STATE OF NEW YORK

DEPARTMENT OF TAXATION AND FINANCE

COMMISSIONER OF TAXATION AND FINANCE

ALBANY, NEW YORK

Pursuant to the authority contained in subdivision First of section 171 and subsection (a) of section 1096 of the Tax Law, the Commissioner of Taxation and Finance hereby makes and adopts the following amendments to the Business Corporation Franchise Tax regulations, as published in Subchapter A of Chapter I of Title 20 of the Official Compilation of Codes, Rules and Regulations of the State of New York, such amendments to read as follows:

Section 1. Section 1-2.6 of such regulations is amended to read as follows:

§1-2.6 Definition of partnership.

The term "partnership" shall have the same meaning as set forth in section 761(a) of the Internal Revenue Code and 26 CFR §1.761-1(a) whether or not the election provided for therein has been made. Also, the term "partnership" does not include a corporation within the meaning of section 1-2.5(b) of this Subpart.

Section 2. Subdivision (c) of section 3-1.2 of such regulations is amended to read as follows:

(c) For special rules concerning domestic international sales corporations, real estate investment trusts, regulated investment companies and [foreign] corporate [limited] partners, see Subparts 3-9, 3-11, 3-12 and 3-13 of this Part, respectively.

Section 3. Section 3-2.1 of such regulations is amended by adding a new subdivision (d) to read as follows:

(d) For rules relating to corporate partners, see Subpart 3-13 of this Part - Corporate Partners.

Section 4. Section 3-3.1 of such regulations is amended by adding a new subdivision (f) to read as follows:

(f) For rules relating to corporate partners, see Subpart 3-13 of this Part - Corporate Partners.

Section 5. Paragraph (1) of subdivision (a) of section 3-3.2 is amended to read as follows:

(a)(1) The term “investment capital” means the taxpayer's investments in stocks, bonds and other securities issued by a corporation (except as provided in paragraph (2) of this subdivision) or by the United States, any state, territory or possession of the United States, the District of Columbia, or any foreign country, or any political subdivision or governmental instrumentality of any of the foregoing (see subdivisions (c) - (g) of this section). [The term “investment capital” includes stock of target corporations described in section 3-6.3(e) and (f) of this Part.] At the election of the taxpayer, cash on hand and cash on deposit may be treated on any report as either investment capital or business capital (see section 3-3.3 of this Subpart). In making the election, a taxpayer that is a partner in a partnership and is using the aggregate method pursuant to section 3-13.3 of this Part or that is a foreign corporate limited partner that has made an election with respect to such partnership pursuant to the provisions of section 3-13.5 of this Part takes into account its proportionate part (see section

3-13.3(a)(2) of this Part) of partnership items which constitute cash on hand and cash on deposit. Any debt instrument, including a certificate of deposit, which is described in paragraph (2) or (3) of subdivision (c) of this section and is not described in paragraph (2) of this subdivision and which is payable by its terms on demand or within six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit. Any such debt instrument which is payable by its terms more than six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit on any day which is not more than six months and one day prior to its date of maturity. Cash also includes shares in a money market

mutual fund. A money market mutual fund is a no-load, open-end investment company registered under the Federal Investment Company Act of 1940 which attempts to maintain constant net asset value per share and holds itself out to be a "money market" fund. A taxpayer may not elect to treat part of its cash as investment capital and part as business capital. No election to treat cash as investment capital may be made where the taxpayer has no other investment capital.

Section 6. Subparagraph (vii) of paragraph (2) of subdivision(a) of section 3-3.2 is amended to read as follows:

(vii) stocks, bonds and other securities held by the taxpayer for sale to customers in the regular course of its business and, in the case of a taxpayer that is a partner in a partnership using the aggregate method pursuant to section 3-13.3 of this Part or that is a foreign corporate limited partner that has made an election with respect to such partnership pursuant to the provisions of section 3-13.5 of this Part, its proportionate part (see section 3-13.3(a)(2) of this Part) of such items which are held by such partnership for sale to customers in the regular course of the partnership's business.

Section 7. Subparagraph (ii) of paragraph (2) of subdivision (d) of section 3-3.2 is amended to read as follows:

(ii) Principally engaged in the business of lending funds. A taxpayer is "principally engaged in the business of lending funds", for purposes of this subdivision, if during the taxable year more than 50 percent of its gross receipts consist of interest from loans [or] made by the taxpayer and net gain from the sale or redemption of notes or other evidences of indebtedness arising from such loans [made by the taxpayer]. A taxpayer that is a partner in a partnership and is using the aggregate method pursuant to section 3-13.3 of this Part determines whether more than 50 percent of its gross receipts consist of interest from loans made by the taxpayer and net gain from the sale or redemption of notes or other evidences of indebtedness arising from such

loans by dividing (A) the sum of the taxpayer's own gross receipts consisting of interest from such loans and such net gain plus its distributive share of the partnership's gross receipts consisting of interest from loans made by the partnership and such net gain arising from loans made by the partnership by (B) the sum of the taxpayer's own gross receipts and its distributive share of the partnership's gross receipts. A taxpayer that is a partner in a partnership for which an election has been made with respect to such partnership pursuant to the provisions of section 3-13.5 of this Part makes such determination by dividing (A) its distributive share of the partnership's gross receipts consisting of interest from loans made by the partnership and such net gain arising from loans made by the partnership by (B) its distributive share of the partnership's gross receipts. For purposes of [the preceding sentence] this subparagraph, receipts do not include return of principal or nonrecurring, extraordinary items.

