

April 23, 2010

Via E-Mail

Mr. Robert Plattner
Deputy Commissioner for Tax Policy
New York State Department of Taxation and Finance

Re: New York State Corporate Tax Reform:
Comments to February Draft Bill Text

Dear Deputy Commissioner Plattner;

This is further to our continuing dialogue on the New York State corporate tax reform project. We understand that you are interested in receiving comments on the draft bill text released in February and that you are intending to print, in the next few weeks, a draft of the bill to present to the Governor as a program bill. Before you do so, The Clearing House Association¹ would like to raise with you one troubling discrepancy between the February 26th descriptive outline of the bill, on the one hand, and the actual text of the February 26th draft bill, on the other hand.

In addition to describing this discrepancy below, we are attaching a “mark-up” of four pages from the February draft bill which are marked to show the changes necessary to conform the bill text to the February 26th descriptive outline.

Explanation of the Discrepancy

Under the February outline and the February draft bill, a corporate taxpayer could have two kinds of income (i) business income and (ii) investment income. Business income would generally be apportioned between New York sources and non-New York sources, and the New York source portion would be taxed, subject to one exception: dividends from a unitary corporation not included in the combined group would be exempt from tax. Investment income would also be exempt from tax.

¹ The members of The Clearing House Association are: Bank of America, National Association; The Bank of New York Mellon; Capital One, National Association; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; The Royal Bank of Scotland, N.V.; UBS AG; U.S. Bank National Association; and Wells Fargo Bank, National Association.

The method used to apportion business income between New York and non-New York sources is described as “customer-based sourcing” which generally means that the location of the payor of the income determines its source. Both the February outline and the February draft bill provide that a taxpayer which has business income that is from “qualifying financial instruments” (as defined, “QFIs”) may elect to use a fixed 8% to determine the portion of that type of income that is New York sourced. It is after that point where the outline and the bill text diverge.

The outline states that if the 8% election is made, the taxpayer must “treat all income from qualifying financial instruments as taxable business income and then apportion eight percent of the net income ... from qualifying financial instruments to New York.” (February Outline page 6) What this means is that any income from QFIs that would otherwise be investment income is recharacterized as business income. (Essentially, in exchange for the convenience of using a fixed 8%, the taxpayer must throw into the business income pot all its income from QFIs.)

The draft bill text, we hope inadvertently, provides that if the 8% election is made, then

(i) *all investment income* (including investment income that is not from QFIs) is recharacterized as business income (converting exempt income to fully taxable income) and

(ii) dividends from unitary non-combined subsidiaries would be converted from exempt income to fully taxable income.

Thus, two types of income that have no connection at all to QFIs (investment income that is not from QFIs and dividends from non-U.S. subsidiaries) are converted into taxable income.

While these changes from the outline to the draft bill consist of just a few missing words in four different sections of the draft bill, they could amount to a significant increase in the total taxes due from our members (and presumably many other New York taxpayers).

We believe these must be drafting errors since they were not reflected in the February outline (or any of the prior outlines). Nevertheless, we believe it is very important that these four sections be corrected at this time so as to avoid printing and releasing a bill which, as written, would be unlikely to have support in the financial community.

By submitting this letter with these corrections, we do not mean to suggest that these are the only comments we will have on the draft bill or that there are not other important issues that we believe warrant additional dialogue. We anticipate and look forward to that continuing dialogue. By submitting these corrections, we also do not intend to suggest that all the members of TCH support the bill.

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If you have any questions or would like to arrange a call with us to discuss this, please contact Henry Wysocki, Senior Vice President and Senior Counsel, at 212-612-9216.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Paul Saltzman".

cc: Ms. Jamie Woodward (Acting Commissioner)
New York State Department of Taxation and Finance

Ms. Jessica Howard (Office of Tax Policy Analysis)
New York State Department of Taxation and Finance

Ms. Linda DiBernardo (Office of Tax Policy Analysis)
New York State Department of Taxation and Finance

TCH Comments in bold italic large type

TCH deletions in bold italics with strikethrough (regular size type)

Footnotes are TCH explanations

AN ACT to amend the tax law, in relation to repealing article 32 and various other provisions of the tax law, and amending article 9-A of the tax law and other provisions of the tax law to reform the taxation of business corporations

The People of the State of New York, represented in Senate and Assembly, do enact as

follows:

1 Section 1. Article 32 of the tax law is REPEALED.

2 § 2. Section 180 of the tax law is REPEALED.

