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NYSBA

February 25, 1999

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Department of Finance
345 Adams Street
Brooklyn, New York 11201

Re: Draft Amendments to UBT and GCT Rules

Dear Ellen:

This is in response to your memorandum of October 21, 1998, requesting comments on the preliminary discussion draft of proposed amendments to the UBT and GCT rules reflecting recent legislation.* Response to your request for comments and recommendations on the operation of the carryover of the UBT paid credit for combined corporate taxpayers will be addressed separately.

As a preliminary matter, we refer you to a letter to Speaker Silver and others dated May 26, 1995 on behalf of the Tax Section relating to the bill which was ultimately enacted as chapter 128 of the Laws of 1996, of which you have a copy. As noted below, we reiterate in our comments on pages 4, 5 and 8 of this letter relating to Rules §§ 28-02 (g) (4) (iv), 28-05 (c) (9) and 28-18 (j), the comments that we made in the letter of May 26, 1995. The comments below are in the order of the sections of the UBT amendments on pages 1-67 of the draft. We have no comments on the GCT amendments on pages 68 - 80 of the draft. Where we have suggested specific changes in your draft language, we have used underscoring and brackets to show additions to and deletions from your language.

§ 3. New Rule § 28-02 (a) (7) (i) provides in part:

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*This letter was drafted by Robert J. Levinsohn.

> "However, if an individual owns an interest in an unincorporated entity and performs services in whole or in part in the City for the entity, the performance of such services in whole or in part in the City will constitute the conduct of an unincorporated business by the individual if the performance of such services would otherwise constitute the conduct of an unincorporated business under these rules."

This new provision does not seem to be required by any of the statutory changes, and is not stated to depend on whether the individual receives compensation for his or her services to the entity other than the individual's distributive share of the entity's income. Nor does there appear to be any other provision of the rules, either existing or as proposed to be amended, which expressly spells out when the performance of services by an individual partner for his partnership "would otherwise constitute the conduct of an unincorporated business."

Moreover, this new provision may create confusion with other provisions of the Code or other Rules. For example, Adm. Code § 11-502 (a) provides in part as follows:

> "If an individual or an unincorporated entity carries on wholly or partly in the city two or more unincorporated businesses, all such businesses shall be treated as one unincorporated business for the purposes of this chapter."

This statutory provision is embodied in pre-existing Rule § 28-02 (a) (4) (i), which is amended to conform more closely to the statute. Existing provisions incorporated in amended Rule § 28-05 (a) (1) state that an individual member of a partnership who also carries on a separate and independent unincorporated business is not required or permitted to include his distributive share of partnership income in computing his separate unincorporated business gross income. This is followed by an example of a doctor who is a member of a medical partnership which provides medical services to members of a group health plan, and who, in addition, carries on his own separate and independent medical practice. The example states that the doctor may not include his distributive share of partnership income in his computation of his own unincorporated business gross income. Related provisions also appear in existing Rule § 28-02 (e)(4) (see discussion under § 5 below) which, however, apply only to the rendition of personal services by an individual "as an employee, officer, director or fiduciary." How do the provisions of the example described above square with the new language quoted from §28-02 (a) (7)(i)? Since the doctor in the example must be performing services for the medical partnership of which he is a member, which services would in and of themselves constitute the conduct of a business like his own medical practice, such services for the medical partnership would seem to constitute the cdnduct of an unincorporated business under the new language. Existing Rule § 28-02 (a) (4) (i) and the

corresponding statute would then require the doctor's independent medical practice and his business of performing services for the medical partnership to be treated as one unincorporated business. This interpretation would be inconsistent with the conclusion of the example, and clarification is therefore required.

At the end of new Rule § 28-02 (a) (7) (i), a cross reference to Rule § 28-02 (e) (1) and (4) would be helpful.

In new Rule § 28-02 (a) (7) (ii), Examples 1 and 2 both deal with Partnership A which is a partner in Partnership B, but does not participate in the management of Partnership B or in the operation or management of B's hotel. An example of the result where Partnership A does so participate would be helpful.

§ 4. In the newly added cross-reference at the end of Rule §28-02 (c) (1) to the section treating unincorporated entities electing to be subject to the unincorporated business tax under Administrative Code § 11-602 (1) (b), we would suggest changing "electing" to "which elected", since the reference is to a grandfathered provision which is no longer operative.

§ 5. Existing Rule § 28-02 (e) (4) is repeated without change, except for the deletion of the bracketed language in the following sentence:

> "Where an individual maintains an office or employs assistants in connection with the performance of services as an employee, officer, director or fiduciary for one or more employers or other principals, the services so performed will be deemed part of a business regularly carried on [if the individual regularly performs or offers to perform similar services to the general public on an independent basis]."

What is the significance of this omission; does it derive from a statutory change or otherwise? If the example in newly added Rule § 28-05 (a) (2) on page 38 of the draft illustrates a situation to which the quoted sentence applies, we suggest adding a cross-reference to that example.