Section 8. Subdivision (d) of section 3-3.3 is amended to read as follows:

(d) At the election of the taxpayer, cash on hand and cash on deposit may be treated on any report as either business capital or investment capital. In making the election, a taxpayer that is a partner in a partnership and is using the aggregate method pursuant to section 3-13.3 of this Part or that is a foreign corporate limited partner that has made an election with respect to such partnership pursuant to the provisions of section 3-13.5 of this Part takes into account its proportionate part (see section 3-13.3(a)(2) of this Part) of partnership items that constitute cash on hand and cash on deposit. Any debt instrument, including a certificate of deposit, which is described in paragraph (2) or (3) of subdivision (c) of section 3-3.2 of this Subpart and is not described in paragraph (2) of subdivision (a) of such section, and which is payable by its terms on demand or within six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit. Any such debt instrument which is payable by its terms more than six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit on any day which is not more than six

months and one day prior to its date of maturity. Cash also includes shares in a money market mutual fund. A money market mutual fund is a no-load, open-end investment company registered under the Federal Investment Company Act of 1940 which attempts to maintain a constant net asset value per share and holds itself out to be a "money market" fund. A taxpayer may not elect to treat part of its cash as business capital and part as investment capital. No election to treat cash as business capital may be made where the taxpayer has no other business capital.

Section 9. Section 3-4.1 of such regulations is amended by adding a new subdivision (e) to read as follows:

(e) For rules relating to corporate partners, see Subpart 3-13 of this Part - Corporate Partners.

Section 10. Section 3-5.1 of such regulations is amended by amending paragraph (1) of subdivision (b) and adding a new subdivision (e) to read as follows:

(1) “Gross Payroll” is the same as the total wages, salaries and other personal service compensation paid to all of the taxpayer’s employees, within and without New York State, as defined in Subpart 4-5 of this Title, except that wages, salaries and other personal service compensation paid to general executive officers and, in the case of a taxpayer that is a partner in a partnership and is using the aggregate method pursuant to sections 3-13.3 of this Part or that is a foreign corporate limited partner that has made an election with respect to such partnership pursuant to the provisions of section 3-13.5 of this Part, wages, salaries and other personal service compensation paid to employees of the partnership having partnership-wide authority or having responsibility for an entire division of a partnership must be included.

(e) For rules relating to corporate partners, see Subpart 3-13 of this Part - Corporate Partners.

Section 11. The opening text of subdivision (b) of section 3-6.2 of such regulations is amended and a new example 3 is added to read as follows:

(b) The test of ownership is actual beneficial ownership, rather than mere record title as shown by the stock books of the issuing corporation. Actual beneficial ownership of stock does not mean indirect ownership or control of a corporation through a [corporate] structure consisting of several tiers and/or chains of corporations and/or partnerships. A corporation will not be considered to be a subsidiary merely because more than 50 percent of the shares of its voting stock is registered in the taxpayer's name, unless the taxpayer is the actual beneficial owner of such stock. However, a corporation will not be considered a subsidiary if more than 50 percent of the shares of its voting stock is not registered in the taxpayer's name, unless the taxpayer submits proof that it is the actual beneficial owner of such stock.

Example 3: Corporation C is a 60 percent partner in Partnership P. Corporation D has 100 shares of stock issued and outstanding entitling the holders thereof to vote for the election of the corporation’s directors. P owns 60 shares of D and C owns the remaining 40 shares. Corporation D is not a subsidiary of C because C does not directly own more than 50 percent of the shares of stock of D entitling the holders thereof to vote for the election of Corporation D’s directors.

Section 12. Section 3-6.3 of such regulations is amended by adding a new subdivision (e) to read as follows:

(e)(1) In the case of a taxpayer that (i) directly owns (within the meaning of section 3-6.2(b) of this Subpart) more than 50 percent of the shares of stock of a corporation entitling the holders thereof to vote for the election of the corporation’s directors or trustees, and (ii) is a partner in a partnership with respect to which the taxpayer uses the aggregate method pursuant to section 3-13.3 of this Part; subsidiary capital includes the taxpayer’s proportionate part (see section 3-13.2(a) of this Part) of any stock or indebtedness described in subdivision (a) of this section of such corporation that is owned by such partnership.

Example: Corporation C is a 90 percent partner in partnership P. Corporation D has 100 shares of stock issued and outstanding entitling the holders thereof to vote for the election of the corporation's directors. C owns 60 shares of D and P owns the remaining 40 shares. Since C directly owns more than 50 percent of the shares of D it would include 96 shares of D in its subsidiary capital; its 60 shares plus its proportionate part, 36 shares (90% X 40), of P's shares.

(2) In the case of a taxpayer that (i) does not directly own more than 50 percent of the shares of stock of a corporation entitling the holders thereof to vote for the election of the corporation's directors or trustees, and (ii) is a partner in a partnership with respect to which the taxpayer uses the aggregate method pursuant to section 3-13.3 of this Part; subsidiary capital does not include taxpayer's proportionate part (see section 3-13.2(a) of this Part) of any stock or indebtedness of such corporation owned by such partnership. Such stock or indebtedness is includible in investment capital if it meets the definition of investment capital as set forth in section 3-3.2 of this Part. Otherwise, it constitutes business capital.

Section 13. Section 3-11.1 of such regulations is amended by adding a new subdivision (e) to read as follows:

(e) For rules relating to corporate partners, see Subpart 3-13 of this Part - Corporate Partners.

Section 14. Section 3-12.1 of such regulations is amended by adding a new subdivision (e) to read as follows:

(e) For rules relating to corporate partners, see Subpart 3-13 of this Part - Corporate Partners.

Section 15. The index of Subpart 3-13 of such regulations is amended to read as follows:

SUBPART 3-13

CORPORATE PARTNERS

Sec.

Section 16. Section 3-13.1 is renumbered to be section 3-13.5, sections 3-13.2 and 3-13.3 are repealed and new sections 3-13.1, 3-13.2, 3-13.3 and 3-13.4 are added to read as follows:

3-13.1 General.

