Summary of Certain Personal Income Tax Legislative Changes Enacted in 2005

This memorandum contains brief summaries of the personal income tax changes that are part of the 2005-2006 New York State budget bills (Chapters 58, 61, 63 and 161 of the Laws of 2005).

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 $6 million to $8 million per year.

This provision takes effect immediately.

(Public Housing Law, section 22)

Green buildings credit

The green buildings tax credit provides incentives for the construction, rehabilitation and maintenance of buildings with high environmental standards and energy efficiency through the use of environmentally preferable building materials and energy technologies that are renewable and clean.

Section 19 of the Tax Law, providing for the green buildings tax credit, has been amended to extend the program and to provide an additional $25 million in credits over the life of the extended period. During this extended period (second time period) initial credit component certificates may be issued by the Department of Environmental Conservation for the years 2005 through 2009. If the certificates issued during the second period (2005-2009) do not total $25 million, then the second period will be extended through 2010. Taxpayers may claim the credit for the second time period for taxable years 2006 through 2014. The total amount of credit allocated with respect to a particular certificate may not exceed $2 million. However, a taxpayer who is the owner or tenant of more than one building may obtain a certificate for each building with the aggregate amount of credit allocated for each certificate being $2 million.

Under the original enactment of the Green Buildings Tax Credit program the eligible period during which initial credit component certificates could have been issued was during the years 2001 through 2004, with taxpayers being allowed to claim the credit for five taxable years during the period 2001 through 2009. The first step in obtaining eligibility for the green buildings tax credit is for the taxpayer to apply to the Department of Environmental Conservation for the initial credit component certificate. The certificate provides for a period of five taxable years during which the credit may be claimed and sets forth the amount of credit that may be claimed for each taxable year in the five year period.

The amendment provides that if taxpayers issued credit component certificates during either the first period (2001-2004) or the second period (2005-2009) are unable to claim any amount of credit as set forth on the certificate, the amount of that unclaimed credit may be allocated to another taxpayer that has already been issued a credit component certificate or the unclaimed credit may be allocated to a new applicant for a credit component certificate.

Taxpayers who were issued an initial credit component certificate for the eligible period prior to the amendment (2001-2004) may not be issued an initial credit component certificate with respect to the same building for the second eligible period (2005-2009).

The provision takes effect immediately and applies as described above.

(Tax Law, section 19)

Special additional mortgage recording tax credit

Section 606(f) of the Tax Law has been amended to provide for a special additional mortgage recording tax credit for tax years beginning on or after January 1, 2004. The credit is equal to the amount of the special additional mortgage recording tax paid by the taxpayer for mortgages recorded on or after January 1, 2004, on real property located in New York State. Partners in a partnership (including members of an LLC that is treated as a partnership for federal income tax purposes), estates and trusts, and beneficiaries of estates and trusts may also qualify for this credit if the partnership, estate or trust, in its tax year beginning on or after January 1, 2004, paid the tax to record a mortgage on or after January 1, 2004. This new credit does not apply to shareholders of New York S corporations. A New York S corporation will continue to claim a credit for this tax directly on its New York State S corporation return using Form CT-43, *Claim for Special Additional Mortgage Recording Tax Credit*.

This credit may be claimed by the lender or borrower, as the case may be, that paid the special additional mortgage recording tax. Except for loans made by a federal credit union and some loans made by a federal savings bank or by an exempt organization, in the case of a residential mortgage, the special additional mortgage recording tax is paid by the lender. In most other cases, the special additional mortgage recording tax is paid by the borrower. A taxpayer should contact the lending institution or a tax advisor to determine the amount, if any, of special additional mortgage recording tax paid.

The credit is not allowed for the special additional mortgage recording tax paid on residential mortgages if the real property is located in Erie County or any of the counties within the Metropolitan Commuter Transportation District. A *residential mortgage*, for purposes of this credit means a mortgage on real property which is principally improved by one or more structures containing a total of not more than six residential dwelling units, each with its own separate cooking facilities.

