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New York Corporate Tax Overhaul Broadens Bases, Lowers Rates, and Reduces Complexity

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Key Findings

- The four different tax bases for calculating corporate tax are reduced to three as of FY 2015 (eliminating the corporate AMT base) and further reduced to two over time (eliminating the capital stock base).
- The corporate net income tax rate is reduced from 7.1 percent to 6.5 percent, the lowest level since 1968.
- The duplicative bank tax system is merged into the better-developed corporate tax system.
- The estate tax is recoupled over time to the higher federal threshold, exempting many small businesses from hefty taxes upon the death of their owners. The generation-skipping transfer tax is repealed.
- Net operating losses are restructured to reduce uncertainty for taxpayers, NOL carrybacks are extended to three years, and the $10,000 cap is removed. NOL carryforwards remain twenty years, similar to federal law.
- The individual add-on Minimum Tax is repealed.
- If the changes enacted by the bill were in full effect for the most recent version of the State Business Tax Climate Index, New York's corporate tax system would have ranked 4th best of the fifty states instead of 25th best.

Executive Summary

On March 31, New York Governor Andrew Cuomo (D) signed into law the FY 2014-2015 state budget, which includes major reforms to the state's corporate income tax system and estate tax.[1] The bill contains a number of provisions to reduce business tax complexity and burdens, with two tax practitioners describing it as "the most significant revisions to the [corporate income] tax since its enactment in 1944."[2] The bill includes broad-based changes that affect most businesses as well as targeted incentives for particular business types.

While some of the targeted credits and programs deserve criticism, the broad-based changes to the corporate tax are impressive and will greatly reduce complexities and burdens in New York's corporate tax structure. Key features of the bill:

- The four different tax bases for calculating corporate tax are reduced to three as of FY 2015 (eliminating the corporate AMT base) and further reduced to two over time (eliminating the capital stock base).
- The corporate net income tax rate is reduced from 7.1 percent to 6.5 percent, the lowest level since 1968.
- The duplicative bank tax system is merged into the better-developed corporate tax system.
- The estate tax is recoupled over time to the higher federal threshold, exempting many small businesses from hefty taxes upon the death of their owners. The generation-skipping transfer tax is repealed.
- Net operating losses are restructured to reduce uncertainty for taxpayers, NOL carrybacks are extended to three years, and the $10,000 cap is removed. NOL carryforwards remain twenty years, similar to federal law.
- The individual add-on Minimum Tax is repealed.

In the 2014 *State Business Tax Climate Index,* which evaluated state tax laws as of July 1, 2013, New York's corporate tax system ranked 25th best out of the fifty states, and the overall tax structure ranked 50th, or last.[3] If the changes enacted by the bill were in full effect for the most recent version of the Index, New York's corporate tax system would have instead ranked 4th best of the fifty states, behind only three states with no corporate income tax. The state's overall rank would have improved two spots to 48th, beating New Jersey and

1 Disclaimer: As first reported by *Capital New York* and the *New York Post*, the Cuomo administration reached out to the Tax Foundation to learn how the *State Business Tax Climate Index* works, and the subsequent discussions reviewed the corporate variables on which New York scores poorly and the economic evidence behind each of those conclusions. *See, e.g.*, Jimmy Vielkind, *Cuomo's Tax Foundation Consult*, Capital New York, Mar. 26, 2014, http://www.capitalnewyork.com/article/albany/2014/03/8542611/cuomos-tax-foundation-consult; Aaron Short, *New York leads US in residents' tax burden for 7th straight year,* New York Post, Apr. 3, 2014, http://nypost.com/2014/04/03/new-york-leads-us-in-residents-tax-burden-for-7th-straight-year/.

2 Irwin M. Slomka & Kara M. Kraman, *New York Governor Cuomo Signs Sweeping Corporate Tax Reform Legislation*, Morrison & Foerster Client Alert (Apr. 2, 2014).

3 Scott Drenkard & Joseph Henchman, *2014 State Business Tax Climate Index*, Tax Foundation Background Paper No. 68, Oct. 9, 2013, http://taxfoundation.org/article/2014-state-business-tax-climate-index.