(a) Except for a foreign corporate limited partner that has made an election pursuant to section 3-13.5 of this Subpart, a taxpayer that is a partner in a partnership shall compute its tax with respect to its interest in such partnership under the aggregate method or entity method, whichever applies (see section 3-13.2 of this Subpart - Determination of applicable methodology).

(b)Under the aggregate method, a corporate partner is viewed as having an undivided interest in the partnership's assets, liabilities and items of receipts, income, gain, loss and deduction. Under the aggregate method, the partner is treated as participating in the partnership's transactions and activities.

(c) Under the entity method, a partnership is treated as a separate entity and a corporate partner is treated as owning an interest in the partnership entity. The partner's interest is an intangible asset.

3-13.2 Determination of applicable methodology.

(a) A taxpayer must use the aggregate method in determining its tax with respect to its interest in a partnership if it has access to the information necessary to compute its tax using such method. A taxpayer is presumed to have access to the information if any one of the following is met:

(1) it is conducting a unitary business with the partnership within the meaning of section 6-2.2(b) of this Title,

(2) it is a general partner of the partnership or is a managing member of a limited liability company which is treated as a partnership for Federal income tax purposes,

(3) it has a five percent or more interest in the partnership determined in the manner provided in section 1-3.2(a)(6)(iii)(a) of this Title,

(4) it has reported information from the partnership in a prior taxable year using the aggregate method,

(5) its partnership interest constitutes more than 50 percent of its total assets,

(6) its basis in its interest in the partnership pursuant to section 705 of the Internal Revenue Code and 26 CFR § 1.705-1 on the last day of the partnership year that ends within or with the taxpayer's taxable year is more than $5,000,000, or

(7) any member of its affiliated group has the information necessary to perform such computation.

(b)(1) If a taxpayer does not meet any of the presumptions set forth in subdivision (a) of this section, does not have access (and will not have access within the time period allowed for filing a return with regard to

all available extensions of time to file) to the information necessary to compute its tax using the aggregate method and certifies these facts to the Commissioner, then the taxpayer shall use the entity method.

(2) If a taxpayer meets one or more of the presumptions set forth in subdivision (a) of this section but the taxpayer establishes to the satisfaction of the Commissioner that neither it nor any member of its affiliated group has access to the information necessary to compute the taxpayer's tax using the aggregate method, then the taxpayer shall use the entity method. The taxpayer shall certify that neither it nor any member of its affiliated group has (or will have within the time period allowed for filing a return with regard to all available extensions of time to file) access to the information necessary to compute its tax using the aggregate method.

(c) If a taxpayer is a partner in a partnership ("upper tier partnership") and such partnership is a partner in another partnership ("lower tier partnership") and the taxpayer has the necessary information to use the aggregate method with respect to the items of receipts, income, gain, loss, deduction, assets and liabilities, and activities of the upper tier partnership that are not attributable to the lower tier partnership, but does not have the necessary information to use the aggregate method with respect to such items that are attributable to the lower tier partnership, then such taxpayer shall use the aggregate method with respect to the items of receipts, income, gain, loss, deduction, assets and liabilities, and activities of the upper tier partnership that are not attributable to the lower tier partnership and shall use the entity method with respect to such items that are attributable to the lower tier partnership. If there are additional tiers of partnerships, this methodology shall be employed at each tier. The taxpayer shall be presumed to have access to the necessary information with respect to a lower tier partnership and shall be subject to the provisions of paragraph (b)(2) of this section with respect to a lower tier partnership if one or more of the presumptions set forth in subdivision (a) of this section is met at each tier. If the taxpayer does not meet any of the presumptions set forth in subdivision (a) of this section and

does not have access to the necessary information with respect to a lower tier partnership the provisions of paragraph (b)(1) of this section shall apply.

(d)(1) For purposes of this section, the term "affiliated group" shall have the same meaning as such term is defined in section 1504 of the Internal Revenue Code except that the term "common parent corporation" shall be deemed to mean any person as defined in section 7701(a)(1) of the Internal Revenue Code. Such section 1504 shall be read without regard to the exclusions provided for in section 1504(b).

(2) For purposes of this section, a partnership interest constitutes more than 50 percent of a taxpayer's total assets if its interest in the partnership is more than 50 percent of the taxpayer's total assets. In determining its interest in the partnership and its total assets, the taxpayer may elect to use ending amounts, or the average of the beginning and ending amounts as reported on the taxpayer's balance sheet included in its Federal income tax return or average amounts determined on a more frequent basis as determined in a manner consistent with the taxpayer's balance sheet included in its Federal income tax return. Whichever method a taxpayer elects to use, it must use that method for all of its assets. If the taxpayer is not required to include a balance sheet in its Federal income tax return, it must use a method which it would have used if it had been required to include a balance sheet in its Federal income tax return.

3-13.3 Computation of tax under the aggregate method - source and character of partnership items.

(a)(1) Under the aggregate method, the taxpayer's distributive share (see section 704 of the Internal Revenue Code) of each partnership item of receipts, income, gain, loss, and deduction and the taxpayer's proportionate part of each partnership asset and liability and each partnership activity are included in the computation of the taxpayer's entire net income base, capital base, minimum taxable income base and the fixed dollar minimum and shall have the same source and character in the hands of the partner for article 9-A purposes as such item has in its hands for Federal income tax purposes. Where an item, amount or activity of

the partnership is not characterized for Federal income tax purposes or is not required to be taken into account for Federal income tax purposes, the source and character of each item, amount or activity of the partnership shall be determined as if such item, amount or activity realized, incurred or experienced by the partnership were realized, incurred or experienced directly by the partner.

