

# Rosen Seymour Shapss Martin & Company LLP

*Certified Public Accountants & Profitability Consultants*

## State and Local Tax Update

Dear Clients and Friends of the Firm:

Discussed below are some of the major highlights of the 2010-11 New York State budget which make some significant changes to the Tax Law.

### **PERSONAL INCOME TAX**

**New Higher New York City Tax Rates:** The law eliminates the STAR tax rate reduction for New York City income taxpayers with taxable incomes in excess of \$500,000. The base rate for these taxpayers is increased from 3.2 percent to 3.4 percent for tax years 2010 and after. The total tax rate for taxable incomes in excess of \$500,000 (including the base rate and additional 14% surcharge) is therefore increased from 3.648 percent to 3.876 percent. The Commissioner of Taxation and Finance is authorized to adjust the withholding tables to account for the rate change. Also, the estimated tax underpayment penalty is waived on additional amounts due prior to, or within 30 days of, the effective date of this provision provided that taxpayers remit these additional estimated taxes by their next quarterly due date. This is effective immediately and applies to taxable years beginning after 2009.

**Itemized Deductions:** Effective for tax years beginning on or after January 1, 2010, the law requires taxpayers who elect to take an itemized deduction on their federal returns for state and local sales taxes paid must add such amounts back when determining their New York itemized deductions.

**Charitable Contributions:** Effective for tax years beginning on or after January 1, 2010 and ending after tax year 2012, taxpayers with \$10 million of NYAGI will have their charitable contribution itemized deduction reduced from 50% to 25%. Because the New York City income tax conforms to the State tax base, these changes would also affect deductions for City tax purposes. The bill allows the City of New York to opt out of these limitations on charitable contributions. This is effective for taxable years beginning on or after January 1, 2010 and ends after tax year 2012.

**Treatment of Termination Pay to Nonresidents:** The law makes termination pay, covenants not to compete, and any other employment-related compensation for past services received by nonresidents taxable if the taxpayer had New York employment nexus at the time of payment. Decisions rendered by the Tax Appeals Tribunal had held that these forms of income earned by nonresidents were not taxable, overruling previous Tax Department (the Department) guidance on this issue. This is effective for taxable years beginning on or after January 1, 2010.

**Sales of S Corporation Shares by a Nonresident:** The law provides that nonresident

shareholders of S corporations who make an election under §338(h)(10) or §453 of the Internal Revenue Code (IRC) are taxed in accordance with that election and the transaction is treated as producing New York source income. The provision also requires that income received by nonresidents from installment sale contracts entered into before a New York S corporation terminated its taxable status in New York be included as New York source income. The provisions regarding §338(h)(10) or §453 of the IRC apply to taxable years beginning on or after January 1, 2007 for which the statute of limitations for seeking a refund or assessing additional tax is still open. For cases involving failure to file or report federal changes, filing fraudulent returns to evade tax, or substantial underreporting of income, the provisions apply to all taxable years as long as such statute of limitations remains open and subject to assessment. The provision regarding income received from installment sales contracts applies to taxable years beginning on or after January 1, 2010.

### **BUSINESS RELATED CREDITS**

**Deferral of Business Tax Credits:** Effective for tax years' 2010, 2011, and 2012, taxpayers with more than \$2 million in aggregated business tax credits would be required to defer the amounts above \$2 million until 2013. The total amount of credits deferred under this proposal would be paid back to taxpayers (without interest) over tax years 2013, 2014 and 2015. The deferral would affect dozens of business tax credits available, including Empire Zone and QETC credits and credits for low-income housing, fuel-cell generating equipment, biofuel production, rehabilitation of historic structures, employment and transportation of people with disabilities and other credits.

**Replacement of the Empire Zones Program:** On June 22, 2010, Governor Paterson signed into law the Excelsior Jobs Program Act which replaces the Empire Zones program, which officially expired on June 30, 2010 (see below). The still-outstanding provisions in the budget bill address issues relating to retroactive decertification of existing Empire Zone business, the treatment and timing of applications into the program and eligible credits during the transition.

