2018-2019 Budget Bill Highlights

On March 31, 2018, Governor Cuomo signed the New York State ("NYS") Fiscal Year 2018-2019 Budget Bill ("Bill"). Some of the changes were in direct response to the Federal Tax Cuts and Jobs Act ("TCJA") while others were not.

Discussed below are the major highlights of the Bill.

Federal TCJA Responses:

Contributions to Charitable Trust Funds

Beginning on or after January 1, 2019, individual taxpayers will be allowed an income tax credit equal to 85% of any donation made to certain state-operated charitable funds for the tax year following the year in which the donation is made. The charitable funds include the State University of New York Impact Foundation, the Research Foundation of the City University of New York, and Health Research, Inc. The Bill also grants political subdivisions, (i.e. school districts, counties, towns, cities, and villages) the authority to create similar funds for education, health care, and other charitable purposes. Donations to these local charitable funds would result in a local credit, reducing local property taxes equal to 95% of the donation, or a lower percentage as established by the political subdivision.

However, based on some Internal Revenue Service rhetoric, it is not certain that they will allow this contribution to be deducted for federal tax purposes.

Employer Compensation Expense Tax

To help minimize the $10,000 SALT deduction, the Bill creates an Employer Compensation Expense Tax (“ECET”) system whereby employers may opt-in, for employees making more than $40,000, and pay the ECET. The tax will be phased in over three years beginning on January 1, 2019 at a rate equal to 1.5 percent in the first year, a 3 percent in the 2020, and a 5 percent in 2021 and thereafter. Employees will receive a tax credit related to the ECET paid by their employers, in accordance with the following formula: (the employee’s wages for the year in excess of $40,000) x (1.5% for 2019, 3% for 2020 and 5% thereafter) x (1-[personal tax imposed on the employee, before credits/the employee’s taxable NYS income]). The employer’s election to opt-in to the ECET must be made by December 1 of the prior calendar year.

As an example, an employee with an annual salary of $300,000 having a tax liability of $20,000 before credits, would be entitled to an income tax credit equal to $12,133 [$260,000 x 5% x (1 - $20,000/$300,000)] once the ECET is fully phased-in. As a result, the employee’s state personal income tax is reduced below the $10,000 SALT deduction cap. This allows for a deduction for some real estate tax if the IRS does not allow the deduction to the charitable fund.

Employers are prohibited under the Bill from reducing wages by any amount representing the ECET. The employer would be entitled to a deduction on its return for the additional taxes paid. Although the deduction relieves some of the burden of the added tax, employers would be bearing most of the added cost, perhaps minimizing their willingness to participate.

Partial Decoupling from Federal Changes

Prior to the Bill, if taxpayers itemized deductions for federal taxes, they had to itemize for NYS as well. Therefore, the new federal rules limiting certain itemized deductions would adversely affect NYS taxpayers. To alleviate this, the Bill decouples

from the federal law to allow a NYS taxpayer to itemize his/her deductions even if (s)he take a standard deduction for federal tax purposes. Further decoupling includes the deduction of alimony payments by the payor and the inclusion in income by the recipient, regardless of when the divorce became final. Also included is the continued deductibility of certain qualified moving expenses.

Global Intangible Low-Taxed Income (GILTI)

TCJA created new Internal Revenue Code ("IRC") § 951A, Global Intangible Low Taxed Income, ("GILTI"). This taxes a U.S. shareholder on income from controlled foreign corporations (CFCs) to the extent it exceeds a fixed return on the tangible assets of such CFCs. This income is subject to tax at regular income tax rates, but under new IRC § 250, a deduction is allowed for 50% of the amount included in income. Additionally, foreign tax credits are also available to offset GILTI at the federal level equal to 80%.

The Bill does not specifically address GILTI. Therefore, both GILTI and the 50% GILTI deduction under IRC § 250 are included in the computation of NY taxable income. However, the Bill amends the subtraction modification related to IRC § 78 gross ups to limit the subtraction modification to dividends that were not included in the IRC § 250 deduction. This change was necessary to prevent taxpayers from obtaining a double deduction related to IRC § 250.