California (see Table 1). (The bill phases in many of these changes, so the full effect will be seen over a number of years.)

New York is not a low-tax state, and its economic success is because of strengths that overcome a challenging tax environment, with recent tax commission reports recommending many of the changes incorporated in the bill.[4] High taxes need not also be complex or poorly structured taxes, however, and removing these obstacles will encourage job creation and economic activity. New York's 2014 corporate tax reform is an impressive first step toward tackling this problem by broadening bases, lowering rates, reducing burdens, and eliminating needless complexity.

Table 1. Effect of New York Tax Changes on 2014 *State Business Tax Climate Index*

	Overall Rank	Corporate Tax Component Rank	Individual Income Tax Component Rank	Sales Tax Component Rank	Unemployment Insurance Tax Component Rank	Property Tax Component Rank
2014 Index Rank, using law as of July 1, 2013	50th	25th	49th	38th	45th	45th
2014 Index Rank, if changes in budget bill had been in full effect on July 1, 2013	48th	4th	49th	38th	45th	44th

Source: Tax Foundation analysis of 2014 New York Senate-Assembly Bill S. 6359D, A. 8559D.

Each tax-related provision of the bill is discussed in detail below.

Corporate Tax Rate Reduced

The 7.1 percent corporate net income tax rate (known as the franchise tax in New York) drops to 6.5 percent, effective January 1, 2016. This change, which brings the tax to its lowest rate since 1968, was recommended by the Pataki-McCall tax reform commission late last year. C corporations and S corporations are subject to the tax.

4 *See, e.g.*, Tax Foundation, Liz Malm & Gerald Prante, *Annual State-Local Tax Burden Ranking FY 2011* (Apr. 2, 2014), http://taxfoundation.org/article/annual-state-local-tax-burden-ranking-fy-2011; Liz Malm, *New York Governor Cuomo Offers Tax Package in Executive Budget*, Tax Foundation Tax Policy Blog, Jan. 30, 2014, http://taxfoundation.org/blog/new-york-governor-cuomo-offers-tax-package-executive-budget; Liz Malm, *New York Governor Cuomo's Second Tax Commission Publishes Recommendations*, Tax Foundation Fiscal Fact No. 409 (Dec. 19, 2013), http://taxfoundation.org/article/new-york-governor-cuomo-s-second-tax-commission-publishes-recommendations; Liz Malm, *New York Governor's Tax Commission Releases Reform Recommendations*, Tax Foundation Fiscal Fact No. 403 (Nov. 18, 2013), http://taxfoundation.org/article/new-york-governor-s-tax-commission-releases-reform-recommendations; Joseph Henchman, *Governors React to State Business Tax Climate Index*, Tax Foundation Tax Policy Blog, Oct. 18, 2012, http://taxfoundation.org/blog/governors-react-state-business-tax-climate-index.

Four Corporate Tax Bases Reduced to Two

Corporate taxpayers currently pay the highest of four separate tax base calculations:

- 7.1 percent tax on net income; or
- 0.15 percent tax on capital base (up to a maximum of $1 million); or
- 1.5 percent alternative minimum tax; or
- A fixed dollar tax of up to $5,000.

The net income base (at a lower 6.5 percent rate) and the fixed dollar tax (with the maximum amount increased to $200,000) are retained (see Tables 2 and 3). The alternative minimum tax base is repealed effective tax year 2015, and the capital stock base is phased down each year beginning in 2016, reaching zero in 2021. The bill also grants taxpayers a deduction for taxes paid to foreign governments, allowing them to avoid double taxation.

Table 2. New York Corporate Tax Rate and Base Changes, 2014 to 2022

	2014	2015	2016	2017	2018	2019	2020	2021
Corporate Tax Rate	7.1%	7.1%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
Capital Stock Base Rate	0.150%	0.150%	0.125%	0.100%	0.075%	0.050%	0.025%	Repealed
AMT	1.5%	Repealed	Repealed	Repealed	Repealed	Repealed	Repealed	Repealed

Source: 2014 New York Senate-Assembly Bill S. 6359D, A. 8559D.
Note: For manufacturers, see Table 7.

