Combined Reporting for General Business Corporations

Effective for tax years beginning on or after January 1, 2007, the combined reporting rules for general business corporations subject to the tax imposed by Article 9-A of the Tax Law have been changed. Chapter 60 of the Laws of 2007 amended section 211 of the Tax Law. The amendment changes the circumstances under which a taxpayer corporation must file a combined report with other related corporations. While the Department is preparing regulations to further explain the amendments, this TSB-M outlines the Department's interpretation of the revised statute.

I. The Combined Reporting Rules

Tax Law section 211.4, as amended by Chapter 60, requires a taxpayer to file on a combined basis with related corporations, as defined below, where there are substantial intercorporate transactions among the related corporations. For a combined report to be required, it is necessary that there be substantial intercorporate transactions between the taxpayer and a related corporation or collectively, a group of such related corporations.

Use the following steps to determine whether a combined report is required and, if so, which corporations are in the combined group:

1. Every taxpayer must identify all of the corporations to which it is related. Where one or more of the related corporations are taxpayers, identify all of the corporations related to these taxpayers. Do this until all related corporations have been identified. If a taxpayer has no related corporations, it must file on a separate basis. This constitutes the Step 1 group of related corporations.

2. Identify all of the related corporations that have substantial intercorporate transactions with any taxpayer identified in Step 1. These related corporations and the taxpayers constitute the Step 2 tentative combined group.

3. Add to the Step 2 tentative combined group every related corporation that has substantial intercorporate transactions with any corporation identified in Step 2. This constitutes the Step 3 tentative combined group.

4. Add to the Step 3 tentative combined group every related corporation that has substantial intercorporate transactions with any corporation identified in Step 3. Repeat this process until it adds no more corporations to the group. This constitutes the Step 4 tentative combined group.

5. Identify each related corporation not in the Step 4 tentative combined group that has substantial intercorporate transactions with another related corporation not in the Step 4 tentative combined group. Compare all such groups and combine into one group those

with common members ("unattached related group"). There may be more than one unattached related group.

6. If there are substantial intercorporate transactions between any one corporation in an unattached related group and the Step 4 tentative combined group, then all corporations in that unattached related group are included in the combined group. Do this for each unattached related group. As unattached related groups are included in the combined group, do this analysis between the expanded group and each unattached related group. The resulting group is the Step 6 tentative combined group.

7. If there are substantial intercorporate transactions between any one corporation in the Step 6 tentative combined group and an unattached related group, then all corporations in the unattached related group are included in the combined group. Do this for each unattached related group. As unattached related groups are included in the combined group, do this analysis between the expanded group and each unattached related group. The resulting group is the Step 7 tentative combined group.

8. Add to the Step 7 tentative combined group each related corporation that has substantial intercorporate transactions with the Step 7 tentative combined group.

9. Repeat the processes set forth in Steps 4, 6, 7, and 8 until no more corporations can be added to the tentative combined group.

10. Eliminate from the tentative combined group those corporations that are formed under the laws of another country (alien corporations), that are taxable pursuant to a different article of the Tax Law (or would be taxable under a different Article if subject to tax), and corporations that compute their business allocation percentage using a statutory method that is different from the taxpayer's (e.g., airline corporations and trucking corporations compute their business allocation percentage using a different business allocation percentage than manufacturing corporations). If two or more like corporations are eliminated, it is possible that they will constitute a combined group if they have substantial intercorporate transactions. For example, one group could consist of trucking corporations and another group could consist of manufacturing corporations. However, the law provides that alien corporations are not to be included in a combined group.

In addition, the Department may require or permit the taxpayer to file a combined report with one or more related corporations even where substantial intercorporate transactions are absent if a combined report is necessary to properly reflect the taxpayer's Article 9-A tax liability because of inter-company transactions or some agreement, understanding, arrangement or transaction. (See, Tax Law section 211.4(a)(4))

Where a combined report will include more than one taxpayer, the corporations included in the group must designate which of the taxpayers is to be "the taxpayer" for the purposes of computing and assessing the tax. The taxpayer so designated is often referred to as the parent corporation, even though it may not be the parent of the other related corporations included in the combined report. Where a related corporation does not have the same tax year as the parent,

the related corporation's activities for its taxable year that ends during the parent's taxable year are used for purposes of reporting and filing as part of a combined report.

II. Key Terms

Related Corporation

"Related corporation" means any corporation (1) substantially all the capital stock of which is owned or controlled either directly or indirectly by the taxpayer; (2) any corporation which owns or controls directly or indirectly substantially all the capital stock of the taxpayer; and (3) any corporation the capital stock of which is owned or controlled directly or indirectly by interests that own or control directly or indirectly substantially all the capital stock of the taxpayer. "Substantially all" means ownership or control of 80 percent or more of the stock that entitles the holder thereof to vote for the election of directors and to receive dividends. The taxpayer is a related corporation.

