Corporations have the obligation to withhold and remit estimated taxes on behalf of nonresident owners who will have a tax liability to New York form flow-through items of at least \$300. Waivers are available. Tax Law 658(c)(4); TSB-M-04(1)I; Form IT-2658.

New York State Taxation of S Corporations

- Apportionment: Pre 2015 law:
 - Sales of tangible personal property shipped or delivered to the taxpayer's customers in New York;
 - Sales of services to the extent the services were performed in New York;
 - Other business receipts to the extent "earned" in New York.

New York State Taxation of S Corporations

- 2015 Law: Market based sourcing for all receipts.
 - Services will not be sourced to the location where the services are delivered, not where the services were performed.
 - If the delivery or access point is unknown, the customer's billing address/zip code can be used. Last year's apportionment factor can be used as a last resort.
 - Digital products and receipts from "other business receipts" sourced as follows: (1) location of primary use; (2) location where product is received by the customer; (3) prior year's apportionment factor for the digital product; (4) current year's apportionment factor for other digital products that can be sourced using the hierarchy.

New York State Taxation of S Corporations: Special Situations

- 338(h)(10) Elections
 - 2009 *Baum* Case: confirmed that when a nonresident sells shares in an S corporation, the gain or loss on the sale if not considered New York “source” income subject to tax.
 - Anti-Baum Legislation in 2010:
 - Claiming *Baum* had “erroneously overturned longstanding policy” of the Tax Department, the Legislature responded in 2009 by enacting legislation to reverse the Tribunal’s ruling.
 - Sale of stock with 338(h)(10) election: Gain on deemed asset sale is taxed to extent of apportionment to New York. Deemed liquidation (sale of shares) is disregarded. Tax Law Sec. 632(a)(2).
 - Sale of assets for a distributed installment note (Code Sec. 453(h)(1)(a)): Gain recognized by shareholders as payment are received are sourced to New York based on corporation’s pre-sale business allocation percentage. Tax Law Sec. 632(a)(2).

New York State Taxation of S Corporations: Special Situations

- 338(h)(10) Elections
 - *Caprio* (July 1, 2015, Court of Appeals)
 - Caprios argued that the retroactive application of the amendment violated their New York and federal due process rights.
 - NY's highest court overturned lower court's decision and held that the retroactive application of the 2010 amendment to Tax Law Sec. 632(a)(2) did not violate the Caprios' due process rights!
 - Is it over?

New York State Taxation of S Corporations: Special Situations

- Hybrid Corporations (Federal S/NYS C)
 - Taxation of Entity - Hybrids are taxed like regular C corporations under Article 9-A.
 - 2007 New Rules - Effective for tax years beginning on or after January 1, 2007, hybrid S corporations are no longer allowed if the S corporation's investment income for the current year exceeds 50% of its federal adjusted gross income. Because shareholders may not know whether a mandatory S election will be required until the end of the S corporation's tax year, estimated tax rules are relaxed for affected S corporation shareholders.
 - The *Siegel* Case (TAT, August 2012). For years before 2007, taxpayer transfers shares to hybrid S corporation, set up also to do future consulting, and has hybrid sell the shares. Tribunal held that this was done for tax avoidance purposes and can be disregarded.

New York State Taxation of S Corporations: Special Situations

- Special Sourcing Rules: Real Property Sales
 - The sale of an interest in a partnership, limited liability company, S corporation that owns real property located in New York State if the value of the real property exceeds 50 percent of the value of all of the assets in the entity.
 - Two-year lookback rule to avoid taxpayers' "stuffing" non RP assets into an existing entity before a sale.
 - For sales of entity interests occurring on and after May 7, 2009, any gain recognized on the sale of an interest in that an entity will be allocated among the assets in the entity, and the amount allocated to New York real property will be treated as New York-source income.
 - Applies to LLCs and Partnerships too

New York City Taxation of S Corporations

- Taxation at the Entity Level
 - NYC taxes corporations that make an S election as if they were regular C corporations for purposes of the General Corporation Tax (“GCT”) and Bank Tax.
 - This also means that a qualified subchapter S subsidiary (Qsub) must file a separate GCT return in NYC if it has nexus. (*Finance Memorandum 99-3*)
 - NYC Corp Tax Reform? Not for S corps!!

New York City Taxation of S Corporations

- Since 2009, NYC has been phasing in its single factor allocation method for business income, using a phase-in over 10 years. Prior to 2009, an equal-weighted 3-factor formula was used.
- After 2017, only a sales factor will be used.
- 2014: 73% receipts, 13.5% property, 13.5% payroll
- Still “cost of performance” for apportionment of sales because of nonconformity with Corporate Tax Reform



***Part 2: New York State
and City Taxation of
LLCs/Partnerships***

New York State Taxation of Partnerships/LLCs

- Taxation of Entity

Partnerships:

If the New York source gross income is:	The fee is:
exactly \$1,000,000	\$500
more than \$1,000,000 but not over \$5,000,000	\$1,500
more than \$5,000,000 but not over \$25,000,000	\$3,000
more than \$25,000,000	\$4,500

New York State Taxation of Partnerships/LLCs

- Taxation of Entity

LLCs/LLPs (same as S Corporations):

If the New York source gross income is:	The fee is:
not more than \$100,000	\$25
more than \$100,000 but not over \$250,000	\$50
more than \$250,000 but not over \$500,000	\$175
more than \$500,000 but not over \$1,000,000	\$500
more than \$1,000,000 but not over \$5,000,000	\$1,500
more than \$5,000,000 but not over \$25,000,000	\$3,000
more than \$25,000,000	\$4,500

New York State Taxation of Partnerships/LLCs

- **Taxation of Resident Individual Owners:** Resident owners are taxed on modified federal taxable income.
- **Taxation of Nonresident Individual Owners:** Nonresident owners are taxed (in effect) only on New York source income.
 - Allocation and Apportionment - Partners use a *different apportionment approach* than S corporation shareholders.
 - The formula is three-factor (property, payroll, gross income), and, by regulation (a regulation which is likely fundamentally unsound), gross income is attributed to New York by *originating office* (not by destination or customer location).
 - Withholding requirement - Same as with S corporation shareholders.