Table 3. New York Corporate Fixed Dollar Tax

(Brackets added by budget bill are in bold)

<table>
<tr><th>Receipts</th><th>Tax for C Corporations</th><th>Tax for S Corporations</th></tr>
<tr><td>>$0</td><td>$25</td><td>$25</td></tr>
<tr><td>>$100,000</td><td>$75</td><td>$50</td></tr>
<tr><td>>$250,000</td><td>$175</td><td>$175</td></tr>
<tr><td>>$500,000</td><td>$500</td><td>$300</td></tr>
<tr><td>>$1,000,000</td><td>$1,500</td><td>$1,000</td></tr>
<tr><td>>$5,000,000</td><td>$3,500</td><td>$3,000</td></tr>
<tr><td>>$25,000,000</td><td>$5,000</td><td rowspan="6">$4,500</td></tr>
<tr><td>>$50,000,000</td><td>$10,000</td></tr>
<tr><td>>$100,000,000</td><td>$20,000</td></tr>
<tr><td>>$250,000,000</td><td>$50,000</td></tr>
<tr><td>>$500,000,000</td><td>$100,000</td></tr>
<tr><td>>$1 billion</td><td>$200,000</td></tr>
</table>

Source: 2014 New York Senate-Assembly Bill S. 6359D, A. 8559D.
Note: For manufacturers, see Table 7.

Bank Tax Merged into Corporate Income Tax

The state's two parallel business tax systems (Article 32 for banks and Article 9-A for other corporations) are merged into one tax system. Two parallel tax systems led to divergence in definitions and rules, as well as differing standards for nexus, sourcing, and combined reporting.

Adoption of Economic Nexus and Other Rules

The legislation enshrines an economic nexus standard—which means corporations are taxed based on where they have customers rather than where they have property or employees—for businesses with over $1 million in receipts from activities in New York, sets bright-line rules for combined reporting provisions (50 percent common ownership and unitary business), and establishes a hierarchy for the taxation of digital products or services (customer's primary use location, then location received by customer, then previous year's apportionment fraction, then current year's apportionment fraction for those products that can be sourced). The New York presence of a partner in an otherwise out-of-state corporation constitutes nexus so long as the basis of the interest is more than $1 million. Fulfillment services are no longer exempt from the nexus rule. The shift to economic nexus had been considered for some time and may spur further discussion of the federal Business Activity Tax Simplification Act (BATSA), which would enshrine a physical presence rule.

Net Operating Loss (NOL) Changes

Companies incur net operating losses (NOLs) when their expenses exceed income. NOL carryforwards and carrybacks allow corporations to apply those losses against recent years of profitability to smooth tax burdens over time. Currently, taxpayers may take a net operating loss deduction based on the federal deduction, but because the NOL is computed on a pre-apportionment basis, it can have less value if applied in a year where the taxpayer's apportionment is lower. NOL carrybacks are further limited to two years with a maximum carryback of $10,000. Under the budget legislation, New York now adopts the post-apportionment approach followed by most states, removes the cap, and extends the carryback period to three years. NOLs under the new system may be carried forward twenty years or carried back three years. A transition rule is established to convert accumulated NOLs under the old system into credits against the new tax system.

Metropolitan Transportation Authority (MTA) Corporate Tax Surcharge Made Permanent

Corporate taxpayers currently pay a 17 percent tax surcharge to fund regional transportation. The tax was first adopted on a "temporary" basis in 1982 and periodically extended. Under the budget bill, the tax is made permanent, increased to 25.6 percent in 2015 (due to application to a lower tax base), and then adjusted each year thereafter to meet, but not exceed, projected revenue needs.

Estate Tax Reform

The bill overhauls the state estate tax, retaining the 16 percent top rate but phasing in an increase in the exclusion amount, previously set at $1 million. The exclusion will rise to approximately $2 million immediately and recouple with federal law in 2019 (see Table 4). Maryland also passed similar legislation this year, although they recouple immediately. Reaching a $1 million estate in New York is not uncommon where property values are high, and a low exclusion threshold can mean the estate tax hits immobile capital, such as family farms or businesses.

