REPORT #786

TAX SECTION

New York State Bar Association

Report on Governor's 1994-95 Budget Proposal

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TAX SECTION

New York State Bar Association

March 22, 1994

Hon. James W. Wetzler
Commissioner
Department of Taxation and Finance
W. A. Harriman Campus, Building 9
Albany, NY 12227-1215

Re: New York State Budget Bills

Dear Commissioner Wetzler:

Enclosed is a report jointly prepared by several of our committees dealing with certain of the tax provisions included in the Governor's Budget Proposals for 1994-95. In view of time constraints, we have focused on those provisions which we felt most deserved comment.

Please call me if you have any questions.

Very truly yours,

Michael L. Schler
Chair, Tax Section

Encl.

cc: Hon. Sheldon Silver
Speaker
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Albany, NY 12247

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Tax Report #786

NEW YORK STATE BAR ASSOCIATION
TAX SECTION

Report on Governor's 1994-95 Budget Proposal

Governor Cuomo's budget proposal for 1994-95 contains several tax initiatives, including a number of tax rate extensions (certain rates were scheduled to decrease), an extension and phase down of certain tax surcharges and several procedural and substantive amendments to various taxes.

This report was prepared by the Committees on New York State Income Taxes, New York State Sales and Miscellaneous Taxes and New York City Taxes (the “Committees”). It focuses on the proposals that these Committees believe warrant comment because of technical, administrative, or conceptual issues they raise.

1. S.6474/A.9174 - Relating to Real Property Transfer Gains Tax [1/]

I. Existing Law

The New York 10% Real Property Transfer Gains Tax ("Gains Tax") is imposed on the difference between the consideration paid for the transfer of an interest in real property and the original purchase price of that interest. Tax Law section 1440.5(a) defines "original purchase price" for purposes of the Gains Tax as the consideration paid or required to be paid by the transferor to acquire the interest in real property and for any capital improvements made or required to be made to the real property, including solely those costs which are customary, reasonable and necessary, as prescribed by the Commissioner, incurred for the construction of such improvements. Original purchase price also includes amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees and any customary, reasonable and necessary advertising and marketing costs not included in customary brokerage fees paid by the transferor and incurred to sell the property.

Tax Law section 1440.5(a) has been interpreted by the Department of Taxation and Finance ("Department") as not permitting the inclusion in original purchase price of any selling expenses other than those specifically listed in the Tax Law or costs, fees and expenses incurred in connection with the creation of a leasehold or sublease.

1/ This section was primarily drafted by Pamela Ehrenkrarz and Maria T. Jones. Helpful comments were contributed by Carolyn Joy Lee, James A. Locke and Michael L. Schler.

Original purchase price also includes any interest paid or required to be paid by the transferor on a loan used to acquire the property provided that such interest "accrues during a construction period" and is attributable to that portion of the real property which is the subject of the construction of a capital improvement during such construction period.+

Tax Law section 1443 totally or partially exempts certain specific transactions from the Gains Tax.

Tax Law section 1440.7 defines a "transfer of an interest in real property" for purposes of the Gains Tax as including partial or successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfer a transfer which would otherwise be included in the coverage of the Gains Tax, and the transfer of real property by tenants in common, joint tenants or tenants by the entirety. The subdividing of real property and the sale of such subdivided parcels improved with residences to transferees for use as their residences, other than transfers pursuant to a cooperative or condominium plan, is not deemed to be a single transfer of real property.

II. Proposed Changes

The bill would expand the definition of original purchase price to include any New York State real estate transfer tax, New York City real property transfer tax and any similar real estate transfer tax (collectively, "transfer taxes") "paid or required to be paid by the transferor upon the transfer by such transferor of the real property or interest therein which transfer is subject to the [Gains Tax]".

The bill would also add to the definition of original purchase price to include the customary, reasonable and necessary costs, fees and expenses (including brokerage fees and commissions, professional fees and payments to or on behalf of a tenant as an inducement to enter into a lease or sublease) incurred in connection with the creation of a leasehold or sublease to which the real property is subject at the time of transfer. Such costs, fees and expenses may be included in original purchase price based on the length of the unexpired term of the lease or sublease determined as of the date of transfer.

The bill would also change the definition of construction period for purposes of determining the period during which construction period interest and other periodic costs are includible in the original purchase price.

The bill would also add to the list of transfers that are partially exempt from the Gains Tax, a transfer of real property on which, and to the extent that, certain “qualifying capital improvements” are constructed. The provision operates by including certain hard construction costs incurred during the construction period in original purchase price twice: once under the existing rules regarding capital improvements and again under this new provision. To be a qualifying capital improvement, construction of the capital improvement must commence on or after January 1, 1994 and before January 1, 1996, and be distinct and separate from any other capital improvement which commenced prior to January 1, 1994. Construction will be deemed to end on the earlier of December 31, 1997 or the date such capital improvement is ready to be placed in service.

The bill would also treat as a transfer of real property subject to the Gains Tax, if such transfer occurs within a three-year period, without regard to the use of such real property or whether such transfers were pursuant to a plan or agreement, the partial or successive transfers of interests in (i) contiguous or adjacent real property by one or more transferors to one or more transferees and (ii) real property by tenants in common, joint tenants or tenants by the entirety to one or more transferees. The bill would also treat as a transfer of real property subject to the Gains Tax, partial or successive transfers (i) made pursuant to a cooperative or condominium plan; and (ii) of interests in subdivided parcels of real property without regard to the use of such property or whether such transfers were pursuant to a plan or agreement.

III. Comments

A. Amendments to Definition of Original Purchase Price.

The Committees strongly support the definitional changes to the Gains Tax included in the bill and commends the administration on its continued initiative to rectify problems with the Gains Tax. The Tax Section's Report on the 1989 Budget Bills (dated March 30, 1989) recommended that the statute be amended to permit the inclusion of all selling expenses in the definition of original purchase price, including advertising costs and transfer taxes, in order to reflect more accurately a transferor's legitimate economic gains that should be subject to the Gains Tax. The 1993 Budget Bills expanded the includible costs to include advertising and marketing costs. Inasmuch as this bill incorporates the Tax Section’s recommendation that transfer taxes also be included in original purchase price, we support the amendment.

The bill provides that the transferor is permitted to include in original purchase price the amount of transfer taxes "paid <u>or required to be paid by the transferor</u>" (emphasis added). Regulations should clarify that the transferor is permitted to include transfer taxes paid by the transferee on behalf of the transferor in the transferor's original purchase price (since such taxes are included in the transferor's consideration received on the sale).

The bill provides that the transfer taxes are includible in original purchase price "upon the transfer by such transferor of the real property or interest therein." The language in the bill should be redrafted to clarify that the transfers intended to be covered are "transfers of real property" as such term is defined in Tax Law section 1440.7.

The bill also provides that transfer taxes are includible in original purchase price, but only when "the transfer is subject to the" Gains Tax. The Committees recommend that the bill be amended to clarify or that regulations clarify that a transfer which is exempt from the Gains Tax is nevertheless "subject to the Gains Tax" for purposes of including transfer taxes in the original purchase price. For example, the New York City real property transfer tax does not contain a "mere change in form" exception as the Gains Tax does and therefore subjects to tax the contribution of an interest in real property to a wholly-owned corporation or partnership. The transfer taxes paid by the transferor or transferee on the transfer into a wholly-owned entity should be included in the original purchase price of the transferee entity on any subsequent taxable transaction.