New York State Taxation of Partnerships/LLCs: New Audit Guidelines

- Nexus-type Stuff
 - Nonresident partner taxable if partnership “doing business” in NY
 - Trading for own account exemption
- Allocation of Business Income
 - Allocation “by the books”

New York State Taxation of Partnerships/LLCs: New Audit Guidelines

- By the books example

- ABC Partnership is a law firm with offices in New York City, Chicago and Los Angeles. Based on its own books and records:

NYC	Chicago	Los Angeles
\$500,000,000	\$200,000,000	\$300,000,000

- John Marshall is a partner working out of the Chicago office with a 10% capital and profits interest. His taxable share of New York source income for tax year 2010 would be \$50 million ($\$500,000,000 \times 10\%$). Note that this would be the same result regardless of which office he worked in since as a nonresident he is taxable only on the amount from New York sources, which is the amount generated by the New York office

New York State Taxation of Partnerships/LLCs: New Audit Guidelines

- Allocation of Business Income - Other Method
 - Three-factor alternative
 - Property, payroll, “gross income”
 - No market-sourcing for services!

New York State Taxation of Partnerships/LLCs: New Audit Guidelines

- Sale of partnership interests
 - Not taxable to a nonresident
 - But look out for 2009 sourcing rules with real property assets
- Retirement Payments to Nonresidents
 - Also covered by special federal exemption
- Limited and “Nonequity” Partners
 - No distinction between Ltd and General partners
 - Nonequity: If you get a K-1, you are a partner (Tosti)

New York State Taxation of Partnerships/LLCs: New Audit Guidelines

- Statute of Limitations Issues

- From the Guidelines:

“When auditing a partnership the auditor must be cognizant of the statute of limitations for the partners, both individual and corporate. This is because any adjustments made at the partnership level will flow to the partners. Therefore, it may be necessary to obtain waivers for the partners depending on when they filed their own returns.”

- But if partner being audited, no waivers needed for partnership, since the return is informational only

New York State Taxation of Partnerships/LLCs

- Special sourcing rule for real and tangible property
 - Gains and losses from the ownership of real and tangible property are allocated (and not apportioned) to the location of the state where the property is located. Tax Law Sec. 631(b)(1)(A).
 - This is also applied to real estate operated as a business (e.g. a hotel). *Linde* (TAT May 24, 2012).

New York State Taxation of Partnerships/LLCs

- Taxation of SMLLCs:
 - Generally are disregarded for income tax purposes
 - Treated as sole proprietorship
 - Watch out for sales tax issues!

NYC Taxation of LLCs and Partnerships (The UBT)

- Entity-Level Taxation

- The UBT is imposed on any individual or unincorporated entity (including a partnership, LLC, fiduciary, or corporation in liquidation) engaged in any trade, business, profession, or occupation wholly or partly carried on within New York City.
- A partnership includes any entity treated as a partnership for federal income tax purposes.
- Also applies to Schedule C taxpayers!

NYC Taxation of LLCs and Partnerships (The UBT)

- Exempt Activities
 - Own Account: An individual or other unincorporated entity is not subject to the UBT if it only engages in activities (trade or the purchase, holding or sale of property) for its own account. The exemption applies if the individual or entity is “primarily engaged” (90% of the gross value of its assets) in trading or investing activities for its own account.
- Real Estate: if activities in the nature of holding, leasing or managing real property, the taxpayer is not subject to the UBT
- Sales reps excluded
- Beginning in 2009, taxpayers with unincorporated business income of \$95,000 or less are not required to file a UBT return.
- If the UBT is \$3,400 or less, the business is permitted a credit for 100% of the tax.

NYC Taxation of LLCs and Partnerships (The UBT): 2015 NYC Task Force on Flow-Through Entities

- Recommendations
 - Conform to revised definition of investment capital
 - Institute minimum fee for UBT
 - Repeal trading/investment exemption and real estate exemption
 - Improve compliance of investment management firms and hedge funds by: (i) adopting cost-plus method for determining income; and (ii) characterizing income from management fees waivers as business income
 - Raise caps that limit the GCT and UBT-paid credits for PIT filers that report flow-through income



Part 3: Other Stuff

Residency Stuff

- Residency Update
 - Auditors continue!
 - *Sobotka* case
 - Continued *Gaied* Fallout
- Wynne v. MD: Does it Affect NY's Rules?
 - Must NYC provide residency credit against City tax?
 - Is Statutory Residency at Risk?

Special Situations: Sales Tax Issues

- Creative Use of Separate Entities?
 - Sales tax is form over substance, so LLCs and partnerships (including SMLLCs) are treated as separate taxpayers.
 - Can be a disaster: intercompany transactions
 - Can also be pretty awesome: structuring ideas
- Tax Department's recent efforts to close "loopholes"
 - 2012 legislation on use tax for boats and vehicles
 - Broader 2015 legislation (did not pass)



Contact Information

Timothy P. Noonan, Esq.
HODGSON RUSS LLP
716.848.1265

tnoonan@hodgsonruss.com

Twitter: @NoonanNotes