§ 7. In new Rule § 28-02 (g) (4) (iii) (A), incorporating the definition of "investor" for purposes of the partial self-trading exemption, the draft incorporates the statutory language in stating as one requirement that a taxpayer must not receive a distributive share of the other unincorporated entity's income, etc, that is "materially greater" than its distributive share of any other item. We suggest that the rules include some clarification of the parameters of the phrase "materially greater."

In new Rule § 28-02 (g) (4) (iv), the draft tracks the statutory language in stating that gross values must be used "unless the commissioner determines that the use of gross values results in an improper or inaccurate reflection of the primary activities of the taxpayer. In that event, the commissioner may exercise his or her discretion, in such manner as he or she may determined [sic], to reduce the gross value of the taxpayer's assets by liabilities attributable thereto or to exclude assets so as to properly and accurately reflect the primary activities of the taxpayer." There is no amplification of the scope of the Commissioner's permitted exercise of discretion except in Examples 4 and 5, which follow. It would help if, in addition to the examples, there were textual elaboration of the principles which should guide the Commissioner's exercise of discretion.

On page 5 of our letter dated May 26, 1995, we stated that "we understand that the intent of the bill is that persons may own multiple entities that regularly deal with one another, with one entity carrying on dealer activities (which would not be exempt) and the other entity carrying on exempt activities, and that the exempt activities of one entity would not be rendered taxable by the dealer activities of the related entity." This concept is illustrated by Example 1 in new Rule 28-02 (g) (4) (v) but is not otherwise developed in the text of the rules. Here again, we recommend that the text describe the rule, as spelled out in our letter, which is illustrated by the example.

New Rule § 28-02 (g) (4) (iv) repeats the statutory provision that average monthly values will be used. At page 6 of our letter of May 26, 1995, we stated as follows:

> "The requirement for using average monthly gross values was inserted in the bill having in mind primarily its application to marketable securities. Average monthly gross values for real estate are generally not readily ascertainable. Monthly appraisals, while theoretically possible, would be prohibitively expensive. Therefore, we assume that regulations will provide for a reasonable interpretation of this provision in its application to the determination of the fair market value of real estate, such as permitting the use of beginning and end-of-year values, which we believe will be a reasonable approximation of monthly values."

Accordingly, we urge that the rules permit the use of beginning and end-of-year values for real estate where appropriate.

§ 25. New Rule § 28-05 (c) (9) tracks the statutory language in providing that taxpayers eligible for the partial self-trading exemption shall subtract from gross income, inter alia, "other substantially similar income from ordinary and routine trading or investment activity to the extent

determined by the Commissioner of Finance". At page 5 of the City's Memorandum in Support of the 1995 bill which became chapter 128 of the Laws of 1996, it was stated as follows:

> "It is expected that rules will be adopted under this provision that will exempt, for example, commitment fees, standby fees, breakup fees and similar fees commonly received by investors who receive such fees as an incident to their investment activity."

At page 5 of our letter of May 26, 1995, we stated that the Tax Section's endorsement of the bill was subject to our understanding that the above interpretation of the self-trading exemption will be incorporated in the Department's regulations. We continue to believe that paragraph (9) should be expanded to incorporate the above interpretation.

§ 38. In Rule § 28-07 (d) (1), we recommend the following changes in the newly proposed language:

> "... unless the taxpayer elects to use a double-weighted gross income percentage as provided in paragraph (2) of this subdivision (d), in which event the [portion of the] taxpayer's business allocation percentage [unincorporated business income allocable to the City] is determined as provided in paragraph (2) of this subdivision (d)]."

The language as drafted would give the erroneous impression that election of the double-weighted gross income percentage for manufacturers trumps the normal priority of the books and records allocation method. The change would make clear that the election is only applicable where the "business allocation percentage "under Adm. Code § 11-508 (c) (i.e., the formula method) applies.

In Rule § 28-07 (d) (1) (iii) (B) (1), we recommend that the newly added proviso be revised to add the underscored language, which tracks the statute, Adm. Code § 11-508 (c) (3):

> "...provided, however, for taxable years beginning on or after July 1, 1996, sales of tangible personal property shall not be allocated to the city as hereinabove in this sentence provided , but only sales of tangible personal property where shipment is made to points within New York City shall be allocated to New York City for purposes of the gross income percentage."

The language as drafted could be misread as requiring that sales both originate from and be shipped to points within the City in order to be allocated to the City in years beginning after 7/1/96. The change would conform to the statute and eliminate any possible misunderstanding.

In Rule § 28-07 (d) (1) (iii) (B) (3), relating to allocation by broadcasters, we recommend the addition of the underscored language:

> "...the sales and charges for services arising from the sale of subscriptions to such programs or from the broadcasting of such programs and of commercial messages in connection therewith, will be allocated to New York City according to the ratio of the number of listeners or viewers within the City to the total number of such listeners or viewers."