(2) A taxpayer's proportionate part of the partnership's assets and liabilities and activities is determined in accordance with the taxpayer's capital interest in the partnership. If using a taxpayer's capital interest in a partnership to determine the taxpayer's share of partnership items constituting business capital and investment capital does not properly reflect the taxpayer's share of partnership items constituting business income and investment income, then the taxpayer's proportionate part of the partnership's assets and liabilities and activities is determined using the percentage resulting from the manner in which the partners divide the partnership's profits in a profit year and losses in a loss year.

Example: Corporations A and B are partners in partnership P. A will perform services for a 40% interest in the profits and losses of the partnership and B will contribute $1000 for a 60% interest in the profits and losses of the partnership. B's capital interest is 100% and A's capital interest is zero. P's only asset is $1000 of stock. The stock pays dividends of $30 during the taxable year. A's distributive share of the dividends is $12 and B's distributive share is $18. Based on capital interests, A's proportionate part of P's stock is zero ($1,000 x 0%) and B's proportionate part of P's stock is $1,000 ($1,000 x 100%). In this case, using capital interests does not properly reflect A's share of P's stock (which constitutes investment capital). This is because A receives 40% of P's dividends (which constitutes investment income) and using capital interests attributes none of P's stock (which constitutes investment capital) to A. Likewise, B receives 60% of P's dividends and using capital interests attributes all of P's stock to B. In this case, both A

and B must determine their proportionate part of P's assets and liabilities in accordance with their profits and loss interest (40% and 60%, respectively) in P.

(3)(i) An allocation of an item, amount or activity, even if recognized for Federal income tax purposes, will not be recognized where it has as a principal purpose the avoidance or evasion of any tax imposed on the taxpayer, or the combined group of which the taxpayer is a member, by New York State or any of its political subdivisions. Where an allocation is not recognized, the taxpayer's distributive share shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances).

(ii) The determination of whether a principal purpose of an allocation of an item, amount or activity is the avoidance or evasion of any tax imposed on the taxpayer, or the combined group of which the taxpayer is a member, by New York State or any of its political subdivisions depends on all the surrounding facts and circumstances. Among the relevant circumstances to be considered are the following:

"(a)" whether the allocation has substantial economic effect, that is, whether the allocation may actually affect the dollar amount of the partners' shares of total partnership income or loss independently of the tax consequences;

"(b)" whether the related items of partnership income, gain, loss and deduction from the same source are subject to the same allocation;

"(c)" whether the allocation was made without recognition of normal business factors and only after the amount of the allocated item could reasonably be estimated;

"(d)" the duration of the allocation; and

"(e)" the overall tax consequences of the allocation.

(b) Entire net income and minimum taxable income bases.

(1) The taxpayer's distributive share of each partnership item of income, gain, loss and deduction shall be taken into account in the computation of entire net income and minimum taxable income. These amounts shall be taken into account in determining the taxpayer's business income and investment income. (See Subpart 3-2 of this Part and sections 208.9 and 210.1(a) of the Tax Law for information relating to the tax measured by the entire net income base. See Subpart 3-4 of this Part and sections 208.8-B and 210.1(c) of the Tax Law for information relating to the tax measured by the minimum taxable income base).

(2) A taxpayer may use the reduced rate of tax for a small business taxpayer provided in section 210.1(a) of the Tax Law if the taxpayer qualifies as a small business taxpayer as defined in section 210.1(f) of the Tax Law. For purposes of the entire net income component of such section 210.1(f), it shall take into account its distributive share of the partnership items described in paragraph (1) of this subdivision that are included in determining its entire net income.

(c) Capital base.

(1) The taxpayer's proportionate part of each asset and liability of the partnership, such amounts being valued pursuant to Subpart 3-3 of this Part, shall be taken into account in the computation of the capital base. These amounts shall be taken into account when determining business and investment capital. The capital base does not include any amount with respect to the taxpayer's interest in the partnership itself. (See Subpart 3-3 of this Part and sections 210.1(b), 210(1-c) and 210.2 of the Tax Law for information relating to the tax measured by the capital base. See section 3-3.3 of this Part and section 208.7 of the Tax Law for the definition of business capital, section 3-3.2 of this Part and section 208.5 of the Tax Law for the definition of investment capital, and for special rules relating to business and investment capital, see sections 3-3.2(a)(1), 3-3.2(a)(2)(vii), 3-3.2(d)(2)(ii) and 3-3.3(d) of this Part).

(2) For purposes of the exemption from the tax measured by the capital base for a small business concern, the taxpayer must qualify as a small business concern as defined in section 210(1-c) of the Tax Law. In determining whether the taxpayer qualifies, it shall take into account its proportionate part of partnership amounts described in paragraph (d) of such subdivision.

(d) Fixed dollar minimum.

(1) A taxpayer's distributive share or proportionate part, as the case may be, of partnership amounts of the items described in section 3-5.1(b) of this Part shall be taken into account in determining the tax measured by the fixed dollar minimum. (See Subpart 3-5 of this Part and section 210.1(d) of the Tax Law for information relating to the tax measured by the fixed dollar minimum).

(e) Subsidiary capital base.

(1) A taxpayer's proportionate part of stock of a corporation owned by a partnership is not subsidiary capital unless the taxpayer directly owns more than 50 percent of the voting stock of such corporation. (See section 3-6.2 of this Part and section 208.3 of the Tax Law for the definition of the term subsidiary. See section 3-6.3 of this Part and section 208.4 of the Tax Law for the definition of subsidiary capital).

(f) For rules relating to the computation of the business and investment allocation percentages, see section 4-6.5 of this Title.

3-13.4 Computation of tax under the entity method.