**Decertification:** The bill clarifies that any decertification of an existing Empire Zone business that occurred based on the 2009 changes to the eligibility criteria and review of all existing Empire Zone certifications was intended to be retroactive to tax years beginning January 1, 2008. Although some provisions in the 2009 legislation indicated a 2008 effective date, the actual decertification provisions contained no such designation. A State Supreme Court judge recently held there was no statutory authority to make an Empire Zone decertification retroactive to 2008 (James Square Associates LP et al v. Mullen, NY Supreme Court, June 11, 2010). The current budget bill contains the language to do so.

**Transition Provisions:** The bill addresses various issues relating to events occurring before the June 30, 2010 expiration date. The bill provides that:

If a local Zone Administrative Board had applied before June 30 to revise the borders of a particular Zone in order to accommodate a new project or had applied to the Department of Economic Development (DED) for approval of "a regionally significant project," the DED can revise the effective date of the project to be before June 30 to allow entry into

the program.

**Investment tax credit:** If a taxpayer was certified as a "qualified investment project" (QIP) prior to the June 30 expiration, it would retain such status for the remainder of 2010 and for the next nine years for the purposes of the Empire Zone investment tax credit. A taxpayer certified as an Empire Zone project before June 30 would continue to be designated as such for investment tax credits until April 1, 2014, as would the areas in which the taxpayer was certified.

**Capital tax credit:** If an area is no longer designated an Empire Zone because of the expiration of the program, a taxpayer who made a contribution of money before June 30 to a community development project approved by the DED in that area, could continue to claim the Empire Zone capital tax credit for additional contributions to the project up until April 1, 2014.

**Excelsior Jobs Program Act:** The Excelsior Program ("Program") replaces the Empire Zones program, which expired on June 30, 2010. The Program essentially contains four components:

***The Excelsior Jobs Tax Credit*** - for increasing employment in the State;

***The Excelsior Investment Tax Credit***  
- for investments in property in the State;

***The Excelsior Research and Development Tax Credit***  
- for research and development expenditures in the State (this is based on the federal R&D Credit);

***The Excelsior Real Property Tax Credit***  
- allows real property credits for regionally significant projects (as defined by statute) or for businesses located in economically depressed areas. In general, a business must be predominantly engaged in one of the following categories and meet certain employment growth thresholds in order to participate in the program (though there are some exceptions): (1) as a financial services data center or a financial services back office operation, (2) in manufacturing, (3) in software development and new media, (4) in scientific research and development, (5) in agriculture, (6) in the creation or expansion of back office operations, or (7) in a distribution center. Each of these terms is specifically defined by the statute. A general overview of the program is available on Empire State Development's website at:

<http://www.empire.state.ny.us/BusinessPrograms/Excelsior.html>

## **SALES AND USE TAXES**

**Elimination of Clothing and Footwear Exemption:** Effective October 1, 2010, the law eliminates the statewide sales and use tax exemption for clothing and footwear sold for less than \$110, effective October 1, 2010 and lasting through March 31, 2011. A limited exemption for clothing and footwear under \$55 would be reinstated between April 1, 2011 through March 31, 2012, after which, the original (\$110) exemption would be reinstated indefinitely.

**Hotel Room Remarketers:** The law requires room remarketers to collect State and local sales tax on their charges to their customers. A "room remarketer" includes a person who reserves, arranges for, conveys, or furnishes occupancy to an occupant for rent in an amount determined by the room remarketer. Prior to this legislation, room remarketers (such as online travel companies) would rent rooms from a New York hotel operator at a discounted rate, pay sales tax on that discounted rate, and resell the room at a higher price without charging tax to the customer. Thus, no sales tax was collected on the room remarketer's markup of the room. Part AA grants to room remarketers who are registered and collecting sales tax a refund or credit in the amount of tax they paid the hotel operator. The legislation also conforms New York City's local Hotel Room Occupancy Tax to the changes made by this bill. This is effective September 1, 2010.

**Affiliate Nexus:** The law amends legislation enacted with the SFY 2009-10 Budget that updated the definition of a sales tax vendor to include an "affiliate nexus" provision. It now provides that the in-state activities of an affiliate in providing accounting or legal services or advice to a seller, or in directing the activities of a seller, including but not limited to, making decisions about strategic planning, marketing, inventory, staffing, distribution, or cash management, do not make the seller a vendor. This is effective immediately and is deemed to have been in full force and effect on and after June 1, 2009.