The proposed revision would be clearer, and more consistent with the statutory language in Adm. Code § 11-508 (e-1) (2), which refers to allocation "according to the number of listeners or viewers within and without the city." See also discussion under § 41 below.

§ 39. We recommend revision of the first sentence of new Rule § 28-07 (d) (2) (i) to read as follows:

> "For taxable years beginning on or after July 1, 1996, a taxpayer that is a manufacturing business as defined below may elect to determine its business allocation percentage by adding together the percentages determined under subparagraphs (i), [and] (ii) and (iii) of paragraph (1) of this subdivision (d) and adding to that sum an additional percentage equal to [two times] the percentage determined in subparagraph (iii) of paragraph (1) and dividing the total by the number of percentages."

This language would be more consistent with the statutory language and avoid the possible misimpression from the language as drafted that the divisor is three rather than four.

We recommend the following additions to the last two sentences of new Rule § 28-07 (d) (2) (iii), relating to the manufacturers' election:

> "The election is irrevocable and cannot be made on an amended return except with the permission of the Commissioner upon such terms and as the Commissioner may specify where the Commissioner concludes that such permission should be granted in the interests of fairness and equity due to changes in circumstances

> resulting from an audit adjustment. If a taxpayer fails to make an election to use the double-weighted gross income percentage, its business allocation percentage, where applicable, must be determined under the provisions of paragraph (1) of this subdivision (d)."

The first change would conform to the statutory language in Adm. Code § 11-508 (g) (2). The second change would serve as a reminder that the formula method only applies in the first instance where the normal priority of the books and records method is overcome.

§ 40. Since Example (i) of Rule § 28-07 (d) (4) is stated to be for 1997, paragraph (c) on page 51 is incorrect in applying the old sales office allocation method. The new destination method is applicable to taxable years beginning on or after July 1, 1996. Adm. Code § 11-508 (c) (3).

We recommend that Example (ii) of the same section be clarified by adding, after "tangible personal property manufactured by the taxpayer" the following: "(within the definition in paragraph (2) above)"

§ 41. We recommend that Rule § 28-07 (d) (4), Example (iii), be revised to add the underscored language:

> "Partnership A is engaged in providing cable television service both inside and outside the City. All of Partnership A's gross receipts are attributable to its cable television service business. Therefore Partnership A is required to use formula allocation unless the commissioner determines that the formula in paragraph (1) (iii) (b) (3) above does not fairly and equitably reflect the business income from the city. Partnership A receives income from sales of advertising on its programs as well as income from subscriptions. Subscription prices are not uniform throughout Partnership A's service area; some subscribers pay a higher price than others. Partnership A can identify the source of the subscription receipts directly by the location of the subscriber. In this case, the commissioner may determine that the use of audience data for allocating subscription receipts does not fairly and equitably reflect Partnership A's subscription receipts from the City, and, under subdivision (e) of this section, may require subscription receipts to be sourced according to subscriber location while advertising receipts must be sourced according to the audience data."

Since the special formula for broadcasters in Adm. Code § 11-508 (e-1) (2) only permits allocation in proportion to the number of viewers within and without the City, the recommended changes would make clear that the example is an application of the Commissioner's discretionary authority under Adm. Code § 11-508 (d) and Rule § 28-07 (e) to prescribe a different method.

§ 42. Rule § 28-07 (d) (5), relating to missing factors, is renumbered but otherwise unchanged. We recommend that a sentence be added to the paragraph covering the situation where the double-weighted manufacturing formula applies.

Between §§ 43 and 44, on page 53, we recommend adding a reference to Rule § 28-07 (i) being reserved for the allocation of investment income, since there are subsequent cross-references to this section.

§44. In Rule § 28-07 (j), dealing with allocation for multi-tiered partnerships, § 28-07 (j) (2) (i) (c) (b) prescribes an alternative method whereby the partner's distributive share from the other partnership is allocated by the partner's business allocation percentage without regard to the business allocation factors or boqks and records of the partnership. There should be some elucidation of the type of situation in which this alternative would be appropriate.

§ 50. In new Rule § 28-18 (j), relating to reporting requirements for the exemption for parking services provided to tenants, in the sentence providing that failure to submit prescribed information "for a garage or similar facility at any such property will result in parking" etc. services rendered to tenants being subject to UBT, the words "in any material respect "should be inserted between "property" and "will". This will incorporate essential language from the statute, Adm. Code § 11-502, second subsection (d), last sentence.

At page 6 of our letter of May 26, 1995, we stated as follow:

> "We also assume that regulations on the provision barring application of the real estate exemption to garaging for tenants if information required to accompany the return is omitted "in any material respect" will provide that inadvertent omission of information on a small number of tenants or minor inadvertent factual errors will not destroy the exemption."

We urge inclusion of such a provision.

Sincerely yours,

Harold R. Handler

Harold R. Handler
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