If the amount of the credit exceeds a taxpayer's tax for the year, a taxpayer may elect to treat the excess as an overpayment of tax to be credited or refunded (without interest) or carried over to future tax years.

If a taxpayer qualifies to claim this credit for tax year 2004 and has already filed his or her 2004 tax return without claiming the credit, an amended return must be filed to claim the credit. See Notice N-05-13, *Recent Legislation Provides Personal Income Tax Taxpayers a Special Additional Mortgage Recording Tax Credit Retroactive to 2004*, for information on how to file an amended return to claim the credit for the 2004 tax year.

(Tax Law, section 606(f))

Limited liability company (LLC), limited liability partnership (LLP), and single-member LLC disregarded entity filing fees extended for tax years 2005 and 2006

The increased filing fees for LLCs and LLPs that were enacted in 2003 have been extended for tax years beginning in 2005 and 2006.

Accordingly, the filing fee for LLCs and LLPs that are treated as partnerships for federal income tax purposes and that have income, gain, loss or deductions derived from New York sources remains at $100 multiplied by the total number of members in the LLC or number of partners in the LLP. Also, the minimum and maximum filing fee amounts remain at $500 and $25,000 respectively. In addition, the new law imposes the partnership filing fee on an LLC with more than one member that is a disregarded entity for federal income tax purposes (e.g., an LLC owned solely by a husband and wife who are residents of a community property state that can elect disregarded status for federal purposes under Revenue Procedure 2002-69).

Also extended for tax years beginning in 2005 and 2006 is the $100 filing fee payable by a single-member LLC (SMLLC) that is a disregarded entity for federal income tax purposes and that has income, gain, loss, or deductions derived from New York sources. The return and payment are due within 30 days of the last day of the tax year.

(Tax law, section 658(c)(3))

Tax Shelters

The Tax Law has been amended to provide new reporting requirements with respect to the disclosure of information relating to transactions that present the potential for tax avoidance (a tax shelter). These new reporting requirements are similar to the tax shelter disclosure requirements for federal income tax purposes. Separate reporting requirements are imposed on those who utilize tax shelters and those who promote the use of tax shelters. The amendments also impose penalties for nondisclosure and the underpayment of taxes due to participation in these transactions, extend the statute of limitations for assessments relating to these transactions, and create a voluntary compliance initiative to allow taxpayers to report and pay underreported tax liabilities and interest attributable to these transactions with a waiver of penalties. For more information, see TSB-M-05(4)I, *Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*, TSB-M-05(4.1)I, *Supplement to the Disclosure of Certain Transactions and Related Information Regarding Tax Shelters*, and Publication 671, *New York State Tax Shelter Voluntary Compliance Initiative*.

(Tax Law, sections 25, 683(c) and 685)

New York State offsets

A new section 171-m has been added to the Tax Law to authorize the Commissioner of Taxation and Finance and the Commissioner of Finance of the city of New York to agree to offset certain New York City tax overpayments against New York State debts arising from a warrant filed with the county clerk against an individual, corporation, association, company, partnership, estate, trust, liquidator, fiduciary, or other entity identified in a tax warrant as the judgment debtor for an unpaid tax or other imposition.

A new section 171-n has been added to the Tax Law to authorize the Commissioner of Taxation and Finance to agree with tax administrators of other states to offset a New York State tax overpayment against outstanding tax debts owed by a taxpayer to other claimant states, provided the claimant state grants substantially similar privileges to New York State. *Taxpayer* means an individual, corporation, partnership, member, manager, estate, trust, fiduciary or other entity, who or which has made an overpayment of any tax administered by the Commissioner.

The outstanding tax debts owed to other claimant states must arise from:

a. an enforceable judgment by a court no longer subject to judicial review,
b. an enforceable determination by an administrative body no longer subject to administrative or judicial review, or
c. an assessment or determination which is final and irrevocably fixed and no longer subject to administrative or judicial review and which has not been delinquent for more than ten years.

These provisions take effect immediately.