3 § 3. The title of section 181 of the tax law is amended to read as follows:

4 [License and maintenance fees] Maintenance fee on foreign corporations.

5 § 4. Paragraph (a) of subsection 1 of section 181 of the tax law is amended to read as

6 follows:

7 1. [(a)] Definition. As used in this section, the term "corporation" includes a joint-stock
8 company or association and any business conducted by a trustee or trustees wherein interest or
9 ownership is evidenced by certificate or other written instrument.

10 § 5. Paragraphs (b), (c), (d), (e) and (f) of subsection 1 of section 181 of the tax law are
11 REPEALED.

12 § 6. Paragraph (a) of subsection 2 of section 181 of the tax law, as amended by chapter 389
13 of the laws of 1997, is amended to read as follows:

1 6. (a) The term "investment income" means income, including capital gains in excess of
2 capital losses, from investment capital, to the extent included in computing entire net income, less,
3 [(a)] in the discretion of the commissioner, any interest deductions allowable in computing entire
4 net income which are directly or indirectly attributable to investment capital or investment income[,
5 and (b) such portion of any net operating loss deduction allowable in computing entire net income,
6 as the investment income, before such deduction, bears to entire net income, before such deduction,]
7 provided, however, that in no case shall investment income exceed entire net income[;]. If the
8 taxpayer attributes interest deductions¹ to investment income and the amount subtracted exceeds
9 investment income, the excess of the interest deductions over investment income must be added
10 back to entire net income as business income. If the taxpayer makes the election provided for
11 in clause (~~A~~C) of subparagraph one of paragraph (a) of subdivision five of section two hundred ten-
12 a of this article,² the n all income from qualified financial instruments of the
13 taxpayer shall ~~not have any investment~~ constitute business income.³

14 (b) In lieu of subtracting from investment income the amount of those interest deductions,
15 the taxpayer may elect to reduce its total investment income by forty percent. If the taxpayer makes
16 this election, the taxpayer must also make the elections provided for in subparagraphs one and two
17 of paragraph (a) of subdivision nine of this section. A taxpayer which does not make this

1 DRAFTING COMMENTS: The term "interest" is added throughout this Section 208(6) to conform to the February Outline (page 3). "As business income" is added solely as clarification.

2 DRAFTING COMMENT: Correcting cross reference: the Fixed Percentage ("8%") Method election is provided for in 210-a(5)(a)(1)(C).

3 DRAFTING COMMENT: If the Fixed Percentage Method election is made, the result is that "all income from qualified financial instruments constitutes business income". 210-a(5)(a)(1)(A)(last sentence, explaining consequences of election under 210-a(5)(a)(1)(C)). It should be noted that as written the provision would seriously disadvantage firms with significant presence in New York as they, more so than firms without such presence, would be more likely to make

1 *election because it has no investment income will not be precluded from*
2 *making those other elections.*⁴

3 7. (a) The term "business capital" means all assets, other than [subsidiary capital,] investment
4 capital and stock issued by the taxpayer, less liabilities not deducted from [subsidiary or] investment
5 capital [except that cash on hand and on deposit shall be treated as investment capital or as business
6 capital as the taxpayer may elect]. Business capital shall include only those assets the income or
7 expense of which are properly reflected (or would have been properly reflected if not fully
8 depreciated or expensed or depreciated or expensed to a nominal amount) in the computation of
9 entire net income for the taxable year.

