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MULTISTATE INCOME/FRANCHISE TAX

New York adopts final corporate income tax regulations

Tax Alert

Overview

On December 27, 2023, a Notice of Adoption of final regulations was published in the New York State Register. These regulations are intended to provide guidance on the state's sweeping corporate tax reform legislation enacted in 2014, with related amendments enacted in 2015 and 2016 ("New York Corporate Tax Reform"). The publication of the Notice of Adoption concluded an eight-year long process of drafting, public comment, and agency response. A link to the Notice of Adoption can be found here. The final text of the regulations has been posted on the New York Department of Taxation and Finance (the "Department") website here. In Part 1, this alert addresses the effective date of the final regulations, the Department's position on their retroactive application, and the regulations' applicability in New York City. In Part 2, this alert gives a brief overview of three select regulatory provisions that, based on comments generated during the regulatory drafting process, are of interest to taxpayers.

Part 1: Application of Final Regulations

Effective Date

The regulations were adopted by the Department on December 11, 2023. The New York State Administrative Procedures Act generally provides that "no rule shall become effective until it is filed with the secretary of state and the notice of adoption is published in the state register…" Accordingly, the final regulations became effective when the notice of adoption was published in the New York State Register on December 27, 2023. Therefore, for financial accounting purposes, any impact of the regulations must be considered and, as applicable, accounted for in the quarter in which December 27, 2023 falls, making it a 2023 fourth quarter event for companies using a calendar year for financial statement reporting.

Retroactive Application

As part of its "Assessment of Public Comment," posted here, the Department responded to the issue of the retroactive application of the final regulations.

The Department states its position that the final regulations apply to all taxable years beginning on or after January 1, 2015, and further provides that "the department, based on a totality of the circumstances, may choose not to apply penalties in cases where taxpayers took a position in their tax filings prior to adoption of the proposed rule in reliance upon prior article 9-A regulations or prior drafts of the proposed rule." Taxpayers should review positions taken in any open years beginning on or after January 1, 2015, which may be contrary to the final regulations, and evaluate whether adjustments to tax reserves should be made for financial reporting purposes or whether amended tax returns should be filed. Such evaluations should include whether retroactive application of a given regulation is appropriate in a specific factual context.

New York City

New York City ("NYC") is not bound to follow the final regulations as promulgated by the state. Therefore, these regulations are not binding for purposes of the NYC Business Corporation Tax. However, the NYC Department of Finance has stated its intention to eventually adopt rules that generally correspond to the regulations New York State has issued to implement New York Corporate Tax Reform, in so far as the underlying statutes themselves correspond. See the City statement here under "Regulations." Notwithstanding this statement, at a recent conference NYC Department of Finance officials indicated they would be reviewing the Department's regulations when adopted and may choose to take a different approach in certain circumstances. Deloitte will continue to monitor the City's response to the promulgation of these final state regulations.

Part 2: Select regulatory provisions

In Part 2, the alert highlights three specific positions taken in the final regulations which, based on comments submitted throughout the drafting process, generated significant taxpayer interest.

Billing address "safe harbor" clarified as presumption

New York Tax Law sections 210-A(4) and 210-A(10) require that taxpayers use a hierarchy of methods to source receipts from digital products and services and other business receipts and services, respectively. During the drafting process, the Department received comments advocating that the regulations establish a "safe harbor" allowing taxpayers with more than 250 customers to generally source receipts to their customer's billing address, rather than using the hierarchy or rules specified in the statutes. Some comments pointed out that safe harbors of this kind were used in other states with similar sourcing rules. When the proposed regulations were issued by the Department on August 9, 2023, they addressed the issue by including provisions referenced as a business customer "billing address safe harbor" in Proposed Regulation sections 4-3.2(d)(1)(ii) and 4-4.2(d)(1)(ii), which related to the two statutory provisions above. These billing address safe harbors generally provided that for taxpayers with more than 250 business customers purchasing substantially similar digital product/service or service/other business activities (and no more than 5% of receipts are from that particular customer), the primary use location of the digital product/service or the benefit of the service/business activity is presumed to be received at the customer's billing address.

However, the specific language used in defining the billing address safe harbors led to further questions and the Department received comments requesting clarification, including whether these provisions were intended to be elective.

In the final regulations, the term "billing address safe harbor" was changed. The Department states, in the Notice of Adoption, that "[c]larifying revisions were made to substitute the term, 'billing address safe harbor' for the more precise term, 'business address presumption'" in applicable sections of the regulations. Accordingly, now characterized as a presumption, these provisions

must be applied first; and the use of them, by the Department or a taxpayer, may only be overcome using clear and convincing evidence that another proposed method better reflects the location where the customer derives the value from the digital product/service or service/other business activity, as applicable. When the Department is seeking to overcome the presumption, it must also prove by clear and convincing evidence that the taxpayer had access to, or could have obtained upon reasonable inquiries when required, information at the time it filed its original return that could have been used to apply the Department's method.

Sourcing of receipts from services to passive investment customers unchanged in final regs

Consistent with the proposed regulations of August 9, 2023, final regulation Section 4-4.4(c) provides that receipts for "management, distribution, and administration services", provided to a "passive investment customer" are generally sourced to the location of the investors in such passive investment customer unless the investor is holding the interest in the passive investment customer for a beneficial owner.

The regulations further state that management, distribution and administration services provided to a passive investment customer generally "are apportioned to this state in proportion to the average value of the interests in the passive investment customer held by the passive investment customer's investors and beneficial owners located in this state." While the Assessment of Public Comment states that an industry group advocated for sourcing based on the direct tracing of fees, as the management fee paid by investors in many cases is not a set percentage but instead may decrease based on the amount of capital committed, the Department rejected this suggestion, as well as other suggestions made by industry groups related to sourcing receipts from services to passive investment customers.

Sourcing of gains from the sale of goodwill

Also included in both the proposed and final versions of regulation Section 4-4.3(e), net gains from the sale of goodwill are to be sourced to New York based on "where the value of goodwill is accumulated." This, in turn, is determined using a three-year average of the business apportionment factor or other percentage used to apportion or allocate income to New York State of the entity that is sold, unless the facts and circumstances indicate another period of time is a better measure of where the value is accumulated.

Conclusion

The Department's final regulations, issued on December 27, 2023, provide taxpayers with greater certainty regarding the application of New York Corporate Tax Reform. Furthermore, given the Department's stated intention to apply these final regulations retroactively to open tax years beginning on or after January 1, 2015, significant impacts to taxpayer positions may result. Please reach out with any questions.

Get in touch

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