

## **Summary of Budget Bill** **Personal Income Tax Changes Enacted in 2007**

This memorandum contains brief summaries of personal income tax changes that were enacted as part of the 2007-2008 New York State budgets (Chapter 60 and Chapter 57 of the Laws of 2007), and Chapter 687 of the Laws of 2007 (relating to the middle class STAR rebate program).

### **Extension of tax shelter reporting requirements**

Part I of Chapter 60 of the Laws of 2007 amends Part N of Chapter 61 of the Laws of 2005. The amendment extends the expiration date of the reporting requirements and related administrative provisions concerning the disclosure of certain federal and New York State reportable transactions and related information regarding tax shelters to July 1, 2009. The provisions were due to expire on July 1, 2007.

For more information regarding the reporting requirements and related administrative provisions concerning the disclosure of certain transactions and related information, see the following documents that are available on the Tax Department Web site ([www.nystax.gov](http://www.nystax.gov)):

- TSB-M-05(2)C,(4)I, *Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*
- TSB-M-05(2.1)C,(4.1)I, *Supplement to the Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*
- TSB-M-05(2.2)C,(4.2)I, *Additional Supplement to the Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*
- TSB-M-07(4)C,(4)I, *Amendments to the Procedural Regulations Relating to New York Reportable Transactions*
- TSB-M-07(5)C,(5)I, *Notification of New York Listed Transaction - Certain Charitable Contribution Deductions*

(Tax Law sections 25, 683(c)(11), 685, 1083(c)(11), and 1085, and Department Regulations Part 2500 (20NYCRR Part 2500))

### **Personal service corporations**

Section 632-a has been added to the Tax Law to allow the Commissioner of Taxation and Finance to allocate all income, deductions, credits, exclusions, and other allowances between a personal service corporation or an S corporation (even if the personal service corporation or S corporation is taxed under Article 9-A of the Tax Law or is not subject to tax in this state) and

its employee-owners if allocation is necessary to (1) prevent avoidance or evasion of New York State income tax or (2) to clearly reflect the source and the amount of the income of the personal service corporation or S corporation or any of its employee-owners.

The section provides that the Commissioner may make the allocation described above if:

- 1) substantially all of the services of a personal service corporation or S corporation are performed for or on behalf of another corporation, S corporation, partnership, or other entity; and
- 2) the effect of forming or availing of the personal service corporation or S corporation is the avoidance or evasion of New York income tax by reducing the employee-owner's income (or in the case of a nonresident, the employee-owner's New York source income) or securing for any employee-owner the benefit of any expense, deduction, credit, exclusion, or other allowance that would not otherwise be available.

For purposes of this new section, all related persons as defined by IRC section 144(a)(3) shall be treated as one entity. In addition, the following definitions apply:

- *A personal service corporation* is a corporation whose principal activity is the performance of personal services and such services are substantially performed by the employee-owners of the corporation.
- *An S corporation* is a corporation for which an election under section 1362 of the Internal Revenue Code is in effect for that taxable year and whose principal activity is the performance of personal services and such services are substantially performed by the employee-owner(s) of the corporation.
- *An employee-owner* is any employee who owns, on any given day during the taxable year, more than 10% of the outstanding stock of the personal service corporation or S corporation.

Section 632-a applies to tax years beginning on or after January 1, 2007.

(Tax Law section 632-a)

### **Mandatory New York S corporation election**

Section 660(i) has been added to the Tax Law to provide that if more than 50% of an eligible S corporation's federal gross income (as defined in Internal Revenue Code section 61(a)) for the current tax year is derived from investment income, then the shareholders of that eligible S corporation are deemed to have made the election to be a New York S corporation for the entire current tax year. The new provision does not apply to eligible S corporations that are subject to tax under Article 32 of the Tax Law.

The following definitions apply for purposes of section 660(i):

- An *eligible S corporation* is (i) an S corporation that is subject to tax under Article 9-A or (ii) an S corporation that is the parent of a qualified subchapter S subsidiary subject to tax under Article 9-A, where the shareholders of such parent corporation are entitled to make the election under section 660(a) by reason of section 208.9(k)(3).
- *Investment income* is the sum of an eligible S corporation's gross income from interest, dividends, royalties, annuities, rents, and gains derived from dealings in property (real, intangible, and tangible), including the corporation's share of such items from a partnership, estate, or trust, to the extent such items would be includable in the corporation's federal gross income for the taxable year.

Under the new provision, an eligible S corporation will be treated as a New York S corporation only for a tax year for which the 50% test described above is met. If the 50% test is not met for a tax year, the eligible S corporation will be treated as a New York C corporation for that year, even if the corporation was treated as a New York S corporation under the provisions of section 660(i) for the prior year.

