

2009-2010 NEW YORK STATE BUDGET

April 29, 2009

On April 3, one month after Governor Paterson's optimistic target for a new budget, New York's legislature approved the 2009-10 New York State budget. After public outcries against far-reaching attempts in the Governor's proposed budget to tax sugary soft drinks, iTunes, and a whole range of personal services, the final budget seemed to please no one. The new budget eliminates many of the new sales tax measures that caused such a stir among New Yorkers, but creates a new higher tax rate for higher income earners. Critics of the budget argue that it does too little to address New York's projected \$16 billion deficit and relies too heavily on federal stimulus money without making the difficult cuts and decisions that these recessionary times require. Regardless of its limitations, the 2009-10 budget does make some significant changes to the Tax Law, the most noteworthy of which are discussed below.

Practices & Industries

State & Local Tax

BUSINESS RELATED TAXES, FEES AND CREDITS

Filing Fees: The filing fees previously imposed only on LLCs and LLPs have been extended to all partnerships with \$1 million or more in New York source gross income. The fee for partnerships ranges from \$1,500 to \$4,500, depending on the amount of New York source gross income earned by the partnership. The new law also contains authorization for New York City to impose similar filing fees. This new fee is applicable for tax years beginning on and after January 1, 2009.

Mandatory First Installment: The new law requires that most businesses make a mandatory first-estimated tax payment of 40% of the tax imposed for the prior taxable year if the preceding year's tax exceeded \$100,000. Under prior law, the required first estimate was 30% of the tax for the preceding taxable year. This change takes effect for tax years beginning on and after January 1, 2010.

Changes to the Empire Zone Program: Significant changes to the Empire Zone Program in the 2009-10 Budget warrant particular scrutiny. The new law requires that the Commissioner of Economic Development promulgate regulations for the *decertification* of businesses based on three new tests. The first new test requires decertification if there's a finding that the business was certified prior to August 1, 2002 and either: (1) the business caused individuals to transfer from existing employment with another New York business with similar ownership, or (2) the enterprise acquired, purchased, leased or had transferred to it real property previously

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owned by an entity with similar ownership.

The second new test applies to all certified businesses, regardless of when they were certified. It is referred to as the “one-to-one” test, and considers whether the sum of the annual wages paid to all employees and investments in the facility are greater in value than the tax benefits provided to the enterprise under the Empire Zone Program. This test looks at wages and employee benefits, investments, and tax benefits during a three-year period, but it is not clear what three-year period will be used.

The third new test is whether the business enterprise had changed ownership or moved its operations out of the Empire Zone.

In addition to passing new regulations, the Commissioner is required to conduct a review in 2009 of all certified business enterprises to determine whether they pass the one-to-one test and, if applicable, the new test for those businesses first certified prior to August 1, 2002. Any business enterprise decertified by the Commissioner may challenge the Commissioner’s determination by filing a notice within 15 business days and a formal written appeal within 60 days following the date of the Commissioner’s revocation notification. Although there are indications in the new law that a decertification under the new rules is intended to have retroactive effect back to January 1, 2008, there is a reasonable argument that decertification under the new rules would be effective no earlier than the date Governor Patterson signed the bill: April 7.

Any business seeking Zone certification after April 1, 2009 must project that the sum of its wages for zone employment during the first three years following certification and the dollar value of its capital investment in the zone during the first three years after certification will equal more than 20 times the sum of the income, franchise and sales tax benefits to be enjoyed by the business in the three years following certification (i.e. a “twenty-to-one” test). Manufacturers, however, need only satisfy a ten-to-one test. Any new application to become an Empire Zone business must be received by June 30, 2010—one year earlier than in the prior law.

For businesses first certified on or after April 1, 2009, the real property tax credit is limited to 75% of the amount calculated under law applicable to businesses first certified on and after April 1, 2005, but before April 1, 2009.

Effective September 1, 2009, the new law also repeals the sales tax provisions that permitted Empire Zone businesses to buy goods and services to be used in the zone, free from State sales tax using an exemption certificate (Form DTF-81). Under the new rules, taxpayers first certified in zones prior to April 1, 2009 are no longer permitted to avoid up-front payment of the sales tax to the vendor at the time of the sale. Instead, they will be required to pay the tax and then claim a credit or refund of the tax paid no more often than quarterly.

Also for businesses first certified after April 1, 2009, no credit or refund will be provided for the State sales tax unless the county in which the zone is located has also opted in to the sales tax exemption. However, local laws opting into the Empire Zone sales tax exemption may only be made effective March 1 in any given year. In as much as March 1 has come and gone this year, it seems likely that March 1, 2010 is the first time local governments will be able to opt in if they have not already done so.

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Repeal of credits: The law repeals the \$1,500 per generating unit credit for qualified fuel cell electric generating equipment and the qualified transportation improvement project credit for tax years beginning on or after January 1, 2009.