Table 4. New York Estate Tax Exclusion Changes

Year	Exclusion
Prior to April 1, 2014	$1,000,000
April 1, 2014 through March 30, 2015	$2,062,500
April 1, 2015 through March 30, 2016	$3,125,000
April 1, 2016 through March 30, 2017	$4,187,500
April 1, 2017 through December 31, 2018	$5,250,000
January 1, 2019 and thereafter	Recoupled to federal exemption (estimated to be approximately $5.8 million)

Source: 2014 New York Senate-Assembly Bill S. 6359D, A. 8559D.

New York's estate tax has remained linked to a federal estate tax and unified credit system that was superseded in 2005 and fully repealed in 2010. The earlier federal estate tax motivated states to adopt their own estate taxes as the federal tax provided a dollar-for-dollar credit for state estate tax paid, up to a certain amount. The repeal of this system means state estate taxes are now additional taxes paid by taxpayers, and thus states must either develop a stand-alone tax or (as most have done) repeal it. The New York bill sets clear estate tax rates (see Table 5) and answers many outstanding questions about estate tax definitions and compliance, generally recoupling with federal law.

Table 5. New York Estate Tax Rates, effective April 1, 2014

Estate Value	Tax Due
>$0	3.06%
>$500,000	$15,300 plus 5.0% over $500,000
>$1 million	$40,300 plus 5.5% over $1 million
>$1.5 million	$67,800 plus 6.5% over $1.5 million
>$2.1 million	$106,800 plus 8.0% over $2.1 million
>$2.6 million	$146,800 plus 8.8% over $2.6 million
>$3.1 million	$190,800 plus 9.6% over $3.1 million
>$3.6 million	$238,800 plus 10.4% over $3.6 million
>$4.1 million	$290,800 plus 11.2% over $4.1 million
>$5.1 million	$402,800 plus 12.0% over $5.1 million
>$6.1 million	$522,800 plus 12.8% over $6.1 million
>$7.1 million	$650,800 plus 13.6% over $7.1 million
>$8.1 million	$786,800 plus 14.4% over $8.1 million
>$9.1 million	$930,800 plus 15.2% over $9.1 million
>$10.1 million	$1,082,800 plus 16.0% over $10.1 million

Source: 2014 New York Senate-Assembly Bill S. 6359D, A. 8559D.

The exclusion is structured as a tax credit, wiping out the tax liability for estates under the exclusion threshold but imposing tax on the full estate for estates above the exclusion threshold. Thus, a $2,060,000 estate pays zero tax at the 2014 exclusion threshold of $2,062,500, but a $2,065,000 estate pays tax on the full value of the estate. The severity of this tax "cliff" is mitigated somewhat by phasing the tax in for estates between 100 percent and 105 percent of the exclusion amount by a special credit.[5] *Crain's New York Business* reported in early April that the New York Society of CPAs, concerned about high effective marginal tax rates on estates in that range, has suggested applying the exclusion threshold to all estates, including those above the exclusion threshold.[6] This would exempt the first $2,062,500 from tax for all estates, eliminating the cliff and the complexity of mitigating it.

Generation-Skipping Transfer Tax (GST) Repealed

The budget bill repeals the generation-skipping transfer tax (GST), a tax designed to deter estate tax avoidance through property transfers to grandchildren. As the Pataki-McCall Commission noted, "Since the federal GST operates with the same purpose, the State GST tax is not necessary."[7]

Individual Add-On Minimum Tax Repealed

The budget bill repeals the individual add-on Minimum Tax. The tax involves high compliance costs for many taxpayers while generating only a small amount of revenue.