When making current tax year estimated tax payments, an eligible S corporation and its shareholders may rely on the eligible S corporation's filing status for the prior tax year in determining the amounts required to be paid. If the status of the eligible S corporation changes from a New York C corporation to a New York S corporation or from a New York S corporation to a New York C corporation, any estimated taxes (along with required declarations of estimated tax for corporations) that would have otherwise been required to be made by the corporation or the shareholders during the current tax year can be made, without penalty, by January 15 of the calendar year following the close of the taxpayer's tax year, regardless of whether the taxpayer's tax year is a calendar or fiscal year. In addition, either the corporation or the shareholders, when filing their tax returns for the year, can claim a refund of any estimated taxes overpaid due to the change in the corporation's filing status.

**Note:** A fiscal year taxpayer **is required** to pay any tax due on or before January 15 or the due date of his, her or its return, without regard to extensions, whichever is earlier.

**Example:** Corporation A was a federal S corporation but a New York State C corporation for fiscal year 6/1/06 - 5/31/07. Corporation A has one individual shareholder (Shareholder X). Shareholder X is a New York State resident.

For fiscal year 6/1/07 - 5/31/08, Corporation A derives **more than** 50% of its federal gross income from investment income. Accordingly, Corporation A is deemed to have made the New York S corporation election for this fiscal year and is required to file a New York S corporation return. Corporation A based its estimated tax payments for this fiscal year on its New York C corporation status for the prior fiscal year. Corporation A's return is due by 8/15/08. Although Tax Law section 660(i) allows Corporation A until 1/15/09 to correct its estimated payments without incurring estimated tax penalties, the corporation must pay the total tax due as shown on its Form CT-3-S, New York S Corporation Franchise Tax Return, by the filing due date of 8/15/08 in order to avoid incurring a late payment penalty. If Corporation A is

*requesting an extension of time to file, it must make any required payment with its extension request. If Corporation A overpaid its franchise tax for this fiscal year, it may claim a refund when it files its franchise tax return.*

*For fiscal year 6/1/08 – 5/31/09, Corporation A derives **50% or less** of its federal gross income from investments. Accordingly, Corporation A is not deemed to be a New York S corporation for this fiscal year and must file as a New York C corporation. Corporation A based its estimated tax payments for this fiscal year on its New York S corporation status for the prior fiscal year. Corporation A's return is due by 8/17/09. Although Corporation A has until 1/15/10 to correct its estimated payments without incurring estimated tax penalties, the corporation must pay the total tax due shown on its Form CT-3, General Business Corporation Franchise Tax Return, by the filing due date of 8/17/09 to avoid incurring a late payment penalty. If Corporation A is requesting an extension of time to file, it must make any required payment with its extension request. If Corporation A overpaid its franchise tax for this fiscal year, it may claim a refund when it files its franchise tax return.*

*Shareholder X files her personal income tax return using the calendar year. Since Corporation A is deemed to have made the New York S election for fiscal year 6/1/07 – 5/31/08, Shareholder X will report the income passed through from Corporation A for that year on her 2008 calendar year federal and New York State income tax returns. However, she based her 2008 estimated tax payments on Corporation A's New York C status for the prior tax year. Under Tax Law section 660(i), Shareholder X has until 1/15/09 to correct her 2008 estimated tax payments without incurring estimated tax penalties. If Shareholder X has overpaid her tax for 2008, she may claim a refund when she files her personal income tax return.*

*For calendar tax year 2009, Shareholder X based her estimated tax payments on Corporation A's New York S status for its prior tax year. Since Corporation A will be treated as a New York C corporation for its fiscal year 6/1/08 – 5/31/09, Shareholder X will report the income passed through from Corporation A on her 2009 calendar year federal and New York State income tax returns, but will make the necessary New York modifications to remove that income from her New York adjusted gross income. Under Tax Law section 660(i), Shareholder X has until 1/15/10 to correct her estimated tax without incurring estimated tax penalties. If Shareholder X has overpaid her income tax for 2009, she may claim a refund when she files her 2009 personal income tax return.*

This provision applies to tax years beginning on or after January 1, 2007.

(Tax Law section 660(i))

### **Low-income housing credit**

The New York State low-income housing tax credit program was established in 2000 to promote the construction and rehabilitation of low-income housing in New York State. The credit is similar to the federal low-income housing credit and is administered by the New York State Division of Housing and Community Renewal.

The Public Housing Law has been amended to increase the statewide aggregate dollar amount of low-income housing tax credits that may be used for qualifying low-income housing projects from \$12 million to \$16 million.

This provision took effect April 9, 2007.