(Tax Law, sections 171-m and 171-n)

Long-term care insurance credit

The long-term care insurance credit computation has been amended for nonresident and part-year resident taxpayers for tax years beginning on or after January 1, 2005. The credit is now limited to the extent of the taxpayer's adjusted gross income derived from New York sources. A nonresident's and part-year resident's credit is calculated by multiplying the long-term care insurance credit by the taxpayer's New York source fraction determined under section 601(e) of the Tax Law. The New York source fraction is the taxpayer's New York source income divided by the taxpayer's New York adjusted gross income from all sources. *The New York source income* of a nonresident individual is the sum of the items of income, gain, loss, and deduction entering into federal adjusted gross income derived from or connected with New York sources and any New York addition and subtraction modifications under section 612(b) and 612(c) of the Tax Law that relate to adjusted gross income derived from New York sources. The New York source income of a part-year resident is the sum of (1) the individual's New York adjusted gross income from all sources during the resident period, determined as if the individual's tax year for federal income tax purposes were limited to the resident period, (2) the individual's New York adjusted gross income derived from New York sources for the nonresident period, determined as if the individual's tax year for federal income tax purposes were limited to the nonresident period, and (3) the special accruals required under section 639 of the Tax Law that relate to adjusted gross income.

Previously, nonresidents and part-year residents were allowed a credit of 20% of the premiums paid for long-term care insurance, similar to residents of New York State.

(Tax Law, section 606(aa))

Tax return preparer electronic filing requirements

Section 658(g) of the Tax Law and section 11-1758(g) of the Administrative Code of the city of New York, regarding requirements applicable to tax return preparers, have been amended to add an electronic filing requirement for certain preparers. The following definitions apply to this new legislation. An *authorized return* means any return required under Article 22 of the Tax Law that the Commissioner of Taxation and Finance has authorized to be filed electronically. An *original return* is a tax return required under Article 22 of the Tax Law that is filed, without regard to extensions, during the calendar year for which that return is required to be filed.

Tax return preparers who prepare more than 200 original income tax returns in calendar year 2005 and prepare one or more authorized returns using tax software in calendar year 2006 must file all authorized returns electronically in 2006, as well as in each subsequent calendar year. Tax return preparers who prepare more than 100 original returns in any calendar year beginning on or after January 1, 2006, and prepare one or more authorized returns using tax software in any succeeding calendar year, must file all authorized returns electronically for the succeeding calendar year and each subsequent calendar year.

In addition, section 685(u) of the Tax Law and section 11-1758(t) of the Administrative Code of the city of New York, have been amended to add a penalty for a tax return preparer's failure to electronically file returns when required. The penalty is equal to $50 multiplied by the number of returns not filed electronically as required under section 658(g) and section 11-1758(g) unless the failure is due to reasonable cause and not due to willful neglect.

Reasonable cause includes, but is not limited to, a taxpayer's election not to file his or her return electronically.

These provisions take effect April 1, 2005, and apply as described above. For more information on the e-file mandate, see the Practitioner Page on the Department's website at *www.nystax.gov*.

(Tax Law, section 658(g) and 685(u); Administrative Code of the City of New York, sections 11-1758(g) and 11-1758(t))

Qualified emerging technology company facilities, operations, and training credit

Effective for tax years beginning on or after January 1, 2005, a new tax credit is allowed for an eligible taxpayer that is a qualified emerging technology company (QETC) pursuant to section 3102-e of the Public Authorities Law. The credit applies to taxpayers subject to Article 22 taxes. To be eligible for this credit taxpayers must have:

- 100 or fewer full-time employees, 75% or more of whom must be employed in New York State,
- a research and development funds to net sales ratio of at least 6% during the tax year, and
- gross revenues (including gross revenues of affiliates and related members) of no more than $20 million for the taxable year immediately preceding the year the taxpayer is allowed the credit.