The inclusion of a portion of lease-up costs in original purchase price was recommended by the Tax Section in its 1991 report on Gains Tax and Troubled Properties. See Report No. 699, September 25, 1991. The proposed amendment is a significant improvement in the Tax Law, for it will permit a better measure of the actual gain derived by a transferor on real property that is subject to leases.

Regulations should also clarify whether the “number of months” that is relevant for purposes of determining the amount of lease-up costs includible in original purchase price means the number of full months remaining or includes partial months. For example, if a building has been leased for 5 years, the land is sold on February 1, 1995, and the lease expires on December 31, 1995, is the number of months remaining on the term of the lease 10 or 11? The answer should be the same with respect to the allowable portion of costs incurred for a real estate tax exemption, because the language is similar.

The Committees also recommend that the bill clarify that costs that are otherwise includible in original purchase price pursuant to Tax Law section 1440.5(a)(1) under existing law should not be subject to the rules of the new provision of Tax Law section 1440.5(a)(vii). The proposed amendment to Tax Law section 1440.5(a)(vii) should, in relevant part, be revised to read as follows: “...which costs, fees and expenses are customary, reasonable and necessary as determined under rules and regulations prescribed by the commissioner <u>and are not includible in original purchase price under another subdivision of this article</u>.” (emphasis added to show recommended additional language.)

The Committees also support the extension of the "construction period" during which interest, taxes and similar costs are includible in original purchase price. Again, this change was recommended in our 1991 Report and we commend the Governor for including in the Budget Bill this important improvement in the fair and accurate measure of taxable gain. The Memorandum in Support states that a transferor will be allowed to include in original purchase price additional costs incurred during the expanded construction period that are not allowed under existing law, such as real property taxes on the land incurred before physical construction work begins. In addition, the Committees anticipate that conforming changes will be made to Regulation §590.16(d) which sets forth the additional costs that are treated as consideration paid for a capital improvement during the construction period. (It is noted that the statute currently refers to the concept of "construction period" only with respect to acquisition indebtedness. While it would be preferable to amend the statutory provisions to permit specifically the additional construction period costs which are now described only in the regulations, we assume that even in the absence of specific legislation, the regulations will continue to permit the inclusion of all types of construction period costs.)

Because the definition of the end of the "construction period" depends on the use of the property, the regulations should clarify that the use of the property is determined by reference to its actual use.

The Committees anticipate that the regulations will address when the real property will be considered to be leased or subleased. Regulations should clarify that a property is not considered leased or subleased merely because a tenant signs a lease; rather the property should be considered leased or subleased at the earlier of (a) the point in time when the real property is first productively used by a tenant for its intended purpose or (b) the date the tenant starts to pay rent. The regulations should also address when construction is deemed to be suspended. The Committees recommend that construction, development or complete renovation should only be considered “suspended” if there is no activity for a certain continuous minimum period of time (e.g., 12 consecutive months). The regulations should also clarify that interest, taxes and other construction-related periodic costs incurred after construction, development or renovation is restarted should be includible in original purchase price.

B. Builders' Exemption.

The addition of a partial exemption for certain new capital improvements seems intended to encourage construction; however the Committees do not know if it will in fact be an effective inducement. It is noted that the provision of an exemption for new construction benefits new building vis-a-vis existing buildings. Given the oversupply of commercial space in some localities such as New York City, it is not clear that this is a good idea. Further, basing this exemption on original purchase price (construction costs must equal 25% of original purchase price) will result in different tax treatment for economically similar projects. Owners with high original purchase prices will find it harder to qualify.

In addition, as drafted the proposal raises some technical questions. The Committees recommend that the definition of “qualifying capital improvement” include specific reference to the rehabilitation of property, to avoid any question that rehabilitation work is intended to benefit from this provision if the other requisites are satisfied. The Committees also recommend that the definition of “qualifying capital improvement costs” include by specific statutory reference environmental clean-up costs, such as the removal of asbestos. The inclusion of environmental clean-up costs as qualifying capital improvements could encourage existing owners of real estate to initiate environmental improvements in 1994 and 1995, possibly sooner than they would otherwise do so. A statutory change is recommended so that it will not be necessary to wait for regulations for clarification.

Construction that has been abandoned and dormant for a certain period of time, but is restarted, should be included in the definitions of “qualifying capital improvement” and “a qualifying period”. This can be made clear in the regulations. The Committees also anticipate that regulations will address (1) whether a transferee who acquires a property in a nontaxable transfer (e.g., a contribution that is exempt as a mere change in form) will benefit from the exemption when the property is sold, and (2) how the exemption is intended to apply to a taxable transfer of an interest in a corporation, partnership or other entity.

The bill provides that original purchase price will include those “qualifying capital improvements costs that are properly accruable to the qualifying period.” The concept of accrual is used in the Gains Tax in Tax Law Section 1440.5(a)(iv) as amended by the bill and under existing law, but that use does not incorporate the highly-technical concept of “properly accruable.” The use of the language “properly accruable” in the Gains Tax raises confusion as to whether it is intended that certain income tax concepts be applied to calculate the computation of costs allowable under the Gains Tax. The

Committees recommend that the language in the bill be changed and that the word “attributable” be used instead of “accruable”. A reference to “generally accepted accounting principles” may not be sufficient to insure that the intended costs are included.

C. Amendment of Aggregation Rules.

The Committees urge that careful consideration be given to the provisions requiring automatic aggregation of multiple transfers (and transfers by tenants in common, joint tenants or tenants by the entirety) which occur within a three-year period, without the ability of the transferors to prove that the transfers are unrelated. While the proposed bright-line test clearly has advantages in its simplicity, it is not clear that given the fairly well-developed case law in this area, such a radical change is required. As with any bright-line test, the application of an automatic three-year cut-off period may lead to unfair results. (It is assumed that as a bright-line test, in order to achieve certainty, the amendment will be read as an absolute line, i.e. transactions falling within the three-year period will be aggregated, transactions outside the three-year period will not be aggregated). Persons who are well-advised and financially able will, even though undoubtedly motivated by a plan, be able to time their sales to fall outside the three-year period and thus avoid aggregation. By contrast, persons who are less well advised will, even if not motivated by a plan, be subject to tax if their sales happen to occur within the three-year period. Furthermore, there will be people who sell one property with no intention of further dispositions and then find themselves, by reason of foreclosure, condemnation, divorce, estate sale or other exigencies forced to made a second disposition within the three-year period.

In addition, while probably not intended, these statutory changes could be read to impose tax on transfers made by unrelated transferors. For example, the transferor in each of the following transfers may become subject to the Gains Tax as a result of the proposed aggregation rule: Property A is sold by Ms. Brown to Mr. Blue for $500,000, Property B (adjacent to Property A) is sold by Ms. Cat to Mr. Dog for $500,000, and Property C (which is also adjacent to Property A and which may or may not be adjacent to Property B), is sold by Mr. Ball to Mr. Chain. This example is currently not subject to aggregation under the existing regulations and should not be taxed under the proposed bill. The language should be redrafted to clarify this.

As a final matter, the use of the language “partial or successive” in proposed Tax Law sections 1440.7(b)(ii),(iii) and (iv) should be deleted as such language is not relevant to the contemplated transfers.