(a) Under the entity method, for purposes of determining the taxes measured by the entire net income base, capital base, minimum taxable income base, and the fixed dollar minimum, a corporate partner is treated as owning an interest in the partnership entity. The partner's interest is an intangible asset which is business capital.

(b) Entire net income and minimum taxable income bases.

(1) To the extent a taxpayer's entire net income includes its distributive share of partnership items of income, gain, loss and deduction, such items shall be treated as business income. The taxpayer's distributive share of such partnership items shall be allocated as provided in section 4-6.5(b) of this Title and included in the taxpayer's allocated business income and allocated alternative business income.

(2) While a taxpayer may have the information concerning one or more of the modifications set forth in sections 3-2.3 and 3-2.4 of this Part, such as state bond interest, a taxpayer using the entity method does not have all the information necessary to properly compute its article 9-A tax using the aggregate method. Therefore, no modifications should be made with respect to any partnership items.

(c) Capital base.

The taxpayer's interest in a partnership is business capital and is allocated as provided in section 4-6.5(b) of this Title. The taxpayer's interest in the partnership is the value shown on its books and records kept in accordance with generally accepted accounting principles. If the interest is a marketable security, it is valued at fair market value. The capital base does not include any other amounts which the taxpayer may have included on its balance sheet with respect to its interest in the partnership.

(d) Fixed dollar minimum.

The taxpayer does not take into account any partnership items in determining its fixed dollar minimum.

(e) Subsidiary capital.

Since the taxpayer's interest in a partnership is treated as business capital under the entity method, it can not have subsidiary capital derived from its interest in the partnership.

Section 17. Subdivision (a) of section 3-13.5, as renumbered by section 16 of this proposal, is amended to read as follows:

(a)(1) A foreign corporation which is a limited partner in one or more limited partnerships, which is subject to tax under article 9-A of the Tax Law solely as a result of the application of section 1-3.2(a)(6) of this Title and which does not file on a combined basis for article 9-A purposes, may elect to compute its tax bases by taking into account only its distributive share [of the income, capital, gain, loss or deduction] of each partnership item of receipts, income, gain, loss and deduction (including any modifications relating thereto) and its proportionate part of each partnership asset and liability, and each partnership activity (see sections 3-13.3(a)(1), (2) and (3)), of each such limited partnership which is doing business, employing capital, owning or leasing property or maintaining an office in New York State, whether or not such share is actually distributed (see section [4-6.5[b]] 4-6.5(c) of this Title). However, such election may not be made if:

[(1)] (i) the limited partnership and corporate group are engaged in a unitary business wherever conducted (see section [6-2.2[b]] 6-2.2(b) of this Title); and

[(2)] (ii) there are substantial inter-entity transactions between the limited partnership and the corporate group.

The term “corporate group” means the corporate limited partner itself or, if it is a member of an affiliated group, the corporate limited partner and all other members of such affiliated group. The term “affiliated group” shall have the same meaning as provided in section [1-3.2(a)(6)(iii)(c)] 3-13.2(c)(1) of this [Title] Subpart.

(2) If the taxpayer meets the criteria to make the election described in paragraph (1) of this subdivision and does not have access to the information necessary to do the computation described in such paragraph the taxpayer may treat its distributive share of such partnership’s items of income, gain, loss and deduction as

business income and its interest in such partnership as business capital and allocate such business income and capital entirely to New York State. Provided however, if the taxpayer can establish to the satisfaction of the Commissioner that allocating such business income and business capital entirely to New York State does not properly reflect the activity, business income, alternative business income or business capital in New York State, the taxpayer shall use any other method which the Commissioner has determined results in a proper reflection of the taxpayer's activity, business income, alternative business income or business capital in New York State. (See sections 4-6.1 and 4-6.2 of this Subpart and section 210.8 of the Tax Law for information relating to the power of the Commissioner to adjust the business allocation and alternative business allocation percentage).

Section 18. Subdivision (d) of section 3-13.5, as renumbered by section 16 of this proposal, is amended to read as follows:

(d) Where a corporation makes such an election with respect to one or more such partnerships ("election partnerships"), but does not make such an election with respect to one or more other such partnerships ("nonelection [partnership] partnerships"), then, subdivision (a) of this section to the contrary notwithstanding, [such election shall be to compute its tax with respect to each election partnership by reducing its entire net income and capital derived from its distributive share of income, capital, gain, loss or deduction by the portion of its permissible deductions and liabilities, respectively, which is directly or indirectly attributable to such election partnership. Also, in computing its tax with respect to the nonelection partnerships, deductions and liabilities otherwise included in the computation of such tax shall be reduced by the portion of such deductions or liabilities which was so attributed to the election partnerships] the taxpayer shall compute its tax bases with respect to nonelection partnerships by reducing its deductions and liabilities by the amounts which are directly and indirectly attributable to such election partnerships.

Section 19. A new section 3-13.6 is added to read as follows:

3-13.6 Tiered partnerships.

Where a taxpayer is a partner in a partnership and is using the aggregate method pursuant to section 3-13.3 of this Subpart or is a foreign corporate limited partner that has made an election with respect to such partnership pursuant to the provisions of section 3-13.5 of this Subpart, and such partnership (hereinafter referred to as the "upper tier partnership") is a partner in another partnership (hereinafter referred to as the "lower tier partnership"), the source and character of such taxpayer's distributive share or proportionate part (see sections 3-13.3(a)(1), (2) and (3) of this Subpart), as the case may be, of each partnership item of receipts, income, gain, loss, deduction, asset, liability, and activity of the upper tier partnership which is attributable to the lower tier partnership retains the source and character determined at the level of the lower tier partnership using the provisions of section 3-13.3(a) of this Subpart. Such source and character are not changed by reason of the fact that such item flows through the upper tier partnership to such partner. Also see section 3-13.2(c) of this Subpart for information relating to tiered partnerships.