Low Income Housing Credits: The new law increases the aggregate dollar amount of credits available for low income housing from \$20 million to \$24 million. The law is also amended to extend the time limit for the assessment by the Commissioner of any credit recapture to three years after the date the selling taxpayers notify the Commissioner of Housing and Community Renewal of a reduction in the qualified basis of such property.

Captive Insurance Companies: The new legislation amends the Article 9-A franchise tax on business corporations and the Article 32 franchise tax on banks to require over-capitalized insurance companies to file on combined reports with any corporate taxpayer that owns or controls such over-capitalized captive insurance companies

Film Production Credits: The aggregate amount of qualified film production credits will be increased by \$350 million.

PERSONAL INCOME TAX

New Higher Tax Rates: A controversial measure in the new law adds two new tax rates for the 2009 through 2011 tax years. For joint return filers earning more than \$300,000 but less than \$500,000, the highest tax rate is 7.85%. The 7.85% rate kicks in for unmarried residents, married residents filing separately, and estates and trusts at \$200,000 and for a resident head of household at \$250,000. For all filers, income in excess of \$500,000 is taxed at the rate of 8.97%.

As in prior years, upper income earners are forced to phase out the benefit of the lower brackets as their income increases.

Itemized Deductions: The new law eliminates the last 50% of itemized deductions from New Yorkers whose New York AGI exceeds \$1 million, although it exempts charitable contributions from the phase-out. Under prior law, individuals earning above certain thresholds lost a portion of their federal itemized deductions, with individuals making over \$525,000 losing a full 50%. Now, ultra-high income earners must choose between the standard deduction or 50% of their federal charitable contribution. Similar rules apply to the New York City resident income tax.

Estimated Taxes: For purposes of calculating estimated tax payment safe harbors for the 2009 tax year, upper income earners must calculate their 2008 liabilities as if the new tax rates and itemized deduction phase-out had been in place for 2008. New York City's personal income tax law contains similar amendments. These estimated tax payment provisions do not apply to any installment due earlier than May 22, 2009 (i.e. 45 days after the Governor signed the bill into law).

548-Day Rule: Under current law, a domiciliary of New York is not taxed as a resident if in any period of 548 consecutive days the taxpayer is in a foreign country for at least 450 days and the taxpayer, the taxpayer's spouse, and the taxpayer's minor children are not present in the State for more than 90 days within that 548-day period. Under prior law, the taxpayer's spouse and minor children could not be present for more than 90 days at the taxpayer's *permanent place of abode*. The new law provides that they must not be present anywhere in New York State for the taxpayer to meet the 548-day test.

Gains from the Sale of New York Property: The budget amends the personal income tax to redefine the phrase "real property located in this state" to include interests in a partnership, limited liability company,¹ S-corporation and closely held C-corporation (i.e. with 100 or fewer shareholders) owning real property located in New York State if the value of the

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real property exceeds 50% of the value of all of the assets in the entity. For sales of entity interests occurring on and after May 7, 2009, any gain recognized upon the sale of an interest in such 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.

Middle Class STAR: Effective immediately, the middle class STAR rebate program has been eliminated.

SALES AND USE TAXES

Definition of a Vendor: The new law expands the definition of “vendor” to include a seller of tangible personal property or taxable services if an entity affiliated with the vendor either: (1) uses in New York the trademarks, service marks or trade names that are the same as those used by the seller; or (2) engages in activities that inure to the benefit of the seller. The law deems the parties affiliated if there is more than 5% common ownership.

Transportation Services: Effective June 1, 2009, there is a new sales tax on the service of transporting persons by limousine, “black car” or other motor vehicle, with a driver, but excluding taxi cabs, buses, any scheduled public transport service and transportation in connection with funerals. If the service is performed in a vehicle that is leased to an unrelated person, such as a limousine driver, then the owner/lessor is deemed to be the person providing the transportation service and the transportation service fee is deemed to be two times the amount of consideration paid by the driver/lessee with respect to the lease, even if the driver/lessee did not carry or convey any person during the lease period. The tax rate for these services is the rate in the jurisdiction where the transportation commences.

Commercial Aircraft Exemption: Effective June 1, 2009, the sales tax exemption for commercial aircraft will no longer apply to airplanes used primarily to transport agents, employees, officers, members, partners, managers or directors of affiliated entities. For purposes of this provision, an entity is affiliated if there is more than 5% common ownership.

Non-resident Use Tax Exemption: The bill also amends the “non-resident” use tax exemption to exclude an entity’s purchase of aircraft, vessels and motor vehicles if the entity intends to use it primarily to carry resident individuals who are agents, employees, officers, shareholders, members, managers, partners or directors of the purchaser or any affiliated person that was a resident when the aircraft, vessel or motor vehicle was purchased. Again, for purposes of this provision, an affiliation exists where there is more than 5% common ownership. This provision will also take effect on June 1, 2009.