2. S.6472/A.9172 - Relating Primarily to the Corporate Franchise Tax [2/]

Sections 1 through 13 of this bill contain an extension of various corporate tax surcharges that were scheduled to expire. These surcharges would be reduced from the current rate of 15% to 10% over a multi-year period. We have no comments on this tax surcharge extension. Sections 14 through 16 of the bill make permanent the provisions of the franchise tax on banking corporations and the New York City banking corporation tax which were scheduled to sunset for taxable years beginning on or after January 1, 1994. We have no comments on the extension.

[2/] This section was primarily drafted by Robert J. Levinsohn. Helpful comments were contributed by Maria T. Jones, Carolyn Joy Lee, James A. Locke and Michael L. Schler.

Sections 17 through 19, also relating to the franchise tax on banking corporations, effective for taxable years beginning on or after January 1, 1994, correct what is stated to be a drafting error in the 1985 legislation that allowed banks to deduct 60% of dividend income and gains from subsidiary capital, by making it clear that they must also add back 60% of their losses from subsidiary capital. This would change prospectively the result reached in Matter of Amsterdam Savings Bank, (New York State Tax Appeals Tribunal, March 11, 1993, 1993-2 N.Y.T.C. T-234). Since achieving symmetry between the treatment of gains and losses from subsidiary capital seems appropriate, we support these provisions.

I. Changes in the Minimum Tax Credit

These changes are in section 20 of the bill. Currently, the franchise tax on business corporations under Article 9-A is composed of the higher of taxes on (1) apportioned entire net income, (2) apportioned business and investment capital, (3) a minimum taxable income base, and (4) a fixed dollar minimum, plus a separate tax on subsidiary capital.

The minimum taxable income base is computed by making adjustments similar to those required for federal alternative minimum tax purposes, plus the disallowance of any net operating loss deduction. There is also only single weighting of the receipts factor in calculating the business allocation percentage, instead of the double weighting generally applicable under the entire net income base.

There is in addition a minimum tax credit in Tax Law section 210.13 which is generally significant only for corporations which alternate from year to year between taxability under the minimum tax base and taxability under the entire net income base. This is because the credit cannot be taken against a tax computed on apportioned capital or against the minimum tax itself. Thus, the credit, in a year when tax is payable on the entire net income base, is calculated as the excess of the “adjusted minimum tax” for all prior taxable years beginning after 1989 over the minimum tax credit previously allowed for such years. The “adjusted minimum tax” for any year, according to the interpretation of present law by the Department, is the excess of the tax payable solely because of the minimum tax (i.e. the minimum tax reduced by the highest of the three other alternative tax bases), over a minimum tax computed by increasing taxable income solely for non-timing items (as well as disallowing any net operating loss deduction), again reduced by the highest tax base otherwise applicable. In other words, the credit is currently equal to the portion of the minimum tax due solely by reason of the inclusion of timing items in the minimum taxable income base, and the purpose of the credit is to eliminate over time the impact of minimum tax that has been paid solely because of the differences between when timing items are taken into account for regular and minimum tax purposes. It should be noted that under the Department’s interpretation of the existing credit formula, minimum tax payable as a result of the add-back of net operating losses that were deducted in computing the entire net income base is excluded from the adjusted minimum tax that measures the amount of the credit.

(Under the existing statute, the only non-timing items are the tax preferences for depletion and for the appreciated value of charitable contributions of tangible personal property. One technical amendment in section 20 of the bill is to delete the reference to the latter preference, in conformity with the 1993 amendment to the Internal Revenue Code (“Code”)).

The significant change in section 20 is a specific statutory rule to allow the net operating loss deduction as a deduction in calculating the amount subtracted to arrive at the adjusted minimum tax. In other words, the only item of tax preference left to be added back into income in calculating the amount of minimum tax to be subtracted would be the adjustment for depletion. The credit would then be equal to the portion of the minimum tax for previous taxable years that is attributable both to timing items <u>and</u> to the denial of the net operating loss deduction. Under section 33(d) of the bill, this change would be effective for net operating losses incurred in taxable years beginning after 1993.

In the case of a taxpayer that does not claim any depletion deduction, the proposed amendment would appear to make the entire amount of prior minimum taxes (in excess of the tax otherwise payable under the other three tax bases) available as a credit against the regular tax on entire net income. To that extent, the amendment would conform the State minimum tax credit to the Federal minimum tax credit for corporations under Code section 53, which, as amended effective for taxable years beginning after 1989, allows the entire amount of alternative minimum tax to be taken into account in computing the credit, rather than only the amount of tax attributable to timing differences with the regular tax, as had been the case before the Omnibus Budget Reconciliation Act of 1989. See Code §53(d)(1)(iv).

Other amendments in section 20 of the bill would correct what are stated to be drafting errors in the provisions of the existing statute limiting the effect of the minimum tax credit. Tax Law section 210.13(d) now provides that the credit shall in no event reduce the tax payable to less than the higher of the taxes on the minimum taxable income or fixed dollar minimum bases. The amended statute would prevent the credit from reducing the tax to less than the sum of (1) the highest of the taxes on the <u>capital</u>, minimum taxable income or fixed dollar minimum bases, <u>and</u> (2) <u>the tax on subsidiary capital</u>. Thus, the credit would be limited to apply only to calculation of the tax on the entire net income base, without affecting any of the other bases for tax. Under section 33(d) of the bill, this change would apply to taxable years beginning after 1993.

There are other clarifying language changes in section 20 which appear to have no substantive significance.

<u>Comments</u>.

The net operating loss deduction is similar to the timing items entering into the minimum tax computation in that it arises from fluctuations from year to year in the earning of income or incurring of losses by a corporation. Its inclusion in calculating the credit is thus entirely consistent with the purpose of smoothing out the impact of the annual taxing system by making the liability for tax on income over a period of years comparable to what would apply if that were treated as a single taxing period. The drafting changes in the limit on the application of the minimum tax credit would render it more consistent with the basic structure of the corporation franchise tax, as a combination of a tax on subsidiary capital plus the highest of four alternative taxes on the parent corporation.

The wording of Tax Law section 210.13 is still quite convoluted and could be further simplified. For example, subd. 13(a) says the minimum tax credit shall not be allowed against taxes computed under the capital or minimum tax bases. But the effect of the limit in subd. 13(d), both at present and as it would be amended, is that the credit is also not allowable against the fixed dollar minimum base. Some rearrangement of these overlapping provisions could eliminate this confusion.

In addition, given that after the proposed amendment the only remaining adjustment limiting full allowance of prior minimum taxes as a credit is that for depletion, which is likely of narrow application, consideration should be given to eliminating this one remaining limitation and following the Federal rule for corporations adopted in 1989 that allows the entire amount of AMT to be taken into account in computing the credit available in future years. This would both promote desirable conformity between Federal and State provisions and permit further simplification of Tax Law section 210.13.

In any event, the proposed amendments to Tax Law section 210.13 in section 20 of the bill are commendable as far as they go, and we support their adoption.[3/]

3/ We understand that it has been suggested that the existing statute is susceptible of the interpretation that the net operating loss deduction is already allowable in calculating the amount subtracted to arrive at the adjusted minimum tax. Without taking a position on the validity of such an interpretation, and in view of the prospective effective date for the amendment dealing with net operating losses, we suggest that there be added to the memorandum accompanying the bill a statement that no inference is intended as to the correct interpretation of pre-existing law on this point.