The amount of the credit is equal to the sum (or pro rata share of the sum in the case of a partner in a partnership) of:

(1) 18% of the cost or other basis for federal income tax purposes of research and development property as defined in Tax Law section 606(a)(2)(B) that is acquired by the taxpayer by purchase as defined by Internal Revenue Code section 179(d) and placed in service during the tax year. In addition, an eligible taxpayer will be allowed a credit for 18% of the:

(A) cost or other basis for federal income purposes for property used in the testing or inspection of materials and products,
(B) costs or expenses associated with quality control of the research and development,
(C) fees for the use of sophisticated technology facilities and processes, and
(D) fees for production or eventual commercial distribution of materials and products resulting from the activities of an eligible taxpayer as long as the activities fall under the activities listed in section 3102-e(1)(b) of the Public Authorities Law.

The costs, expenses and fees included under (1), for which this credit is claimed, cannot be used in the calculation of any other credit allowed under Article 22 of the Tax Law.

(2) 9% of qualified research expenses paid or incurred by the taxpayer during the tax year.

(3) qualified high-technology training expenditures paid or incurred by the taxpayer, limited to $4,000 per employee, per year.

The credit may be claimed for four consecutive tax years by an eligible taxpayer. However, if the taxpayer is located in an academic incubator facility and relocates to a nonacademic incubator facility within New York State, the taxpayer may elect to defer the credit to the first taxable year beginning after the relocation. If the election is made, the taxpayer may claim the credit for five consecutive tax years. The amount of the credit may not exceed $250,000 per year. If the amount of the credit exceeds a taxpayer's tax for the year, a personal income tax taxpayer may elect to treat the excess as an overpayment of tax to be credited or refunded (without interest).

(Tax Law sections, 606(nn) and 606(i))

Qualified emerging technology company (QETC) employment credit

Section 606(q) of the Tax Law, relating to the qualified emerging technology company employment credit, has been amended. For tax years beginning on or after January 1, 2005, if the amount of the credit exceeds the taxpayer's tax for the year, the excess will be treated as an overpayment of tax to be credited or refunded (without interest). Prior to the amendment, the credit could have been carried over to future years. However, if the taxpayer qualified as the owner of a new business, any amount of the credit that exceeded the taxpayer's tax for the year could be treated as an overpayment of tax to be credited or refunded (without interest).

This provision takes effect immediately and applies as described above.

(Tax Law, section 606(q))

Qualified Empire Zone Enterprise (QEZE) tax credits

The following is a summary of the changes to the Empire Zones Program resulting from Chapters 63 and 161 of the Laws of 2005:

- The effective date for the Empire Zone (EZ) designations has been extended through June 30, 2011.
- Each EZ will be designated as either an *investment zone(IZ)*, or a *development zone(DZ)*.

- Effective for taxable years beginning on or after January 1, 2005, a business enterprise first certified prior to August 1, 2002, who has a base period of zero years or whose employment number is zero in the base period will be subject to a new business test.
- Effective for taxable years beginning on or after January 1, 2002, the term *related person* includes an entity which would have qualified as a related person to the QEZE if it had not been dissolved, liquidated, merged with another entity or otherwise ceased to exist or operate.
- Effective for taxable years beginning on or after January 1, 2005, the QEZE employment number can include employees from a related person only if they were not employed within New York State in the immediately preceding 60 months.
- Effective for taxable years beginning on or after January 1, 2005, a business enterprise identical in ownership and operation to an existing taxpayer can qualify as a new business in another county within New York State (the new business must use the remaining business tax benefit period of the existing taxpayer).
- Eligible real property taxes will include property taxes paid by a lessee for taxable years beginning on or after January 1, 2005, under certain circumstances.
- Effective for taxable years beginning on or after January 1, 2005, PILOTs (payments in lieu of taxes) do not constitute eligible real property taxes to the extent the payment exceeds a limitation calculation.

In addition to the above changes, there are amendments for taxable years beginning on or after January 1, 2005, affecting business enterprises first certified on or after April 1, 2005:

- For purposes of the QEZE employment test, taxpayers will include their employees within the EZs in their statewide employment number.
- In order to meet the employment test, the employment number in the current tax year must exceed the employment number in the base period for both the EZs and the state (including the EZs).
- If a business enterprise has zero base period employment or a base period of zero years, it must qualify as a new business in order to meet the employment test.
- The base period is shortened from five years to four years.
- The benefit period is shortened from fifteen years to ten years.
- The real property tax credit calculation has been amended.
- The real property tax credit is limited to the greater of the credit amount or the capital investment amount; however, the credit cannot exceed the eligible real property taxes paid.