Mandatory Repatriation of Income Mandated Under TCJA

For both NYS and New York City ("NYC") corporations, the Bill provides that the mandated repatriation of foreign income under IRC §965 will not be included in the corporate tax base. Any deductions permitted for federal tax purposes will be an add back so that corporate taxpayers will not yield a double benefit.

For the individual shareholder, this income can be spread out over an eight-year period. However, recently-issued Notice N-18-4 provides that the entire repatriation amount will be subject to tax in NYS in the year of inclusion.

2017 Empire State Child Tax Credit Benefits

The TCJA increased the Federal child tax credit. The Empire State Child Tax Credit amount is calculated as a percentage of the Federal child tax credit. To eliminate an increase in the NYS credit, the Bill provides that the NYS York credit remain equal to the Federal credit prior to TCJA.

Other Provisions:

Statute of Limitations Extension on Amended Returns

Effective immediately and applicable to all amended returns filed on or after the effective date, both NYS and NYC can assess additional tax or recover a previously paid refund within one year after the amended return is filed. Prior to the Bill, the Department of Taxation and Finance ("DTF") generally had three years from the original filing date of the original tax return to audit and assess additional tax, and an amended return did not extend the statute of limitations except with respect to determining reductions or offsets to refunds or credits claimed on the amended returns.

Statutory Residency Requirement Clarified

Under NY law, taxpayers are treated as NY State residents if they are either domiciled in the State, or they maintain a permanent place of abode in NYS and are present in NYS for more than 183 days. In 2015, an Administrative Law Judge ruled against NYS in concluding that where the taxpayer is a part-year domiciliary, only the non-domicile portion of the tax year should be considered in determining whether the 183 day test is satisfied.

Effective January 1, 2019 the Bill re-establishes NYS's position that in determining statutory residence all the days that the taxpayer is present in NYS are counted notwithstanding the taxpayer may have been a part-year domiciliary.

Employee Wage Reporting Change

Employers and other entities responsible for the collection, remittance, and reporting of withholding taxes are required to file a Form NYS-45, which is used by both the Department of Labor ("DOL") and DTF. Currently, these entities provide employee-level details to DOL on a quarterly basis and to DTF on an annual basis. The Bill amends the Tax Law to require quarterly reporting to DTF.

Resale Exemption for Prepared Food and Beverages

Prior law § 1105(d) imposed sales tax, with no resale exclusion, on any purchase of restaurant-type food to be sold in establishments such as restaurants, cafeterias, or taverns, or by caterers. These entities were permitted a credit for the taxes paid on food purchases. Effective for sales made on or after June 1, 2018, the Bill amends this law to

allow restaurants, cafeterias, taverns, caterers, and other vendors to purchase food exempt from sales tax when such purchases are for resale via the use of a resale certificate.

Sales and Use Tax Relief for Certain Responsible Persons

Effectively immediately, the Bill makes obsolete a previously existing DTF Technical Memorandum (TSB-M-11(17)S by providing that certain members of an LLC and limited partners in a limited partnership are liable only for their pro-rata share of the business's original liability, if they show that: (i) they were not under a duty to act for the LLC or limited partnership in complying with the requirements of the sales tax; and (ii) their ownership interest and the percentage of their distributive share of the profits and losses of the LLC or limited partnership are each less than 50%.

In addition, the law will only hold eligible persons liable for outstanding sales tax liabilities by assessing them on the higher of the eligible person's ownership percentage in the business or the person's share of profit and losses in the business. Moreover, these individuals cannot be held accountable for penalties owed by the business.

General partners and LLC members holding more than 50% ownership interest in the LLC are not eligible for the relief.