II. Recoupling Depreciation

Sections 21 through 30 of the bill would amend Article 9A (Franchise Tax on Business Corporations), Article 22 (State Personal Income Tax), Article 32 (Franchise Tax on Banking Corporations), Article 33 (Franchise Tax on Insurance Corporations), and the Administrative Code of the City of New York with respect to the New York City resident income tax, to recouple New York depreciation with Federal (MACRS) depreciation in the one remaining area where it has remained decoupled - i.e., property placed in service outside the State, effective for such property placed in service in taxable years beginning after 1993.

The change is adequately explained in the Memorandum in Support of the budget bill, at page 12, as follows (footnotes are added):

> In 1981, Congress enacted section 168 of the Internal Revenue Code, establishing the accelerated cost recovery system (ACRS). ACRS replaced the former depreciation rules (contained in section 167 of the IRC) with respect to most property, and generally permitted a faster write-off. In 1986, section 168 was substantially amended, and is now referred to as Modified ACRS (MACRS).
>
> In 1982, in response to the potential revenue loss resulting from ACRS, New York decoupled from section 168, requiring instead depreciation deductions computed under section 167 of the Internal Revenue Code[4/] (L. 1982, ch. 55). Subsequently, recoupling was established with respect to section 280-F property[5/], property placed in service in this State after 1984, and certain aviation property. This bill would complete the recoupling process by allowing[6/] MACRS for property placed in service outside this State in taxable years beginning after December 31,

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4/ As such section was in effect for property placed in service on December 31, 1980.

5/ Luxury automobiles and certain “listed property.”

6/ And requiring.

> 1993. This change will simplify tax reporting requirements for taxpayers with property outside the State by enhancing Federal conformity, and will, in particular, ease the burden on those taxpayers who would otherwise be required to maintain separate accounting for Federal and New York depreciation purposes in connection with post-1993, non-New York property.

The bill would thus eliminate for property placed in service in years beginning on or after January 1, 1994, the last remaining discrepancy in the depreciation required for New York as against Federal purposes, for both corporation and personal income taxes. The bill is desirable as furthering the goal of reducing differences between the bases on which New York and Federal taxes on income are levied. It would also dispense for future property with the need to refer to provisions which have long since been deleted from the Code.

Accordingly, we support the adoption of these provisions of the bill.

III. Combined Reporting for Section 936 Corporations

Section 31 of the bill would amend Tax Law section 211 to provide that a corporation shall not be required or permitted to be included in a combined report with respect to a taxable year under Article 9-A which is the same as a Federal tax year (or portion thereof) for which an election by such corporation is in effect under Code section 936, relating to corporations with a substantial economic presence in Puerto Rico or the Virgin Islands. The amendment would apply to taxable years beginning on or after January 1, 1994.

The explanation in the Memorandum in Support states in part as follows:

> An Article 9-A combined report including a section 936 corporation calls for the inclusion in the combined New York tax base of all the income of the parent company and its Puerto Rico subsidiary, albeit subject to apportionment. As a result, more income is included in the New York tax base than is taxable at the Federal level (because the section 936 credit shields a significant amount of income from Federal taxation).
>
> Such an increase in tax burden may not be helpful for New York's economic development, especially since a majority of states do not require the inclusion of section 936 corporations in combined or consolidated reports. * * * * Federal consolidated filing rules * * * preclude the inclusion of section 936 corporations on a Federal consolidated return * * *. Enactment of this bill would enhance New York's position in the competition among states for the location of businesses that have subsidiaries operating in American possessions.

Elimination of the power of the Commissioner of Taxation and Finance to require inclusion of section 936 corporations in combined reports thus seems to be a desirable goal. In order to prevent elections against the revenue, barring permissive elections of such combined reporting by taxpayers would seem a necessary corollary.

Accordingly, we support adoption of this provision of the bill.

IV. Refund of Credit for Special Additional Mortgage Recording Tax

Section 32 of the bill primarily affects non-bank lenders outside the metropolitan area taxable under Article 9-A who are required to pay the special additional mortgage recording tax imposed on certain real property mortgages by Tax Law section 253.1-a. Section 210.17 allows a credit in the amount of this tax, with certain exceptions, against the Article 9-A tax provided that it may not reduce the tax payable to less than the higher of the minimum tax or the fixed dollar minimum. Any credit unused because of this limitation may under present law be carried over indefinitely.

In taxable years beginning in 1986 through 1989, taxpayers, in lieu of the carryover, were given an election to treat any unused credit attributable to the tax on certain residential mortgages as an overpayment of tax to be credited or refunded in accordance with the provisions generally applicable to overpayments, but without interest. The bill would restore this election for taxable years beginning on or after January 1, 1994.

This provision is of limited geographical application, since no credit is currently allowed for the tax on the type of residential property affected[7/] where it is located in one of the counties in the Metropolitan Commuter Transportation District or in Erie County.

As explained in the Memorandum in Support:

> Since bank mortgagees are taxable under Article 32 of the Tax Law, the refundability created by this bill will not apply to banks, but only to Article 9-A taxpayers. Such Article 9-A mortgage lenders often do not have sufficient tax liability against which to apply the credit, and are thus either forced to postpone the benefit of the credit until such future year as may see such a liability, or to lose the benefit entirely if tax liabilities never match the level of credits. If, on the other hand, the credit is made refundable, and thus promptly available, then such taxpayers will be encouraged to make further residential mortgage loans.

[7/] Real property principally improved or to be improved by one or more structures containing in the aggregate not more than six residential dwelling units, each dwelling unit having its own separate cooking facilities. Note that the additional mortgage recording tax does not apply at all where the mortgagee of such property is a natural person or persons.

We see no problem with restoration of unused credit refundability that was previously available, in those areas of the State where the credit is allowable for the type of residential property covered, and therefore support adoption of this provision of the bill.

V. Effect of the Proposed Amendments on New York City Taxes

The provisions of Article 9-A regarding depreciation that would be amended by sections 21 and 22 of the bill, Tax Law sections 208.9(b)(10) and 208.9(j), are substantially the same as the corresponding provisions of the New York City Administrative Code relating to the general corporation tax, respectively, Adm. Code sections 11-602.8(b)(11), 11-602.8(j). Likewise, the depreciation provisions of Article 32 (Franchise Tax on Banking Corporations), Tax Law sections 1453(b)(9) and 1453(e)(7), that would be amended by the bill, are the same as the corresponding Administrative Code provisions relating to the banking corporation tax, respectively, Adm. Code sections ll-641(b)(6) and ll-641(e)(7). In order to prevent a disparity in the depreciation provisions for corporations subject to both New York State and City taxes, the Tax Law amendments should be followed by corresponding amendments to the parallel provisions of the Administrative Code, as authorized by the enabling act, Laws 1966, Ch. 772, section 1, as amended. We understand that such amendments are being prepared by the City Department of Finance, and we urge their enactment promptly upon the adoption of the Tax Law changes in order to maintain conformity between the State and City provisions.

Tax Law section 211.4, which would be amended by section 31 of the bill to eliminate combined reporting for section 936 corporations, is similar to the combined reporting provisions of

Adm. Code §11-605.4. Here again, we suggest the prompt preparation of an amendment to that section of the Administrative Code corresponding to the pending State change, since the reasons justifying the change at the State level are equally applicable to the City corporation tax.