(Public Housing Law section 22(4) and Tax Law sections 18 and 606(x))

### **Middle Class STAR rebate program**

Section 1306-b of the Real Property Tax Law has been amended to authorize the Middle Class STAR rebate program. This program replaces the 2006 STAR rebate program and personal income tax credit (Real Property Tax Law section 1306-B and Tax Law section 606(n-1)) that were enacted into law in 2006.

Real property owners who received basic STAR exemptions from their school tax bills and whose affiliated income is \$250,000 or less are eligible to receive rebate checks beginning with the 2007-2008 school year. The amount of the rebate will be based on the property owners' affiliated income and the location of the property. Enhanced STAR exemption recipients will receive a rebate check regardless of their income.

*Affiliated income* means the combined federal adjusted gross income, less any individual retirement arrangement distributions, of all owners who primarily reside on the property, including the income of the owner's spouse if they file a joint New York State income tax return and the income of any non-owner spouse that resides primarily on the property if the spouse files a separate New York State income tax return. For the 2007-2008 school year, affiliated income shall be based upon the parties' incomes for the income tax year ending in 2005. In each subsequent year, the applicable income tax year will be advanced by one year.

Property owners who receive a basic STAR exemption on their 2007-2008 school tax bills and whose affiliated income is \$250,000 or less will be required to submit an application to the Tax Department to obtain the rebate for real property taxes for the 2007-2008 school year. The application must be filed with the Tax Department no later than December 31, 2007<sup>1</sup>. Persons aged 65 and older who are property owners and who receive an enhanced STAR exemption on their 2007-2008 school tax bill are not required to file an application and will receive a rebate check automatically. The Tax Department will notify property owners of the new program and provide application instructions by mail for those required to apply.

Applications received after December 31, 2007, by an otherwise eligible property owner will not qualify for a rebate for the 2007-2008 school year. However the application will be considered timely filed for a rebate for subsequent school years provided the ownership of the property remains unchanged.

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<sup>1</sup> The original application filing deadline of November 30, 2007 was extended by Chapter 687 of the Laws of 2007 to December 31, 2007.

For years after 2007, applications for the rebate will be required only when a new application for a basic STAR exemption for real property taxes is filed under section 425 of the Real Property Tax Law or when there is a change of ownership that does not require the filing of a new application for a basic STAR exemption.

For additional information, including information about the application process and rebate amounts, visit the Tax Department Web site ([www.nystax.gov](http://www.nystax.gov)). For information about the basic or enhanced STAR exemption (New York State school tax relief (STAR) program), contact your local tax assessor or visit the New York State Office of Real Property Services' (ORPS) Web site ([www.orps.state.ny.us](http://www.orps.state.ny.us)).

(Real Property Tax Law section 1306-b and Tax Law sections 178)

### **New York City school tax credit**

Section 1310(e) of the Tax Law and sections 11-1706(c)(2) and 11-1706(c)(3) of the Administrative Code of the City of New York, relating to the New York City school tax credit, have been amended to increase the amount of credit allowed for taxpayers with incomes of \$250,000 or less. The increased credit amounts apply for tax years beginning in 2007 and after.

- For married taxpayers filing joint returns and surviving spouses with incomes of \$250,000 or less, the amount of the New York City school tax credit is as follows:

For tax years beginning in:	The credit is:
2007	\$290
2008	\$310
2009 and after	\$335

- For unmarried individuals, heads of household, or married taxpayers filing separate returns with income of \$250,000 or less, the amount of the New York City school tax credit is as follows:

For tax years beginning in:	The credit is:
2007	\$145
2008	\$155
2009 and after	\$167.50

For taxpayers with incomes of more than \$250,000, the credit amounts have not changed. The credit amounts for these taxpayers are:

- \$230 for married taxpayers filing joint returns and surviving spouses and

- \$115 for unmarried taxpayers, heads of household, or married taxpayers filing separate returns.

For each tax year beginning on or after January 1, 2010, the *more than \$250,000* income limitation will be adjusted for inflation.

For purposes of this credit, *income* means the taxpayer's federal adjusted gross income for the tax year reduced by the taxable amount of distributions from individual retirement accounts or individual retirement annuities.

These provisions apply to tax years beginning on or after January 1, 2007.

(Tax Law section 1310(e) and sections 11-1706(c)(2) and 11-1706(c)(3) of the Administrative Code of the City of New York)

### **Collection of past due child support**

Part C of Chapter 60 of the Laws of 2007 makes permanent the Tax Department's authority to collect child support and combined child and spousal support arrears through a continuing partnership between the Office of Temporary and Disability Assistance (OTDA) and the Department of Taxation and Finance. The authority was set to expire on June 30, 2007.

(Tax Law section 171-i)