ADDITIONAL INFORMATION

Expanded Definition of NY Source Income of a Non-resident

On April 6. 2018, the NYS DTF released Technical Memorandum (TSB-M-18(1)I which expanded the definition of NY source income of a non-resident individual to include the gain or loss from the sale of ownership interests in partnerships, LLC's, S Corporations and non-publicly traded C corporations with 100 or fewer shareholders that own shares in a co-op where the fair market value ("FMV") of all real property in NY and shares in stock in the NY co-op exceeds 50% of the FMV of the assets the entity has owned for at least two years on the date of the sale or exchange. If all of the entity's assets are owned for less than two years, the 50% test is deemed satisfied. The amount gain included as NY source income is equal to the federal gain multiplied by a fraction, the numerator being equal to the FMV of the entity's real property in NY plus the shares of the NY co-op, the denominator being equal to the FMV of all the entity's assets. This change applies to a sale or exchange that occurs on or after January 1, 2017.

NYS Tax Treatment of Nonqualified Deferred Compensation

On April 6. 2018, the NYS DTF released Technical Memorandum (TSB-M-18(2)C, 3I which addresses the NYS treatment of certain nonqualified deferred compensation that was deferred and which was attributable to services performed before January 1, 2009 and which had not been included in federal income prior to January 1, 2018 which now has to be included in federal taxable income in the later of 1) the last tax year beginning before January 1, 2018 or 2) the tax year in which there is no substantial risk of forfeiture of the rights to such compensation.

This is applicable to residents, non-residents, sole proprietors, partnerships, LLC's, LLP's, S-Corporations and estates and trusts.

NYC Commercial Rent Tax Change

Currently, NYC imposes a Commercial rent tax at a current effective rate of 3.9% on base rent paid on property used for commercial activities located between 96th Street and Murray Street where the annualized based rent is equal to or greater than $250,000. Base rent is generally defined as rent paid to the landlord which includes payments for real estate taxes and water and sewer charges, less any mounts received from a sub-tenant. This is a quarterly tax beginning June 1 and ending May 31.

Effective July 1, 2018, businesses paying less than $500,000 in annual base rent with total income less than $5,000,000 will receive a full tax credit. If the base rent is between $500,000 and $550,000 or total income is greater than $5,000,000 but less than $10,000,000 there is a partial credit based on a formula. Businesses with total income greater than $10,000,000 in total income will have no credit.

The formula is equal to the tax multiplied by both an income factor and rent factor. For businesses with less than $5,000,000 in total income and rent between $500,000 and $550,000, the credit is equal to the tax before credit multiplied by an income factor (deemed to be one). The rent factor is a fraction, the numerator being $550,000 less the base rent and the denominator being $50,000.

If total income is between $5,000,000 and $10,000,000 the income factor is a fraction, the numerator being $10,000,000 less total income and the denominator being $5,000,000. If the base rent is $500,000 or less, the rent factor is deemed to be one. If it is between $500,000 and $550,000 the rent factor is calculated as stated above.

For this purpose, total income is the amount reported for federal income tax purposes in the federal tax year immediately preceding the period of the credit and is equal to gross receipts less returns and allowances less cost of goods sold plus most other items of income including dividends, interest, gross rents, gross royalties, capital gains, net gain or loss from the sale of business property and ordinary income or loss from partnerships, estates and trusts.

As an example, assume a business has $8,000,000 in total income and $540,000 in base rent. The credit would be $2,480 calculated as follows:

Tax = $530,000 X 3.9% = $20,670
Credit = $20,670 X ($3,000,000/$5,000,000) X ($10,000/$50,000)

While this seems straightforward there are currently no regulations or guidance. Therefore, the NYC Department of Finance still needs to determine how the thresholds will be determined with respect to businesses that have common ownership that were previously combined.

Lastly, while these changes will eliminate this tax for many businesses, all tenants located in the stated location mentioned above whose base rent or subtenant deduction is equal to or greater than $200,000 must still file tax returns.

If you have any questions regarding the Budget Bill Highlights or the additional information provided, please contact your Gettry Marcus Advisor.

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