The City corporation tax does not contain provisions corresponding to the state minimum tax or the mortgage recording tax credit, so no City amendments are needed to conform to the proposed State changes in those areas.

3. S.6460/A.9160 - Relating to Sales S.6475/A.9175 and Use Taxes [8/]

This bill on sales tax compliance is the result of a working group created last spring in which the Tax Section participated. The Committees support the provisions of this bill but have some suggestions for improvement.

I. Local Reporting

The bill would expand the list of governmental entities required to collect and furnish certain information to the Department to include county level agencies and New York City agencies. Under current law, State agencies are required to ask for the federal social security number or employer identification number of any business when acting with regard to the business' license or when contracting for the purchase of goods or services from the business. Upon the request of the Department, these agencies must furnish it with this information. This provision

[8/] This section was primarily drafted by Paul R. Comeau and Robert D. Plattner. Helpful comments were contributed by Maria T. Jones, Carolyn Joy Lee, James A. Locke and Michael L. Schler.

would take effect immediately, with New York City and the counties having 90 days to request a waiver good until June 30, 1995.

This provision offers a logical extension of the current information-sharing efforts among government agencies to help the Department enforce the State's tax laws. The nature of the information shared is not expanded; only the number of agencies sharing information is increased. We believe that expanding the participants in the information-sharing process in this fashion makes sense.

II. Intrafamily Transfers of Motor Vehicles

The bill would amend Tax Law section 1115(a)(14) to limit the intrafamily sale exemption to situations where the selling family member paid sales or use tax when purchasing the vehicle (except when the state in which the vehicle was purchased imposes no such tax and the seller was a resident of such state at the time of purchase). Tax Law section 1115(a)(14) currently enables two family members (husband, wife and children) who are residents of New York to bring a vehicle into New York without paying sales tax. One family member can purchase a vehicle in a state in which he is not a resident and sell the vehicle to a family member. Assuming that the state in which the vehicle is purchased has a nonresident or export exemption, no sales tax is paid in that state. Additionally, no New York State sales tax is paid because Tax Law section 1115(a)(14) exempts intrafamily sales. Under the proposed legislation such a transaction would be subject to sales tax based on the purchase price paid by the first family member. The effective date for this provision would be December 1, 1994.

The intrafamily exemption recognizes that certain exchanges between family members should not trigger sales tax because of the close relationship and interdependence of the parties. For example, if a parent incurs a loan when purchasing an automobile, and subsequently his child assumes the loan and obtains title to the automobile, a sales tax would ordinarily be due on the transfer because the assumption of a liability constitutes consideration, triggering sales tax. However, the intrafamily exemption protects such a transfer from sales tax. 20 NYCRR §528.15(b)(2), Example 2.

While this exemption may be entirely reasonable as a policy matter, the exemption should not be used as a sword to evade the sales tax. The proposed legislation is intended to prevent taxpayers from evading sales tax by using the intrafamily exemption, without undermining the purpose of the exemption. Specifically, the legislation will amend the intrafamily sales tax exemption so that it no longer applies when the family member making the sale of a motor vehicle paid no sales or use tax when the vehicle was purchased (although the exemption would still apply if the vehicle is purchased in a state which imposes no sales tax and the purchaser is a resident of that state). From a policy perspective, there is no reason why a resident who purchases a car outside New York and brings the car into New York should be taxed differently from a resident family member who purchases a car outside New York and transfers the car to a resident family member. The proposed legislation provides a level playing field by taxing these two transactions similarly and we support it.

III. Registration of Motor Vehicles by Nonresidents

The bill would amend Tax Law section 1117, which exempts sales of motor vehicles to qualifying nonresidents from the sales tax despite the fact the purchaser takes physical possession of the vehicle in New York. The amendment provides that the exemption applies only if the dealer selling the vehicle does not issue the purchaser a temporary certificate of registration or a temporary registration and the purchaser does not register the vehicle in this state before registering it in another state. It would amend Tax Law section 1214 to provide that where a nonresident of New York is subject to sales tax in New York on the purchase of a vehicle in the state for failure to satisfy the conditions of Tax Law section 1117(a), the local sales tax will be imposed as well. These provisions would take effect December 1, 1994.

The nonresident exemption can foster abusive practices. Specifically, the abuse can occur when a nonresident purchases a vehicle under the nonresident exemption and, instead of removing the vehicle from New York to his home state, registers and uses the vehicle in New York State. By doing so, the nonresident can escape paying sales or use taxes in both New York and his home state.

The proposed legislation narrows the nonresident exemption by adding an additional requirement that the nonresident cannot register the motor vehicle in New York other than to obtain an in-transit permit that allows the nonresident to transport the vehicle outside of New York. In other words, the nonresident exemption would no longer be applicable for nonresidents who purchased and immediately registered the vehicle in New York.

Presumably, the policy justification for the existing nonresident exemption is the underlying assumption that the vehicle will be housed and primarily used outside of New York. However, it is appropriate to conclude that a nonresident individual who purchases and registers a vehicle in New York intends to use the vehicle in New York. Therefore, from a tax policy perspective, such an individual should be required to pay New York sales and use taxes on his purchase.

The proposed legislation would not substantially alter the use tax exemption for property purchased by the user while a nonresident (Tax Law section 1118.2). This use tax exemption would continue to apply in cases where the vehicle had been registered in another state prior to being brought into New York. Specifically, Tax Law section 1132(f) would provide that an individual who purchases a vehicle in New York State as a nonresident and pays sales tax or registers his car in another state can register the vehicle in New York State without being subject to sales or use taxes.

The proposed legislation properly limits the nonresident sales tax exemption to situations where a nonresident purchases a vehicle in New York State and brings the vehicle back to his home state for registration. Additionally, the provision will not affect a nonresident who moves into New York State, as long as the individual had previously registered his vehicle in another state or paid sales tax in another state. We support this provision as an acceptable limitation on the nonresident exemption for motor vehicles.

IV. Temporary Certificate of Authority

The bill would amend Tax Law sections 1131 and 1134(a)(2) to provide that show vendors, entertainment vendors and temporary vendors may be issued certificates of authority for a specified period of less than 3 years.

Approximately 10% of registered sales tax vendors are show or entertainment vendors, which frequently have no permanent place of business. The Department believes the issuance of a 3-year certificate of authority to a transient vendor does not give the Department sufficient oversight over such businesses. An annual renewal system is considered preferable to keep better track of such vendors.

This proposal is consistent with the special attention given to the compliance of transient vendors elsewhere in the sales tax law and we support it.

V. Customer Receipt Requirement

The bill would amend Tax Law section 1132(a) to require vendors to furnish customers with receipts on taxable sales of $30 or more (with certain exceptions).

Current law requires that when a vendor gives a customer a sales receipt, the receipt must separately state the amount of the tax, and that when a sales receipt is not given to a customer, the vendor must nonetheless keep a daily record of such sale in "... sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected thereon." The bill seeks to change existing law by requiring that vendors must give a sales receipt for all taxable sales in excess of thirty dollars. The only transactions exempted from this requirement are the sale of automotive fuel that is dispensed into a fuel tank at a filling station, the sale of parking, and the sale of food or drink sold by restaurants. The provision is designed to yield better documentation of retail sales by small vendors for audit purposes, and to foster improved participation in the system generally by small vendors.

