REPORT #796

TAX SECTION

New York State Bar Association

Letter on New York City Unincorporated

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New York State Bar Association

June 30, 1994

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Re: New York City Unincorporated Business Tax Reform
Senate Bill No. 1226-B,
Assembly Bill No. 8828-A

Gentlemen:

We write to reiterate our support for the bill

to reform the New York City Unincorporated Business Tax, which we originally set forth in our letter dated May 24, 1993, to then Deputy Commissioner William Thomas of the New York City Department of Finance, with copies to all interested parties. The Senate bill has been reprinted in amended form in the current session under Bill No. 1226-B, and reprinting of the amended Assembly bill under Bill No. 8828-A is pending. Under the amended bill, the effective date for all of its provisions is changed to taxable years beginning on or after July 1, 1994.

The bill would achieve the following commendable reforms in the City's Unincorporated Business Tax (“UBT”):

1. In situations where a member of a partnership subject to UBT is itself subject to UBT or to corporation tax, the bill would replace the current method of avoiding double taxation, which is an additional exemption at the partnership level, with a credit at the partner level. This change will eliminate compliance problems that exist under the current provision where information as to the income figures reported on partners' City returns may not be readily available to the partnership. In particular, in cases where a partnership and its partners are on different taxable years, the change would eliminate the difficulty a partnership now may have in computing the exemption for a taxable year before it knows the figures for the partner taxable year in which the partnership's taxable year ends. With a credit at the partner level, the partner will always have the figures for the partnership year which ended in its own year before it has to compute its credit for the latter year. The bill would expressly allow the credit to corporate partners against tax computed on the income plus compensation method, consistent with the recent decision of the Court of Appeals allowing the additional exemption under current law against corporate tax computed on that method. Matter of Weil, Gotshal & Manges v. O'Cleireacain, N.Y.L.J. May 6, 1994, p.27, col.5. The new provision will also allow the credit to flow through each level in a multi-tier partnership structure, resolving for the future an issue that has been a matter of dispute under present law.

2. The existing exemption from UBT for income from holding, managing or leasing real property where that is an unincorporated entity's sole activity will be extended to make the exemption available even though the entity carries on other business activity (which will remain subject to tax unless it is incidental to the real estate activity and conducted solely for the benefit of tenants at the property).

3. The method of allocating investment income to the City would be conformed to the allocation method used under the City General Corporation Tax and the State Franchise Tax, so that instead of allocating investment income in the same manner as business income on the basis of the taxpayer's own activities within the City, such income would be allocated in accordance with the in-City allocation percentages of the issuers from whom the income is received. The bill would also drop the current requirement that there be a regular place of business outside the City before investment income may be allocated.

4. The existing exemption from UBT for an unincorporated entity (other than a dealer) engaged solely in the purchase and sale of property for its own account would be clarified by making it applicable even if the entity engages in some other activity which is not otherwise subject to UBT, or if the entity receives $25,000 or less of gross receipts during the taxable year from a taxable business activity.

As we pointed out in our May 24, 1993 letter, the bill does not make all of the improvements in current law which we and others have urged. We are advised that in order to assuage some of the concern that has been expressed at this shortcoming, the City Finance Department has suggested the addition to the bill of a requirement that the Commissioner of Finance convene a working group including representatives of the Department and the private sector to make a further study of the aspects of the UBT which are impacted by the bill. Completion of such study would be required by April 15, 1995.

We regard this proposal as a positive suggestion, and we support its inclusion in the bill. The bill itself was the product of several years of study by a working group on which the Tax Section was represented, and the mandated revival of such a group would insure that attention would be focused on the issues that would remain unresolved after passage of the bill. Among the issues that would be appropriate for further study are the following:

1. The need to clarify the language describing the activities eligible for the trading-for-one's-own-account exemption by adding express references to activities now commonly engaged in by investment firms.

2. The need to clarify that the exemption for trading for one's own account applies to investment income as well as trading income.

3. Clarification of the effect on the trading exemption of ownership interests in other partnerships engaged in business activities having no connection with the activities of the entity seeking the exemption.

4. The need for a solution to the failure of the new credit provision to fully avoid double tax in some situations where a partnership owns interests in other partnerships and one or the other incurs net operating losses, as outlined in our letter to Mr. Thomas of April 14, 1993. One possible solution would be to design a carryover of any unused portion of the credit.

5. The extent to which the real estate exemption should apply to income from incidental activities, such as a garage, which is not exclusively derived from tenants of the property.

In connection with the latter issue, we are advised that an amendment to the bill has been proposed that would exempt all of the income from a garage, including that from outsiders, if it is conducted principally for the benefit of tenants as an incidental service to them and their visitors. Although we take no position at this time on the merits of this proposal as a substantive matter, from the procedural viewpoint we think it is a mistake to make any last-minute changes now in details of the bill which will only serve to encourage other interests to seek amendments that will satisfy their particular concerns, resulting in further delay in passage of the bill.

The City's budget for fiscal year 1995, as adopted, makes an allowance for an estimated $9 million per year as the net cost of the bill, reflecting an estimated cost of $11 million for the change in investment allocation method, offset by a $2 million saving from increased compliance by real estate operators who will no longer fail to report taxable activities for fear of losing their real estate exemption.

The bill if enacted in the form embodied in S. 1226-B would represent a significant improvement in the City's UBT law. It would be a shame if the possibility of accomplishing this reform promptly were delayed or lost in a futile effort to achieve perfection in the first instance. We urge all those interested in the reform of the UBT to support passage of the bill as it is, with the added requirement for a working group study, and let further refinements await the action of the study group.

Very truly yours,

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