Section 20. A new section 3-13.7 is added to read as follows:

3-13.7 Treatment of gain or loss from the sale of a partnership interest.

(a) Except as provided in subdivision (b) of this section, where a taxpayer is a partner in a partnership, any gain or loss that is recognized from the sale of the taxpayer's interest in such partnership and included in entire net income is business income or loss.

(b) Where a taxpayer is a partner in a partnership for which an election has been made with respect to such partnership pursuant to the provisions of section 3-13.5 of this Subpart, the taxpayer shall not take into account any gain or loss that is recognized from the sale of its interest in such partnership.

Section 21. Section 4-1.1 of such regulations is amended by adding a new subdivision (g) to read as follows:

(g) For rules relating to corporate partners, see Subpart 3-13 of this Title - Corporate Partners, and for allocation rules relating to corporate partners, see section 4-6.5 of this Part - Rules relating to allocation by a corporate partner of a partnership or joint venture.

Section 22. Subdivision (b) of section 4-2.2 is amended to read as follows:

(b)(1) The business allocation percentage is computed by [(1)] adding the percentages allocated to New York State during the period covered by the report of the taxpayer's real and tangible personal property factor, business receipts factor, payroll factor and an additional factor equal to the business receipts factor, and [(2)] dividing the total by four. If either the property or payroll factor is missing, the three remaining factors are added and the sum is divided by three, and if the property factor and payroll factor are both missing, the receipts factor is the business allocation percentage. A factor is not missing merely because its numerator is zero, but a factor is missing if both its numerator and its denominator are zero. The business allocation percentage of a corporation principally engaged in the conduct of aviation or in the conduct of a railroad or trucking business is computed pursuant to sections 210(3)(a)(7)(A) or 210(3)(a)(8) of the Tax Law, respectively.

(2) A taxpayer is principally engaged in the conduct of aviation or in the conduct of a railroad or trucking business if, during the taxable year, more than 50 percent of its gross receipts are derived from the conduct of aviation or from the conduct of a railroad or trucking business, respectively. In the case of a taxpayer that is a partner in a partnership using the aggregate method pursuant to section 3-13.3 of this Title, the taxpayer must take into account its gross receipts during the taxable year and its distributive share of gross receipts from the partnership during the applicable partnership year. In the case of a taxpayer that is a partner in

a partnership for which an election has been made with respect to such partnership pursuant to the provisions of section

3-13.5 of this Title, the taxpayer must take into account only its distributive share of gross receipts from the partnership during the applicable partnership year.

Section 23. Paragraphs (1) and (2) of subdivision (a) of section 4-6.5 of such regulations, are amended to read as follows:

(a)(1) [Except as provided in subdivision (b) of this section, a taxpayer which is a partner of a partnership must include] In the case of a taxpayer that computes its tax with respect to its interest in a partnership using the aggregate method as described in section 3-13.3 of this Title, the taxpayer takes into account its [proportionate part] distributive share of the partnership's [property,] receipts and payroll within and without New York State and its distributive share or proportionate part, as the case may be, (see sections 3-13.3(a)(1), (2) and (3) of this Title) of the partnership's property within and without New York State in computing its business allocation percentage and alternative business allocation percentage and must include its proportionate part of the assets and liabilities of the partnership which are used in the computation of investment capital in computing its investment allocation percentage. [The term "proportionate part" as used in this section means the percentage which the partnership used to distribute to the partner its distributive share of partnership ordinary income in an income year, or partnership ordinary loss in a loss year.]

(2) [Except as provided in subdivision (b) of this section, every] A taxpayer [which] that is a partner of a partnership and is using the aggregate method pursuant to section 3-13.3 of this Title computes its business allocation percentage and alternative business allocation percentage by computing the property, receipts and payroll factors as follows:

(i) the average value of the taxpayer's real and tangible personal property, owned or rented, within New York State plus the average value of the taxpayer's distributive share or proportionate part, as the case may be, (see sections 3-13.3(a)(1), (2) and (3) of this Title) of the partnership's real and tangible personal property, owned or rented, within New York State during the applicable partnership year is divided by the average value of all of the taxpayer's real and tangible personal property, owned or rented, within and without New York State plus the average value of its distributive share or proportionate part, as the case may be, of the partnership's real and tangible personal property, owned or rented, within and without New York State during the applicable partnership year. Where a taxpayer has leased or rented real or tangible personal property to a partnership in which it is a partner, the taxpayer includes “only” the average value of such property in its property factor. The taxpayer does not include eight times its distributive share of the partnership’s rental expense because the average value of the property is included by the corporate partner as the owner of the property. Where a taxpayer has leased or rented real or tangible personal property from a partnership in which it is a partner, the taxpayer includes “both” its proportionate part of the average value of such property and eight times the amount of rental expense that is deemed to have been paid to the other partners with respect to such property. The amount of rental expense deemed paid to other partners is the taxpayer’s total rental expense paid to the partnership less the taxpayer’s distributive share of the partnership’s rental income from such property (see Subpart 4-3 of this Part - Property Factor of Business Allocation Percentage);

(ii) the taxpayer's business receipts within New York State plus the taxpayer's [proportionate part] distributive share of the partnership's business receipts within New York State during the applicable partnership year is divided by the taxpayer's total business receipts within and without New York State plus the taxpayer's [proportionate part] distributive share of the partnership's business receipts within and without New York State during the applicable partnership year. Where a taxpayer has receipts from sales to a partnership in which it is a

partner, the taxpayer must reduce its gross receipts from its sales to the partnership by its distributive share of such purchases by the partnership. Where a partnership has receipts from sales to a taxpayer that is a partner in the partnership, the taxpayer does not include its distributive share of the partnership receipts from sales to the taxpayer in its receipts factor (see Subpart 4-4 of this Part - Receipts Factor of Business Allocation Percentage); [and]