Coupled with the proposed change would be a penalty for the failure to furnish sales receipts for sales in excess of thirty dollars. The new provision would be adopted in Tax Law section 1145(a)(6) and would impose a penalty of $100 for each month in which a vendor fails to furnish a customer with a sales receipt.

The Committees support the proposal in the bill. However, the Committees believe that it would be sensible for the bill to provide that written sales receipts not be required to be given where the vendor or someone acting on behalf of the vendor maintains information regarding each sale electronically and provides an electronic “receipt” to the buyer. In this situation there is no need for the vendor to provide a written sales receipts since information concerning each sale is readily available and sales tax compliance would not be increased. Furthermore, imposing a requirement that written receipts be provided for sales that are maintained electronically would be contrary to the technological advance of our economy and the resulting increased efficiency that American businesses strive to achieve.

VI. Alternative Audit Methods

The bill would amend Tax Law section 1138(a) to, in the Department's words: “clarify that where the records of a person required to file a return are unavailable, incomplete, inadequate or inaccurate, the [Department] may select any audit method reasonably calculated to reflect the tax due and the availability of another method shall not be evidence that the method actually employed was not reasonably calculated to reflect the amount of tax due”. This provision would take effect immediately and apply to any open matter.

This provision simply restates current law. The Department is apparently concerned, however, that Matter of Cafe Europa (Tax Appeals Tribunal, July 13, 1989, 1989-1 N.Y.T.C. T-431) established a different rule than that stated in the bill, and that this provision is therefore required. The Department's concern is unfounded, however, and this provision is unnecessary. Further, if the provision is intended to reverse the ruling in Cafe Europa it would be bad policy. Under the particular facts of Cafe Europa (the Department first concluded but later abandoned a mark-up audit without explanation in favor of an observation test) the Tribunal's decision was correct. Finally, the Department's concern that Cafe Europa's holding would “spread” beyond the particular facts present has proven unfounded. We consider this provision unnecessary and it should not be enacted.

VII. Request for Records

The bill would allow the Department to show after the fact (e.g., at hearing) that a taxpayer’s records were inadequate, and that this showing would be sufficient to sustain the use of an estimated audit method even if no attempt was made at the time of audit to ascertain this information. Under current law, an estimated audit is invalid if the auditor fails to first request the taxpayer's books and records so it can be determined whether they are adequate for a full audit. The Memorandum in Support indicates that this bill is intended to prevent an estimated audit from being disallowed where a request for records cannot be established but the request would have been futile. We do not agree that this section is necessary. The present requirement that the Department request the taxpayer's books and records prior to resorting to use of an estimated audit method is not so onerous that a legislative solution is required. In those cases where such a request would in fact be futile, it should not be difficult to make such a request and to establish that adequate books and records were not available. Retaining the requirement that such a request be made eliminates this potentially disputed issue, and provides every taxpayer with the opportunity to produce its books and records at the inception of an audit.

VIII. Shipping and Delivery of Promotional Materials

The bill adds a new paragraph 3 to subdivision (n) of Tax Law section 1115 to provide that the separately stated U.S. postal charges of a vendor to its customer for shipping or delivery of promotional materials are exempt from sales and use taxes. The provision would be effective retroactively to September 1, 1991.

The 1991 budget legislation included in a vendor's receipts subject to sales tax the charges to customers for delivery of property sold to them. Concern was expressed by the direct mail marketing industry at the passage of this legislation, but before the effective date of the statute, that this new provision might be deemed to require the imposition of sales tax on U.S. postal charges paid by printer/mailers to mail promotional materials for customers for whom they had performed any taxable service. For example, a printer/mailer charging $10,000 for labeling envelopes and reimbursement of $750,000 in mailing costs might be required to collect sales tax on the total mailing charges passed through to its customer. The Department therefore issued a Notice that established an interim policy that mailing charges would not be subject to tax under such circumstances. Appropriately, the Department seeks to place this interpretation on secure legal footing through legislation. The policy underlying the statutory change is sound. It was not the legislative intent of the original legislation to cause the imposition of tax on the postal charges for bulk mailings of promotional materials and it is necessary to confirm the nontaxable status of such mailings to protect the competitive position of instate printer/mailers. We support this provision.

IX. Sales of a Telephone Answering Service by Exempt Organizations

The bill amends paragraph one of subdivision (b) of Tax Law section 1116 to provide that sales of an answering service made by an organization exempt from tax under Tax Law section 1116(a)(4),(5), or (6) would be subject to tax.

This change would treat the sale of such services by exempt organizations like sales of taxable personal property now made by shops or stores operated by these organizations. The policy underlying the change is to provide a level playing field for commercial businesses and exempt organizations offering the same service. The economic incidence of the tax, moreover, will not fall on the exempt organization but on its customer. We support this change.

4. S.6468/A.9168 - Relating to Petroleum Business Tax and Lubricating Oil Tax [9]

I. Existing Law

New York's Article 13-A petroleum business tax consists, in part, of a basic tax (Tax Law section 301-a), a supplemental tax (Tax Law section 301-j), and a restructured tax surcharge (Tax Law section 301-g). This levy, computed on the basis of cents per gallon and indexed to follow fluctuations in the price of petroleum in the market, replaced a gross receipts-type tax which was in effect from 1983 to 1991.

Presently farmers are exempted from the measure of the supplemental petroleum business tax when they purchase nonautomotive-type diesel motor fuel for use or consumption directly and exclusively in the production for sale of tangible personal property by farming, subject to certain conditions and limitations. Tax Law § 301-j. Farmers are not, however, exempted from the basic tax and surcharge.[10] Thus, while the combined tax, supplemental tax and surcharge on nonautomotive-type diesel motor fuel is currently 14.03 cents per gallon, farmers pay 8.05 cents per gallon because of their partial exemption. See Tax & Finance Important Notice N-92-27.

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[9] This section was primarily drafted by E. Parker Brown II.

[10] Diesel motor fuel used directly and exclusively in farm production is fully exempt from the Article 12-A motor fuel tax and from the sales and use tax if certain conditions are met. Tax Law §§ 282-a(3)(b)(iv) and 1115(c) and (j). The Article 12-A tax does not apply to residual product, and the sales tax exemption covering diesel motor fuel applies equally to residual.

Presently farmers pay the full tax, supplemental tax and surcharge on residual petroleum (i.e. heavy oils such as #6) without any exemption. The combined rate for this product -- used particularly by greenhouse operators -- is currently 12.42 cents per gallon. Id.

In 1990 the Legislature enacted Tax Law Article 24 imposing a new tax on the retail sale and certain uses of lubricating oil. The tax rate is 10 cents per quart. Tax Law § 802(c).

II. Proposed Changes

Section 4 of the bill would add a new subdivision (g) to Tax Law Section 301-b exempting diesel motor fuel from the measure of the basic Article 13-A tax where the fuel is used or sold for use directly and exclusively in the production for sale of tangible personal property by farming, subject to conditions and limitations similar to those presently in the law with respect to the farmer's exemption from the supplemental tax. The bill would add in the same subsection an exemption for residual petroleum product from the measure of the basic Article 13-A tax where the product is used or sold for use directly and exclusively in the production for sale of tangible personal property by farming, subject to conditions (but not to limitations) similar to those presently in the law with respect to the farmer's exemption from the supplemental tax. Further, the bill would delete the farmer's exemption from the supplemental tax as unnecessary in light of the proposed exemption from the basic tax to which the supplemental tax is tied. See Tax Law § 301-j(a).