**Repeal Sales Tax Vendor Credit:** The law eliminates the sales tax vendor credit for vendors that file or are required to file monthly sales tax returns. Generally, vendors that are required to file monthly returns are retailers that sell or purchase more than \$300,000 in taxable goods and services during a quarter. This change takes effect June 1, 2010 and applies to tax returns beginning with those due on September 20, 2010.

**Bad-Debt Credits on "Private Label" Credit Cards:** Effective for credits or refunds claimed after July 1, 2010, the law repeals the sales tax deduction allowed to vendors and/or lenders for uncollectible amounts charged on "private label credit cards." Under the current law, either a vendor who has issued its own "in-house" credit card or the lender that holds the vendor's card accounts may claim a credit for sales tax previously remitted on an uncollectible or worthless account.

### **ESTATE TAX**

**Preserve the Existing Unified Credit Allowed Against the Estate Tax:** The law eliminates the reference to the unified credit in effect in the IRC on the decedent's date of death and fixes the credit at the amount that would be allowed if the federal unified credit did not exceed the tax due on an estate of \$1 million. This provision is necessary because if Congress does not timely extend the federal estate tax, there will be no federal unified credit in effect on dates of death after the January 1, 2010 expiration of the federal tax and, consequently, no unified credit for purposes of New York's estate tax. This provision preserves the New York unified credit for the estates of decedents dying on or after January 1, 2010.

### **NEW COMPLIANCE & ENFORCEMENT MEASURES**

**Felony for Three Years' Failure to File:** Effective immediately, the law creates new class E felonies for repeatedly failing to file, with intention to evade tax for personal and corporate taxes. A person is guilty of repeated failure to file if they fail to file a return for three consecutive taxable years with the intent to evade taxes, provided the person had an unpaid liability for personal income taxes or an unpaid liability in excess of the threshold amount for corporate taxes for each of the three years. The legislation does, however, create the defense that the defendant had no unpaid tax liabilities for any of the three consecutive tax years.

**Reporting Requirements for IDAs:** Effective immediately, the law requires Industrial Development Agencies (IDAs) to file an informational statement with the Tax Department each time an IDA designates a new project operator or agent who will benefit from the sales and use tax exemption applicable to IDA projects. Additionally, every designated agent and project operator making purchases for an IDA project would be required to file an annual statement with the Tax Department stating the value of all sales and use tax exemptions claimed during the year.

### **MISCELLANEOUS**

**Electronic Filing and Electronic Payment Programs:** The law eliminates the taxpayer opt-out from e-filing as automatic grounds for abatement of the penalty imposed on tax return preparers for failure to e-file tax returns and other tax documents when required to do so. A preparer may now be required to prove the legitimacy of the opt-out by providing a taxpayer certification justifying the opt-out and indicating that the taxpayer's election not to e-file was made voluntarily and without coercion from the preparer. The legislation also authorizes the Commissioner to establish correction periods for timely electronic filings and payments that are not accepted for processing. In addition, the legislation prohibits tax return preparers and software companies from charging separately for e-filing of New York tax documents. A penalty of \$500 is imposed for a first violation and increases to \$1,000 for each subsequent violation. The opt-out provision is effective for required e-filing of tax returns and other tax documents by tax return preparers on or after December 31, 2010, and the other provisions apply to electronic returns and payments made for tax years beginning after December 31, 2010.

**Abandoned Property:** Effective immediately, the law allows the State to declare uncashed travelers checks, money orders, and similar instruments to be declared abandoned property within five years rather than seven years. A new category of abandoned property would also be established for unclaimed funds held by a public utility for at least three years or unclaimed amounts held for three years by a person for services not rendered or for goods not delivered.

Should you require any additional information on the New York State 2010-2011 Budget, please feel free to contact Steven J. Eller at (212) 303-1051 or via email at [seller@rsmcpa.com](mailto:seller@rsmcpa.com).

*Sincerely,*  
***Rosen Seymour Shapss Martin & Company LLP***

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