Substantial Intercorporate Transactions

In determining whether substantial intercorporate transactions exist, the facts and circumstances of all activities and transactions between related corporations and the taxpayer must be examined, including the following: (a) manufacturing, acquiring goods or property, or performing services, for related corporations; (b) selling goods acquired from related corporations; (c) financing sales of related corporations; (d) performing related customer services using common facilities and employees for common customers of related corporations; (e) incurring expenses that benefit, directly or indirectly, one or more related corporations, and (f) transferring assets, including such assets as accounts receivable, patents or trademarks from one or more related corporations. Therefore, intercorporate receipts, intercorporate expenditures and intercorporate transfers of assets all constitute an intercorporate transaction.

Dividends are not considered in determining if there are substantial intercorporate transactions. Loans and interest on loans between related corporations are considered in determining if there are substantial intercorporate transactions. However, if the loan constitutes subsidiary capital pursuant to Tax Law section 208.4, the interest paid and received on the loan does not constitute an intercorporate transaction; but, the loan remains an asset for purposes of the substantial intercorporate asset transfer test.

Substantial Intercorporate Receipts

The substantial intercorporate transactions requirement will be satisfied where during the taxable year 50% or more of a corporation's receipts (excluding extraordinary items) are from one or more related corporations. However, if a corporation's receipts (excluding extraordinary items) from one or more related corporations are between 45% and 55%, the multi-year test, below, applies.

Substantial Intercorporate Expenditures

The substantial intercorporate transactions requirement will be met where during the taxable year 50% or more of a corporation's expenditures, including for inventory, (but excluding extraordinary items) are from one or more related corporations. However, if a corporation's expenditures, including for inventory, (but excluding extraordinary items) from one or more related corporations are between 45% and 55%, the multi-year test, below, applies.

Expenditures incurred by a corporation that directly or indirectly benefit a related corporation can constitute substantial intercorporate transactions. For example, where a related corporation is incurring expenditures that benefit another related corporation and the amount of those expenditures represent 50% or more of the expenditures of the first corporation or are equal to 50% or more of the direct and indirect expenditures of the beneficiary corporation, the substantial intercorporate transactions requirement is satisfied.

Multi-year Test

When, in a particular tax year, a corporation's intercorporate receipts during the taxable year are between 45% and 55%, the substantial intercorporate transactions requirement will be met where 50% or more of a corporation's receipts (excluding extraordinary items) during the taxable year and the prior two taxable years are from one or more related corporations. When, in a particular tax year, a corporation's intercorporate expenditures during the taxable year are between 45% and 55%, the substantial intercorporate transactions requirement will be met where 50% or more of a corporation's expenditures (excluding extraordinary items) during the taxable year and the prior two taxable years are from one or more related corporations. If one or more of the corporations involved in the intercorporate transactions did not exist for the two prior tax years, then the 50% test is to be computed using the number of months the corporations did exist.

Substantial Intercorporate Asset Transfers

A transfer of assets to a related corporation (including through incorporation) will satisfy the substantial intercorporate transactions requirement where the transferred assets constitute 10 percent or more of the transferor's or transferee's total assets at the time of the transfer and the corporations are engaged in a unitary business.

In tax years subsequent to a tax year in which there was an asset transfer between related corporations, where 50% or more of the transferee's income is from the transferred asset, the substantial intercorporate transactions requirement will be deemed satisfied.

For purposes of determining the substantiality of asset transfers, real and personal property and intangible property that is not self-created are to be valued in accordance with the rules applicable to the capital base tax as set forth in Tax Law, section 210.2. The Department will be issuing further guidance as to how to value self-created intangible property for purposes of making this substantiality determination. For purposes of this paragraph, intangible property includes copyrights, patents, trademarks, and like property; "self-created" refers to any intangible that was created by the owner or a related corporation.

Other Considerations with Regard to Substantial Intercorporate Transactions

In determining whether the substantial intercorporate transactions requirement has been met, the Department will consider the materiality of the transactions and whether the transactions have economic substance, including the extent to which the motivation of the taxpayer in undertaking the transactions was to affect the membership of the combined group.

Similar transactions must be treated in a consistent manner from year-to-year.

Service functions are not considered in determining whether there are substantial intercorporate transactions when the service functions are incidental to the business of the corporation providing such service. Service functions include, but are not limited to, accounting, legal and personnel services.

III. Examples The references to "Steps" in the examples are references to the Steps set forth in the part I Combined Reporting Rules, above.