(iii) the wages, salaries and other personal service compensation of the taxpayer's employees, except general executive officers, within New York State plus the taxpayer's [proportionate part] distributive share of the wages, salaries and other personal service compensation paid by the partnership to its employees, except [partners] employees of the partnership having partnership-wide authority or having responsibility for an entire division of the partnership, within New York State during the applicable partnership year is divided by the wages, salaries and other personal service compensation of the taxpayer's employees, except general executive officers, within and without New York State plus the taxpayer's [proportionate part] distributive share of the wages, salaries and other personal service compensation paid by the partnership to its employees, except [partners] employees of the partnership having partnership-wide authority or having responsibility for an entire division of the partnership, within and without New York State during the applicable partnership year (see Subpart 4-5 of this Part-Payroll Factor of Business Allocation Percentage).

Section 24. Paragraphs (3) and (4) of subdivision (a) of section 4-6.5 are renumbered to (4) and (6), respectively, and a new paragraphs (3) and (5) are added to read as follows:

(3) The following examples illustrate the inter-entity eliminations and exclusions discussed in subparagraphs (i) and (ii) of paragraph (2) of this subdivision:

Example 1: Partnership rents a building owned by a corporate partner

Partnership P has two partners, corporation A and corporation B. A has a 20 percent interest in the partnership and B has an 80 percent interest. There are no allocations of an item, amount or activity. A owns a building (average value of $100,000) that is rented to P for $12,000 per year. A must include the average value of $100,000 for the building in its property factor. No portion of the property's rental value is included in A 's property factor.

Example 2: Corporate partner rents a building owned by the partnership

Assume the same facts as in example 1, except P owns the building and rents it to A for $12,000 per year. A must include $20,000 (20% X $100,000) its proportionate part (see section 3-13.3(a)(2) of this Title) of the average value of the building in its property factor and A must take into account $9,600 ($12,000 less 20% thereof) of rental expense into its property factor. Thus, the value of the building to be used in A 's property factor is $96,800 ($20,000 + (8 X $9,600)).

Example 3: Corporate partner sells goods to a partnership

Partnership P has two partners, corporation A and corporation B. A has a 20 percent interest in the partnership and B has an 80 percent interest. There are no allocations of an item, amount or activity. A's sales are $20,000,000 for the year, $5,000,000 of which are made to P. P makes sales of $10,000,000 during the same year, none of which are to A or other partners.

The denominator of A 's receipts factor is $21,000,000, determined as follows:

Sales by A	$20,000,000
Add: A’s distributive share	
(20%) of P’s total sales	$2,000,000

Less: A’s distributive share		
of P’s purchases from		
A (20% x $5M)	$1,000,000	
Denominator of		
A’s sales factor		$21,000,000

Example 4: Partnership sells goods to a corporate partner

Assume the same facts as in example 3.

The sales made by A, B, and P are as follows:

A		$20,000,000
B		$60,000,000
P:		
To A	$1,000,000	
To B	9,000,000	$10,000,000

The denominator of A’s receipts factor is $21,800,000, determined as follows:

Sales by A		$20,000,000
Add: A's distributive share		
(20%) of		
P's total sales	$2,000,000	
Less: A’s distributive share		
of P’s sales to A		
(20% x $1M)	(200,000)	1,800,000

Denominator of	
A's receipts factor	$21,800,000

The denominator of B's receipts factor is $60,800,000, determined as follows:

Sales by B		$60,000,000
Add: B's distributive share (80%) of P's total sales	$8,000,000	
Less: B's distributive share of P's sales to B (80% x $9M)	(7,200,000)	800,000
Denominator of B's receipts factor		$60,800,000

Example 5: Partner sells to corporate partners and unrelated parties

Assume the same facts as in example 3.

The sales made by A, B, and P are as follows:

A		$20,000,000
B		$80,000,000
P:		
To A	$3,000,000	
To B	6,000,000	
To X	1,000,000	$10,000,000

The denominator of A's receipts factor is $21,400,000, determined as follows:

Sales by A		$20,000,000

Add: A's distributive share (20%) of P's total sales	2,000,000	
Less: A's distributive share of P's sales to A (20% x $3M)	(600,000)	1,400,000
Denominator of A's receipts factor		$21,400,000

The denominator of B's receipts factor is $83,200,000, determined as follows:

Sales by B		$80,000,000
Add: B's distributive share (80%) of P's total sales	$8,000,000	
Less: B's distributive share of P's sales to B (80% x $6M)	(4,800,000)	3,200,000
Denominator of B's receipts factor		$83,200,000

(5) A taxpayer which is principally engaged in the conduct of aviation or in the conduct of a railroad or trucking business pursuant to section 4-2.2(b)(2) of this Part computes its business allocation percentage using the factors described in sections 210.3(a)(7)(A) and 210.3(a)(8) of the Tax Law,

respectively. If such a taxpayer is a partner in a partnership, it allocates its business income, business capital and alternative business income as follows:

(i) a taxpayer principally engaged in the conduct of aviation computes its business allocation percentage by including its distributive share or proportionate part, as the case may be, (see sections 3-13.3(a)(1), (2) and (3) of this Title) of partnership amounts described in section 210.3(a)(7)(A) of the Tax Law, during the applicable partnership year;

(ii) a taxpayer principally engaged in the conduct of a railroad or trucking business computes its business allocation percentage by including its proportionate part (see section 3-13.3(a)(2) of this Title) of partnership amounts described in section 210.3(a)(8) of the Tax Law, during the applicable partnership year.