5 The credit is calculated as the amount of tax due on an estate from the tax table, if the estate's value was the exclusion amount multiplied by one minus a fraction of the excess value of the actual estate over five percent of the exclusion threshold. For example, a $2.1 million estate is $37,500 above the $2,062,500 exclusion threshold. Under the tax table, this estate would owe $106,800 in tax. However, this is reduced by the tax that would be due on an estate equivalent to the exclusion amount multiplied by one minus a fraction of the excess value of the actual estate over five percent of the exclusion threshold ($2,062,500 x (1- ($37,500 / $103,125))). This calculates to $1,312,500, and the tax due on such an estate would be $57,488. The actual estate's tax liability is reduced by this amount, resulting in a tax due of $49,313 ($106,800 - $57,488). The table below illustrates how this "cliff" is phased in for estates between 100 percent ($2,062,500) and 105 percent ($2,165,625) of the exclusion threshold. .

Table 6. Illustration of Estate Tax Cliff Phase-In on Select Estates

Estate Value	Tax from Tax Table	Exclusion Amount of $2,062,500 and Cliff Credit	Tax Due	Effective Tax Rate	Additional Tax on Last $25,000	Effective Marginal Tax Rate on Last $25,000
$2,000,000	$100,300	All (estate is below 100% of exclusion)	0	0%	$0	0%
$2,025,000	$101,925		0	0%	$0	0%
$2,050,000	$103,500		0	0%	$0	0%
$2,075,000	$105,175	($88,113)	$17,063	0.8%	$17,063	68.3%
$2,100,000	$106,800	($57,488)	$49,313	2.3%	$32,250	129.0%
$2,125,000	$108,800	($30,925)	$77,875	3.7%	$28,562	114.2%
$2,150,000	$110,800	($9,563)	$87,500	4.7%	$9,625	38.5%
$2,175,000	$112,800	None (estate is above 105% of exclusion)	$112,800	5.2%	$25,300	101.2%
$2,200,000	$114,800		$114,800	5.2%	$2,000	8.0%
$2,225,000	$116,800		$116,800	5.2%	$2,000	8.0%

Source: Tax Foundation calculations.

6 Thornton McEnery, *Estate tax's grave outcome*, Crain's New York, Apr. 6, 2014, http://www.crainsnewyork.com/article/20140406/ECONOMY/140409911/estate-taxs-grave-outcome.

7 New York State Tax Reform and Fairness Commission, *Final Report* (Nov. 2013), at 20, http://www.capitalnewyork.com/sites/default/files/131114%20Solomon%20Tax%20Commission%20Report.pdf.

Does Not Authorize New York City Income Tax Increase

New York City Mayor Bill de Blasio sought to raise the top city income tax rate from 3.876 percent to 4.41 percent for five years, with the estimated $530 million per year to be raised to fund universal pre-kindergarten (pre-K).[8] An increase in the city income tax requires state approval. Instead of the increase, Governor Cuomo and state officials reached an agreement to provide the funds for universal pre-K statewide without the tax increase.[9]

Property Tax Freeze

Local property taxes are currently capped at the lesser of 2 percent annual growth or annual inflation, which will restrain New York's infamously high property taxes over time. Under the budget bill, the state will provide a personal income tax credit in the form of checks to homeowners outside New York City with less than $500,000 in income if:

- In the first year, their local jurisdiction stays within the property tax cap
- In the second year, the jurisdiction both stays within the cap and develops plans to cut taxes by 1 percent a year over three years.

If a jurisdiction keeps its property tax flat or lower in one year, it is under the cap and eligible homeowners will receive a check in the amount of the value of the jurisdictional cap applied to their base-year property tax bill. The average rebate is projected to be $650 over three years.[10]

Governor Cuomo characterizes the net effect as a property tax "freeze," as homeowners within jurisdictions that stay within the cap will receive a state check equal to any increased property tax, holding the total dollar amount steady for taxpayers. The total amount the state is committing to pay is large: $1.5 billion over three years.[11] Local officials complain that the state has not done enough to tackle unfunded mandates, however.[12]

Targeted Incentives for Manufacturers

Manufacturers will pay a reduced corporate income tax: the higher of (1) 0.15 percent of capital base or (2) a fixed dollar tax of up to $4,540, all retroactive to January 1, 2014 (see Tables 7 and 8). The net income tax base is reduced to zero percent for manufacturers. The capital stock base is phased down each year until fully eliminated in 2021. The fixed dollar tax is also reduced over time, reaching

8 *See, e.g.*, Joseph Henchman, *New York City Mayor Unveils Proposed Increase in Top Income Tax Rate*, Tax Foundation Tax Policy Blog, Feb. 19, 2014, http://taxfoundation.org/blog/new-york-city-mayor-unveils-proposed-increase-top-income-tax-rate.