The bill would repeal the lubricating oil tax in its entirety.

The bill would amend Tax Law sections 301-a(e)(3), 301-a(f)(3) and 301-a(g)(3) to provide that the motor fuel and automotive-type diesel motor fuel rate, the nonautomotive-type diesel motor fuel rate and the residual petroleum product rate are not to be decreased when the producer price indices to which these rates are presently tied decrease. The bill would also modify the procedure for increasing rates and make other technical adjustments.

The bill would make the present temporary tax surcharge permanent, but reduce the rate from 15% in steps to 12–% and 10%.

The bill would take effect immediately, except that the expanded farmer's exemption and the section repealing the lubricating oil tax would take effect September 1, 1994.

III. Comments

Chapter 57 of the Laws of 1993 directed the Commissioner of Taxation and Finance to prepare a report reviewing “ongoing problems with petroleum business tax collections . . . and the economic impact upon the selling and use of various petroleum products, taking into consideration the fiscal condition of the State and its economy.” Pursuant to this directive, the Commissioner in December of 1993 issued his final report on this subject, titled New York State Petroleum Business Tax Issues. While the conclusions in this report are the Commissioner's, he was advised during the report's preparation by a Petroleum Working Group consisting of representatives of industry and other branches of state government.

The Commissioner noted that “[a]mong Northeastern states, only New York and Connecticut tax petroleum fuels employed in farm production,” and he recognized the farm representatives' contention that fuel costs attributable to the petroleum business tax place New York's agricultural products at a competitive disadvantage relative to the farm products of sister states. Report p. 79. The Commissioner concluded that total exemption from the tax on diesel fuel and residual product for on-farm production would eliminate this competitive disadvantage “at a relatively minor tax revenue cost to the State.” Report p. iv. While we cannot comment on the wisdom of adopting this policy, we can observe that, technically, the proposed amendment achieves the result intended.

The Bill Memorandum accompanying S.6468/A.9168 maintains that repeal of the lubricating oil tax is necessary to alleviate the cost to and administrative burdens on retailers; that a floor under petroleum business tax rates is necessary to make this important stream of state revenue less volatile; and that the surcharge amendments are justified by improvement in the State's financial position. While it is not our role to comment on these policy judgments, we can observe that, as a technical matter, the bill would appropriately amend the law to reflect them.

5. S.6482/A.9182 - Relating to the Personal Income Tax [11]

The 1987 Tax Reform and Reduction Act instituted tax rates, standard deductions and household credits which were intended to be temporary. The bill extends indefinitely the tax

[11] This section was primarily drafted by J. Brian Kopp. Helpful comments were contributed by Carolyn Joy Lee, James A. Locke and Michael L. Schler.

rates, standard deductions and household credits which were to be phased out and makes conforming amendments in the Administrative Code of the City of New York. We have no comment regarding these changes. The bill also adopts an earned income credit that is calculated based on the Federal earned income credit. Generally, the credit equals five percent, for taxable years beginning in 1994 and ten percent for subsequent years, of the Federal earned income credit provided by Section 32 of the Code. We have no comment with respect to these provisions.

I. New York Sourcing Fraction

The tax for nonresidents and part-year residents is calculated by determining the amount of the tax liability of the nonresident/part-year resident as if he or she were a resident and then apportioning that tax liability by a fraction. The current fraction is calculated by dividing the taxpayer’s Federal adjusted gross income sourced in New York by the taxpayer's total Federal adjusted gross income. For taxable years beginning after 1993, the bill adopts a new sourcing fraction. Specifically, under the bill, the new sourcing fraction will be calculated by dividing the taxpayer's New York adjusted gross income from sources in New York by his New York adjusted gross income from all sources.

We believe that this change is warranted. The current sourcing fraction can cause distortions because a taxpayer's Federal adjusted gross income may be very different from his New York adjusted gross income. Under the bill, the new sourcing fraction will more closely relate to taxpayers' New York taxable income base and, therefore should render more equitable apportionment.

II. Interest Provisions

A. Interest-Free Refund Period

The bill will reduce from three months to 45 days the period in which the Department can refund or credit income or withholding tax overpayments interest-free. Additionally, the period for calculating interest on overpayments of withholding taxes will run from the date of filing the Quarterly Combined Withholding and Wage Reporting Returns showing the overpayment, rather than the April 15 of the succeeding year. We agree with these changes to the Tax Law as they will encourage the Department to process refund claims promptly. The bill makes similar amendments to the Administrative Code of the City of New York and will apply to taxable years beginning after 1993.

B. Interest Rates on Overpayments and Underpayments

For purposes of personal income taxes, effective October 1, 1994, the bill will set the overpayment interest rate at the Federal short-term rate plus two percentage points and the underpayment interest rate at the Federal short-term plus three percentage points. This changes current law which sets both the overpayment and underpayment interest rates at the Federal short-term rate plus two percentage points. This provision is based upon Code Section 6621 which the Tax Section has previously criticized as bad tax policy. While we continue to believe this differential in interest rates is bad policy, we recognize that this change merely conforms the State rule with the Federal rule.

6. S.6467/A.9167 - Relating to Conformity of Underpayment of Estimated Tax Penalty [12/]

I. Proposed Changes.

The bill would simplify the Tax Law by conforming estimated tax and substantial underpayment penalties with the changes made in the Omnibus Budget Reconciliation Act of 1993. The provisions cover the New York personal income tax (including the income tax of estates and trusts), the city income taxes of New York and Yonkers, the franchise tax, other business taxes and the real property gains tax. The bill also directs the Commissioner of Health to enter into a contract with the Secretary of Health and Human Services to provide death certificate information to the federal government. Unless New York enters into such an agreement it will be prohibited by statute from receiving federal tax returns and return information.

These amendments conform closely with Code changes except that a corporation that does not have entire allocated net income of $1 million or more in any of the preceding three tax years will be able to continue to pay 91% rather than 100% of the current year's tax to avoid the estimated tax penalty.

The effective date provisions of the bill are designed to prevent the application of the more stringent penalty provisions of the bill prior to enactment even though the conforming amendments are made effective for taxable years beginning after 1993.

[12/] This section was primarily drafted by Robert E. Brown.

II. Comment.

The Committees support the proposed amendments because they promote simplicity by further conforming the Code and the New York Tax Law and because they significantly reduce the burden on taxpayers in computing estimated taxes.

7. S.6475/A.9175 - Relating to Collection Procedures[13/]

I. Overview

The bill proposes new Tax Law Article 35 dealing with certain procedural and substantive tax collection provisions that are somewhat patterned after the tax collection provisions in the Code. The Tax Section has long supported conformity with the Code. However, the Committee's support for proposed new Tax Law Article 35 is qualified because the bill does not provide New York taxpayers with some of the rights and safeguards that are available to taxpayers in connection with tax collection matters under the Code. Indeed, as will be more fully explained below, one particular provision in the bill that deals with income executions removes rights that are presently afforded to New York taxpayers under current law.