Basic facts for all examples (unless modified): A owns all of B, C, D, E, F, G, H, L, M, N, O, P, Q and R. All of the corporations are calendar year taxpayers for federal income tax purposes. B and C are taxable under Article 9-A of the Tax Law and the other corporations would be taxable under Article 9-A if they had nexus with NY. All of the corporations use (or would use, if subject to tax) the standard business allocation percentage. None of the corporations is an alien corporation.

Example 1: 90% of B's receipts are from D. Therefore, there are substantial intercorporate transactions between B and D. B and D are a tentative combined group and must file a combined report.

Example 2: B's receipts are: 22% from A, 20% from C, 30% from D, 10% from E and the rest are from unrelated entities. 40% of C's expenses are to B. There are no substantial intercorporate transactions here, so B and C file on a separate basis.

Example 3: 90% of B's receipts are from D and 100% of D's receipts are from E. D is an alien corporation. There are substantial intercorporate transactions between B and D, and D and E. B, D and E are a tentative combined group. However, since D is an alien corporation, it cannot be included in a combined report (see Step 10). Therefore, B and E file a combined report.

Example 4: A is the only taxpayer and 50% of A's receipts are from B, with another 4% from E. 30% of E's expenditures are to A and 20% to D. C has no transactions with anyone in the group. 50% of D's receipts are from A. 50% of F's receipts are from A. 100% of H's receipts are from F. 100% of R's receipts are from H. 20% of B's receipts are from L, 20% from M, and 20% from N. 100% of L's receipts are from M. 100% of M's receipts are from N. 40% of O's receipts are from R and 30% are from D. 60% of P's receipts are from O. 80% of L's expenditures are to Q. All of these corporations are in the Step 1 group of related corporations because they meet the stock ownership test.

The Step 2 tentative combined group consists of A, B, D, and F. As a result of Step 3, H is added to the tentative combined group. As a result of Step 4, R is added to the tentative combined group.

As described in Step 5, L, M, N and Q is an unattached related group and O and P is an unattached related group.

Corporations O and P are added to the tentative group pursuant to Step 6 because 70% of O's receipts are from R and D. The Step 6 tentative combined group is A, B, D, F, H, R, O and P.

The corporations in the unattached unrelated group of L, M, N and Q are all added to the tentative combined group pursuant to Step 7 because B has substantial intercorporate transactions with the unattached related group of L, M, N and Q. The Step 7 tentative combined group is A, B, D, F, H, R, O, P, L, M, N and Q.

Pursuant to Step 8, E is added to the Step 7 tentative combined group because 30% of its expenditures are from A and 20% are from D. The Step 9 tentative combined group is the same as the Step 8 tentative combined group.

Since no corporations will be excluded from the Step 9 tentative combined group pursuant to Step 10, the group of corporations that must file a combined report are A, B, D, F, H, R, O, P, L, M, N, Q and E.

<u>Example 5:</u> Same facts as Example 4 except that A, B, D, and F have filed on a combined basis for several years. In the current year, A realizes that it would reduce its New York State tax liability if it included C in the combined report. A creates K by contributing $10,000 of cash to it in exchange for all of K's stock. (In the alternative, A lends $10,000 to K, an existing dormant corporation). K enters into a contract with C to provide it with all of its office supplies (pens, paper, paper clips, etc.). K buys all of its office supplies from A and then sells them at a slight mark-up to C. In addition, K has a very small amount of interest income from a bank account.

The creation of K (or, in the alternative, making K an active corporation) and the transactions of A with K and K with C are not substantial intercorporate transactions because they lack economic substance.

<u>Example 6:</u> A is a bakery in NY and E is a bakery in Florida. Each year, A sells E a few pieces of equipment but the transactions are not substantial from either A's or E's point of view. In a particular year, A realizes it would reduce its New York State tax liability if it included E in a combined report with it. A creates K by contributing $10,000 to it in exchange for all of K's stock. A sells the equipment to K and K sells the equipment to E.

The creation of K and the transactions of A with K and K with E are not substantial intercorporate transactions because they lack economic substance.

Example 7: A's only activity is to receive dividends from its wholly owned subsidiaries. B sells stocks, C sells municipal bonds and D sells corporate bonds. B, C and D each have their own employees. However, the employees of one corporation are authorized to and do sell extensively the securities sold by the other corporations. 80% of the receipts of B, 70% of the receipts of C and 60% of the receipts of D are generated by sales made by the common pool of employees of B, C, and D. All three corporations carry on their activities at or using common facilities. Because there are substantial intercorporate transactions among B, C and D, they are a tentative combined group and must file a combined report. A is not included in the tentative combined group because it has no substantial intercorporate transactions with a related corporation.

NOTE: A TSB-M is an informational statement of changes to the law, regulations, or Department policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in Department policies could affect the validity of the information presented in a TSB-M.