(Tax Law, sections 14, 15, 16, 606(bb) and 606(cc))

Empire Zone wage tax credit

The Tax Law has been amended for tax years beginning on or after January 1, 2005, to change the definition of *targeted employee* to conform to the federal Workforce Investment Act of 1998 (P.L. 105-220) and to add to the definition of a targeted employee an honorably discharged member of any branch of the armed forces of the United States. In addition, for a taxpayer certified in an investment zone, the dollar amount of the credit per employee is increased by $500 for each qualifying employee who received wages in excess of $40,000.

For taxable years beginning on or after January 1, 2002, the definition of a *related person* has been expanded under this section to include an entity which would have qualified as a related person if it had not been dissolved, liquidated, merged with another entity, or otherwise ceased to exist or operate.

(Tax Law, section 606(k))

Empire Zone capital tax credit

The Tax Law has been amended for tax years beginning on or after January 1, 2005, to limit the Empire Zone capital tax credit to investments in certified empire zone businesses and contributions to community development projects. The credit for investments in and contributions to zone capital corporations is eliminated for tax years 2005 and after.

(Tax Law, section 606(l))

Elderly Pharmaceutical Insurance Coverage (EPIC)

Section 171-a (5) of the Tax Law has been amended to allow the Commissioner to enter into a cooperative agreement with the Department of Health to provide for the utilization of information obtained through the statewide wage reporting system for the purpose of verifying eligibility for the program for elderly pharmaceutical insurance coverage (EPIC) under Title 3 of Article 2 of the Elder Law.

This provision takes effect January 1, 2006.

(Tax Law, section 171-a and 697(e))

Nursing home assessment credit

For tax years beginning on or after January 1, 2005, a new credit against tax is allowed for the amount paid by a resident of a health care facility for the assessment imposed on the facility pursuant to section 2807-d(2)(b) of the Public Health Law. The amount must be separately stated on the billing statement of the resident and paid directly by the individual taxpayer. If the amount of the credit exceeds the taxpayer's tax for the year, the excess will be treated as an overpayment of tax to be credited or refunded (without interest).

(Tax law, section 606(hh))

Paid preparer penalties

The penalty under section 685(r) of the Tax Law for aiding or assisting in the giving of fraudulent returns, reports, statements or other documents has been increased to an amount not exceeding $5,000. Previously the penalty was an amount not exceeding $1,000.

Section 685(aa) has been added to the Tax Law and provides for a tax preparer penalty in certain instances when there is an understatement of liability due to a position taken by the preparer.

A penalty of up to $1,000 will be imposed upon the tax return preparer if:

1. any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there is not or was not a reasonable belief that the tax treatment in that position was more likely than not the proper treatment,

2. the preparer with respect to the return or claim knew or reasonably should have known of such position, and

3. the position taken was not disclosed as provided in section 685(p) of the Tax Law, or there was no reasonable basis for the tax treatment of that position.

The penalty of up to $1,000 will not be imposed if it is shown that there is reasonable cause for the understatement and the preparer acted in good faith.

A penalty of up to $5,000 will be imposed upon the tax return preparer if any understatement of liability with respect to any return or claim for refund is due to a willful attempt to understate the liability for tax or any reckless or intentional disregard of rules or regulations by the preparer.

An *understatement of liability* means any understatement of the net amount payable with respect to any tax imposed under Article 22 or any overstatement of the net amount of credit or refund with respect to any such tax. The tax preparer penalty imposed under section 685(aa) of the Tax Law will not apply if the penalty under section 685(r) of the Tax Law is imposed on the tax return preparer with respect to such understatement.

These provisions take effect immediately. However, the provisions will expire and be deemed repealed July 1, 2007.

(Tax Law, sections 685(r) and 685(aa))