Further, the bill does not grant taxpayers the right to receive a notice of levy of property similar to the right under Code section 6331, nor the right to challenge the filing of a tax warrant similar to the right under Code section 6326 to challenge erroneously filed Federal tax liens. While the Committees are aware that as a matter of policy or by virtue of Article 52 of the Civil Practice Laws and Rules (“CPLR”) some of these

[13/] This section was primarily drafted by Robert Plautz. Helpful comments were contributed by James A. Locke.

safeguards are available to New York taxpayers in tax collection matters, the Committees believe that the bill should be modified to fully conform to the tax collection provisions of the Code and to explicitly place such protections within the Tax Law.

II. Specific Comments

Section 1702 of the bill is patterned after Code Section 6321 and creates a lien at the time of assessment against all property, real or personal, owned by the taxpayer who neglects or refuses to pay a tax (plus penalty and interest) after demand.

Section 1701 of the bill requires that “notice and demand” be given to a taxpayer after assessment and that the taxpayer be advised that the amount “shall be a lien” from the time of assessment. Section 1701 is similar to Code section 6303. However, Code section 6303 requires that the “notice and demand” be given within 60 days after assessment. Section 1701 of the bill does not require any period of time. We suggest that section 1701 be amended to require that the “notice and demand” be served upon the taxpayer within 60 days of assessment.

Further, because the lien created under section 1702 is created at the time of “assessment” and the section 1701 notice is to be sent after assessment, we suggest that the language in section 1701 be changed to state that the amount “is a lien”, not that it “shall be a lien”.

Section 1703 of the bill sets forth the length of time in which the lien can be enforced. This also differs significantly from Federal law. Under Federal law, a Federal tax lien can only be enforced by the Internal Revenue Service (“IRS”) for 10 years. Code § 6502. Because under New York law the mere filing of a "tax warrant" creates a "judgment" (e.g., Tax Law sections 692(e) and 1141(b)), the tax lien thus becomes enforceable for 20 years. See CPLR § 211. While the IRS may also reduce its Federal tax lien to a judgment and thereby also extend its collection ability for 20 years, it can only do so by initiating a separate plenary proceeding against the taxpayer in U.S. District Court. This is not required under existing New York law and the bill does not provide for it. However, we do not believe that this non-conformity with Federal law is undesirable.

We believe that certain administrative procedural safeguards should be established in connection with the filing of tax warrants similar to the judicial safeguards available to Federal taxpayers when, and if, the IRS does reduce its Federal tax lien to a judgment. We suggest that this be accomplished by requiring that notice be given to a taxpayer prior to filing a warrant and that the taxpayer be given an opportunity to challenge the filing of such warrant. This would be equivalent to the notice of summons and complaint that a Federal taxpayer receives when the IRS seeks to reduce its Federal tax lien to judgment. Occasionally, warrants are filed without the taxpayer having received proper notice of the original assessment documents. In such a case, the first knowledge of the warrant may occur when there is about to be a house closing or credit application. We also suggest that a procedure similar to the procedure under Code section 6326 be established whereby some meaningful mechanism is established within the division of tax compliance or perhaps the bureau of conciliation and mediation services in which a taxpayer is given an opportunity to present evidence to remove an erroneous tax warrant.

We also believe that if notice were to be given prior to the filing of a tax warrant it would have a positive effect on the collection of taxes. A taxpayer who has not paid an outstanding assessment for one reason or the other may, upon receiving notice of the impending filing of a tax warrant, finally realize that arrangements should be made to pay the liability to avoid the warrant. It might at least encourage taxpayers to enter into deferred payment agreements. Under present law, there is no incentive for the taxpayer to come forward and resolve a tax liability or enter into a deferred payment agreement if a warrant has already been filed. We believe that notice prior to the filing of a tax warrant might encourage voluntary payment.

Section 1704 subordinates the tax lien to certain “super priorities liens” set out in the statute. The priorities liens are identical to Federal law under Code section 6323. We agree with those provisions.

Section 1705 sets out the time limits in which the Department must issue a satisfaction for a tax lien. The bill proposes 20 days and after 40 days penalties may be imposed. Current law under CPLR Article 52 requires it be done in 10 days with penalties after 20 days. Code section 6325 requires 30 days and, as a practical matter, does not make provision for “penalties” but only “actual and direct economic damages” as a result of the delay. Code § 7432. While this is an area where Federal conformity is not necessary, the Memorandum in Support gives no reason for a change from current law. Unless there is a problem with current law, we do not understand why a change is necessary.

Section 1706 of the bill deals with income executions. Current law with respect to income executions is found in the CPLR and as a general rule limits income executions to 10% of the taxpayer's gross income (with adjustments for court ordered support payments). The bill exempts from income execution taxpayers earning less than $20,000. After $20,000, the bill proposes a formula and exempts only an amount equal to the taxpayer's federal standard deduction plus aggregate deductions for personal exemptions divided by 52 plus “reasonable” payroll deductions. What is “reasonable” is to be determined solely by the Department. Further, the formula is adjusted according to the amount of the taxpayer's gross annualized income. For income between $20,000 and $50,000, the formula includes an exemption of 60% of the taxpayer's annualized income. For income between $50,000 and $75,000, the exemption is decreased to 55%. For income between $75,000 to $100,000, the exemption is decreased to 50%. For income between $100,000 to $125,000, the exemption is decreased to 45%. After $125,000, the exemption is capped at 40%.

The Committees support this provision. However, we suggest that section 1706 be modified to make clear that the Commissioner's authority to limit payroll deductions applies only to voluntary payroll deductions (i.e. not payroll tax withholding) and that deductions for health insurance and other similar benefits (consistent with past practice) would be “reasonable”. Moreover, in the case of a self-employed person, estimated tax payments should likewise be considered “reasonable” payroll deductions.

However, we are concerned that section 1706 specifically provides that it supersedes CPLR section 5231 which requires, among other things, that prior to an income execution being served upon an employer it must first be served upon the judgment debtor. This provision is designed to encourage judgment-debtors to voluntarily enter into income executions directly with the judgment-creditor and avoid involvement---and embarrassment---

with the judgment-debtor's employer. Section 1706 of the bill does not have a similar provision. The Committees oppose this provision.

8. S.6465/A.9165 - Relating to Providing a Credit Against Estate Tax for Certain Closely Held Businesses [14/]

I. Existing Law

Current New York estate tax law provides a credit for certain farm property which continues to be used by a family member as farm property. New York also allows special use valuation of certain real property passing to family members, as well as extensions of time to pay the estate tax where a substantial percentage of the estate is composed of a closely held business.

II. Proposed Change

The bill would allow a credit for New York estate tax purposes of up to $39,500 for closely held business assets that pass to certain family members. The credit would be applied after the unified credit and is equal to the amount by which four percent of the first one million dollars of qualified business

[14/] This section was primarily drafted by Thomas M. Barney. Helpful comments were contributed by James A. Locke.

assets exceeds the unified credit (usually $500). The new credit would be applicable to property which qualifies for the extended period to pay federal estate tax under Code section 6166 and for qualified heirs as that term is used in the special use valuation under Code section 2032A. Assets for which a marital deduction was allowed would not qualify for the credit. There are no stated holding periods either before the death of the decedent or for which the qualified heir has to retain the interest after the death of the decedent.

III. Comment

The Committees support the adoption of the new estate tax credit for certain closely held business assets but notes that the lack of a post death holding period may require correction. We note that the extended period to pay federal estate taxes under Code section 6166 is terminated if there is a “disposition” of the business. See IRC § 6166(g).