Section 25. The opening text of paragraph (6) of subdivision (a) of section 4-6.5 of such regulations, as renumbered by section 24 of this proposal is amended to read as follows:

(6) Except as provided in [subdivision] subdivisions (b) and (c) of this section, every taxpayer [which] that is a partner of a partnership computes its investment allocation percentage (see section 4-7.2 of this Part - Computation of investment allocation percentage) as follows:

Section 26. Subdivisions (b), (c) and (d) of section 4-6.5 of such regulations are relettered to (c), (d) and (e), respectively, subdivision (e) is repealed and a new subdivision (b) is added to read as follows:

(b) A taxpayer that is a partner in a partnership and is using the entity method pursuant to the provisions of section 3-13.4 of this Title shall allocate its distributive share of partnership items of income, gain, loss and deduction included in its business income and alternative business income as described in paragraph (1) of subdivision (b) of section 3-13.4 of this Title and its interest in the partnership included in its business capital as described in paragraph (1) of subdivision (c) of section 3-13.4 of this Title, by:

(1) its business allocation percentage determined under section 4-2.2 of this Title, computed without regard to either its distributive share of any partnership items of income, gain, loss or deduction or its proportionate part of the partnership's assets, liabilities, and activities, or

(2) if the taxpayer can establish to the satisfaction of the Commissioner, or the Commissioner finds, that the use of the percentage provided in paragraph (1) of this subdivision does not properly reflect the activity, business income, alternative business income or business capital in New York State, the taxpayer shall use any other method which the Commissioner has determined results in a proper reflection of the taxpayer's activity, business income, alternative business income or business capital in New York State. (See sections 4-6.1 and 4-6.2 of this Subpart and section 210.8 of the Tax Law for information relating to the power of the Commissioner to adjust the business allocation and alternative business allocation percentage).

Section 27. Paragraphs (1) and (2) of subdivision (c) of section 4-6.5 of such regulations, as relettered by section 26 of this proposal, are amended to read as follows:

(c)(1) [A] Except for a taxpayer described in paragraph (2) of subdivision (a) of section 3-13.5 of this Title, a taxpayer which elects to compute its tax bases by taking into account only its distributive share [of the income, capital, gain, loss or deduction of a partnership] of each partnership item of receipts, income, gain, loss and deduction and the taxpayer's proportionate part each partnership asset and liability, and each partnership activity (see sections 3-13.3(a)(1), (2) and (3) of this Title) pursuant to the provisions of section [3-13.1] 3-13.5 of this Title shall allocate its distributive share (including any modifications thereto) of such items [of income, gain, loss or deduction of the partnership] which [is] are used in the computation of business income and investment income, and its proportionate part of such items of assets and liabilities of the partnership which are used in the computation of business capital and investment capital, of each such partnership by computing a

separate business allocation percentage, a separate alternative business allocation percentage and a separate investment allocation percentage with respect to each partnership for which it makes the election set forth in such section [3-13.1] 3-13.5 of this Title.

(2) The property, receipts and payroll factors of the business allocation percentage and alternative business allocation percentage, both referred to in paragraph (1) of this subdivision, are computed as follows:

(i) the average value of the taxpayer's distributive share or proportionate part, as the case may be, (see sections 3-13.3(a)(1), (2) and (3) of this Title) of the partnership's real and tangible personal property, owned or rented, within New York State during the applicable partnership year divided by the average value of its distributive share or proportionate part, as the case may be, of the partnership's real and tangible personal property, owned or rented, within and without New York State during such period (see Subpart 4-3 of this Part --Property Factor of Business Allocation Percentage);

(ii) the taxpayer's [proportionate part] distributive share of the partnership's business receipts within New York State during the applicable partnership year divided by the taxpayer's [proportionate part] distributive share of the partnership's business receipts within and without New York State during such period (see Subpart 4-4 of this Part - Receipts Factor of Business Allocation Percentage);

(iii) the taxpayer's [proportionate part] distributive share of the wages, salaries and other personal service compensation paid by the partnership to its employees, except [partners] employees of the partnership having partnership-wide authority or having responsibility for an entire division of the partnership, within New York State during the applicable partnership year divided by the taxpayer's [proportionate part] distributive share of the wages, salaries and other personal service compensation paid by the partnership to its employees, except [partners] employees of the partnership having partnership-wide authority or having responsibility for an

entire division of the partnership, within and without New York State during such period (see Subpart 4-5 of this Part - Payroll Factor of Business Allocation Percentage).

Section 28. Paragraph (4) of subdivision (c) of section 4-6.5 of such regulations, as relettered by section 26 of this proposal, is renumbered to (5) and a new paragraph (4) is added to read as follows:

(4) A taxpayer subject to the provisions of this subdivision which is principally engaged in the conduct of aviation or in the conduct of a railroad or trucking business pursuant to section 4-2.2(b) of this Subpart, allocates its business income, business capital and alternative business income as follows:

(i) a taxpayer principally engaged in the conduct of aviation computes its business allocation percentage by taking into account only its distributive share or proportionate part, as the case may be, (see section 3-13.3(a)(1), (2) and (3) of this Title) of partnership amounts described in section 210.3(a)(7)(A) of the Tax Law during such period;

(ii) a taxpayer principally engaged in the conduct of a railroad or a trucking business computes its business allocation percentage by taking into account only its proportionate part (see section 3-13.3(a)(2) of this Title) of partnership amounts described in section 210.3(a)(8) of the Tax Law during such period.

Section 29. These amendments shall take effect on the day a Notice of Adoption is published in the State Register and shall apply to taxable years beginning on or after January 1, 2007.

Dated: Albany, New York
October 17, 2006

Andrew S. Eristoff
Commissioner of Taxation and Finance