10 (b) Provided, however, "business capital" shall not include assets to the extent employed for
11 the purpose of generating income which is excluded from entire net income pursuant to the
12 provisions of paragraph (c-1) of subdivision nine of this section and shall be computed without
13 regard to liabilities directly or indirectly attributable to such assets, but only if air carriers organized
14 in the United States and operating in the foreign country or countries in which the taxpayer has its
15 major base of operations and in which it is organized, resident or headquartered (if not in the same
16 country as its major base of operations) are not subject to any tax based on or measured by capital
17 imposed by such foreign country or countries or any political subdivision thereof, or if taxed, are
18 provided an exemption, equivalent to that provided for herein, from any tax based on or measured by
19 capital imposed by such foreign country or countries and from any such tax imposed by any political
20 subdivision thereof[;].

21 8. The term "business income" means entire net income minus investment income[;].

the 8% QFI election. See notes 8 and 12.

4 DRAFTING COMMENT: Sentence added solely to prevent any confusion. See notes 6 and 10.

1 as business income under subdivision eight-A of this section] subpart F income, as that term is
2 defined in section 952 of the Internal Revenue Code, received from a corporation that is conducting
3 a unitary business with the taxpayer but is not included in a combined report with the taxpayer, less
4 any *interest* deductions directly or indirectly attributable to such income.⁵ In lieu of subtracting
5 from ~~such its subpart F~~ income the amount of those *interest* deductions, the taxpayer may
6 elect to reduce ~~its the~~ total *amount of such subpart F* income by forty percent. If the
7 taxpayer makes this election, the taxpayer must also make the elections provided for in paragraph (b)
8 of subdivision six of this section and subparagraph two of this paragraph. *A taxpayer which*
9 *does not make this election because it has no such income will not be*
10 *precluded from making those other elections.*⁶ If the taxpayer makes the election
11 provided for in clause (~~A~~^C) of subparagraph one of paragraph (a) of subdivision five of section two
12 hundred ten-a of this article,⁷ this subparagraph shall not apply *with respect to any income,*
13 *gains or losses from qualified financial instruments.*⁸
14 (2) [fifty percent of dividends (A) other than from subsidiaries, and (B) other than amounts
15 treated as business income under subdivision eight-A of this section, on shares of stock which
16 conform to the requirements of subsection (c) of section two hundred forty-six of the internal
17 revenue code] dividends from a corporation that is conducting a unitary business with the taxpayer

5 DRAFTING COMMENT: “interest” added to conform to February Outline.

6 DRAFTING COMMENT: See notes 4 and 10.

7 DRAFTING COMMENT: Correcting cross-reference. The “fixed percentage method” is provided for in 210-a(5)(a)(1)(C). See note 11.

8 DRAFTING COMMENT: This is to clarify that if the Fixed Percentage Method (the 8% method) election is made, the carve-out in this sentence will only impact QFI income (i.e., QFI income should be included in taxable income and there should be no interest expense disallowance if the 8% election is made). See notes 3 and 12.

1 but cannot be included in a combined report with the taxpayer, less any *interest* deductions
2 directly or indirectly attributable to such income.⁹ In lieu of subtracting from this dividend income
3 the amount of those *interest* deductions, the taxpayer may elect to reduce the total amount of this
4 dividend income by forty percent. If the taxpayer makes this election, the taxpayer must also make
5 the elections provided for in paragraph (b) of subdivision six of this section and subparagraph (1) of
6 this paragraph. *A taxpayer which does not make this election because it has no*
7 *such dividends will not be precluded from making those other elections.*¹⁰ If
8 the taxpayer makes the election provided for in clause (~~A~~C) of subparagraph one of paragraph (a) of
9 subdivision five of section two hundred ten-a of this article,¹¹ this subparagraph shall not apply
10 *with respect to any income, gains or losses from qualified financial*
11 *instruments.*¹²

12 (3) bona fide gifts,

13 (4) income and deductions with respect to amounts received from school districts and from
14 corporations and associations, organized and operated exclusively for religious, charitable or
15 educational purposes, no part of the net earnings of which inures to the benefit of any private
16 shareholder or individual, for the operation of school buses,

9 [DRAFTING COMMENTS: addition of word "interest".](#)

10 [DRAFTING COMMENTS: See notes 6 and 4.](#)

11 [See notes 2 and 7.](#)

12 [See notes 3 and 8.](#)