9 *See, e.g.*, Karen Matthews, *New York city faces huge task to expand full-day pre-K by the fall*, Associated Press, Apr. 5, 2014, http://www.dailyfreeman.com/general-news/20140405/new-york-city-faces-huge-task-to-expand-full-day-pre-k-by-the-fall.

10 Joseph Spector, *N.Y. budget gives tax relief but disappoints others*, USA Today, Apr. 5, 2014.

11 *See, e.g.*, E.J. McMahon, *Andrew Cuomo's confused property tax "cut"*, New York Post, Mar. 21, 2014, http://nypost.com/2014/03/21/andrew-cuomos-confused-property-tax-cut/.

12 *See, e.g.*, Kris Kastberg, *Cuomo's tax caps seek to destroy local governments*, Schenectady Gazette, Apr. 6, 2014, http://www.dailygazette.com/news/2014/apr/06/caps/.

Table 7. New York Corporate Tax Rate and Bases for Manufacturers, 2014 to 2022

	2014	2015	2016	2017	2018	2019	2020	2021
Corporate Tax Rate (Manufacturers)	Zero	Zero	Zero	Zero	Zero	Zero	Zero	Zero
Capital Stock Base Rate (Manufacturers)	0.15%	0.132%	0.106%	0.085%	0.056%	0.038%	0.019%	Repealed

Source: 2014 New York Senate-Assembly Bill S. 6359D, A. 8559D.

Table 8. New York Fixed Dollar Tax for Manufacturers, 2014 to 2018

Receipts	2014	2015	2016-17	2018
>$0	$23	$22	$21	$19
>$100,000	$68	$66	$63	$56
>$250,000	$159	$153	$148	$131
>$500,000	$454	$439	$423	$375
>$1,000,000	$1,362	$1,316	$1,269	$1,125
>$5,000,000	$3,178	$3,070	$2,961	$2,625
>$25,000,000	$4,540	$4,385	$4,230	$3,750

Source: 2014 New York Senate-Assembly Bill S. 6359D, A. 8559D.

a maximum of $3,750 in 2018. Additionally, the state will provide a tax credit of 20 percent of manufacturers' local property tax bills.

Authorizes Electronic Signature on Tax Returns

Prior to this change, tax returns technically needed to be signed.

Conclusion

In December 2013, drawing upon the recommendations from the New York tax reform commissions, the Tax Foundation and the New York-based Empire Center for Public Policy outlined five tax policy options that would reduce high tax burdens while improving the state's business competitiveness:[13]

- Expedite the phasedown of the temporary personal income tax increase on high-income earners, currently set at 8.82 percent and scheduled to drop to 6.85 percent in 2018;
- Make permanent the temporary middle-class income tax cuts, enacted in 2011 and in effect through 2017;
- Index the individual income tax brackets, standard deduction, and dependent exemption to inflation permanently (the tax brackets and

13 Press Release, E.J. McMahon & Joseph Henchman, *5 Steps to Reforming New York's Tax Code: How to Grow the Economy and Increase Competitiveness*, Dec. 4, 2013, http://www.empirecenter.org/AboutUS/news_releases/2013/12/5steps120413tf.cfm.

standard deduction are currently indexed on a temporary basis, through 2017);

- Increase the estate tax exclusion to match the federal level of exclusion; and
- Make the 2 percent local property tax cap permanent.

The corporate tax bill passed in 2014 is an impressive step toward fixing New York's complex and burdensome tax system. We hope the state continues to build on these reforms in years to come.

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