Tobacco Products: On April 7, 2009, the tax rate for tobacco products (e.g. cigars) other than snuff increased from 37% to 46%.

Cigarettes: The prepaid sales tax on cigarettes increases from 7% to 8%, effective June 1, 2009.

Beer and Wine: The tax on beer increases from 11 to 14 cents per gallon and the tax on wine, artificially carbonated wines and naturally sparkling wines increases from 18.93 cents per gallon to 30 cents per gallon. All ciders remain subject to the 18.93 cents per gallon tax if they do not contain more than 3.2% alcohol by volume.

Rental Cars: Effective June 1, 2009, the additional sales tax on rental cars increases from 5% to 6%.

NEW COMPLIANCE MEASURES

There are a number of new enforcement mechanisms and stiffer penalties:

The Commissioner can now compel taxpayers to make electronic records available, even if the taxpayers are not required to keep electronic records. It also permits the imposition of a penalty not to exceed \$5,000 upon any person required to make or maintain sales tax records who fails to do so. Furthermore, any person required to make or maintain sales tax records who fails to present such records is liable for an additional penalty of \$1,000 per sales tax quarter. And even if they have maintained hard copy records, if a person has maintained electronic records and doesn't allow the Commissioner access, they will be subject to the penalty not to exceed \$5,000. These new penalty provisions are effective immediately.

Responsible officers under the withholding tax are now liable for interest on the penalty from the date the penalty is first imposed to the date the penalty is paid. This provision applies to tax years beginning on and after January 1, 2009.

There is clearer statutory guidance on expedited review processes for the denial of licenses, registrations and the like. Taxpayers now have only 30 days after receiving a Notice of Proposed Denial to initiate the conciliation conference process. Likewise, an ALJ petition challenging a license denial must be filed within 30 days of the conciliation order or notice of discontinuance. Once the Division of Tax Appeals has received the Petition, it is required to schedule an expedited hearing within ten days, and the ALJ must render a decision within 30 days from the receipt of the Petition. And when an exception is taken to an ALJ determination, the Tax Appeals Tribunal must issue its decision within three months from the receipt of the Petition. However, the Commissioner may immediately suspend a license, permit or registration if the Commissioner believes that the collection of any tax or public safety will be jeopardized.

Interest rates applicable to underpayments of tax have been increased by 1.5 percentage points, with most changing from 6% to 7.5%.

With respect to sales tax refunds and credits, the amended law permits the State to avoid payment of any interest if the payment of the refund is made within three months after the return on which the refund claim was filed. This also applies to applications for refunds or credits not filed on a sales tax report.

The deadline for filing the annual quarterly combined withholding, wage reporting and unemployment insurance return has been moved from February 28th to January 31st.

Motor vehicle insurers, franchisors, and alcoholic beverage wholesalers must submit information reports to the Department of Taxation and Finance regarding the sales they make to their New York customers. Because there is a new information return required, New York State had to create a new penalty—not to exceed \$10,000 for any annual filing period—for the failure to file that information return.

The Commissioner can now share with the IRS "returns or reports" he receives as a result of the Voluntary Disclosure and Compliance Program.

New York State may now enter into reciprocal agreements with other states and the federal government to apply refunds that are available with respect to those other jurisdictions against New York tax liabilities and vice versa.

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Courts will now have the authority to impose monetary fines for felonies that double the amount of the underpaid tax liability resulting from the commission of the crime. Furthermore, §1801 of the Tax Law has been repealed in its entirety and replaced with a new section, entitled “Tax Fraud Acts.” Likewise, Tax Law §§1802 through 1806, defining criminal tax fraud in the fifth degree through criminal tax fraud in the first degree, respectively, have been repealed and replaced with new language.

The amendments also create three new sections of the Tax Law: §§1831 through 1833. New Tax Law §1831 treats as a misdemeanor the failure to respond to a subpoena by attending as a witness or producing books or failing or refusing to answer material and proper questions. Tax Law §1833 makes the failure of a tax preparer to sign a return a Class A misdemeanor. This provision applies to all failures to sign tax returns that have been filed since April 7, 2009.

The civil fraud penalty has been raised from 50% of the amount of the deficiency due to fraud to two times the deficiency due to fraud. New rules also impose monetary penalties for making “specified frivolous” submissions.

The personal, corporate and sales tax administrative provisions now carry new penalties for submission of a false or fraudulent document. There does not appear to be any requirement that the submission be one that is “knowing” or “willful” before the penalty may be imposed.

Finally, any person aiding or assisting in the giving of fraudulent sales tax returns or other documents with the intent to evade tax will now be subject to a civil penalty not to exceed \$5,000, under new Tax Law § 1145(i).

¹The bill actually refers to a “limited liability corporation.” This is probably a typo and should be “limited liability company.”