

Unincorporated Business Tax
Bill Discussion Draft
Article 24-A

In January 2018, the New York State Department of Taxation and Finance (the Department) released the *Preliminary Report on the Federal Tax Cuts and Jobs Act*. The report outlined several potential state-level tax reforms designed to preserve state and local tax deductibility for New York State residents, including the enactment of an Unincorporated Business Tax (UBT). This discussion draft puts forward a statewide UBT that could preserve federal income tax deductibility for individuals on certain non-wage income while maintaining revenue levels for the State.

The purpose of this discussion draft is to provide interested parties with the opportunity to provide feedback on both the general concept of a statewide UBT and the specific design and implementation details of such a tax. To that end, a list of questions for consideration and comment are outlined below, and the discussion draft is annotated to note areas for public consideration and comment. The draft would apply a new business tax on partnerships doing business in New York while creating a corresponding tax credit for individual and corporate partners of those partnerships.

Please submit comments on this draft by emailing federal.tax.response.comments@tax.ny.gov. Comments are due by July 16, 2018.

Summary of Provisions

The following is a description of the discussion draft. The draft would add a new Article 24-A to the Tax Law, encompassing §§ 860-866, and making corresponding changes to other sections of the Tax Law.

Tax Law § 860: Notable definitions

- **Unincorporated Business Net Income**
 - Unincorporated Business Net Income (“UBNI”) is the tax base before allocation to New York State (NYS); it includes ordinary income reported for federal purposes and guaranteed payments to partners.
 - Ordinary income and guaranteed payments from a lower-tiered partnership are included in UBNI (but will be offset by a credit if UBT was paid on that income by the lower-tiered partnership, as provided in § 862).
 - The only additional modification is an add-back for any federal state and local tax deduction taken for UBT taxes paid by the affected partnership under this article.

- **Unincorporated Business Taxable Income**
 - To calculate Unincorporated Business Taxable Income (“UBTI”), the affected partnership will add together its own UBNI that is allocated to NYS with any income from lower-tiered partnerships that is allocated to NYS.

- Income from a lower-tiered partnership will retain its sourcing as determined by the lower-tiered partnership under the sourcing principles utilized by the lower-tiered partnership in calculating its UBT liability.

Tax Law § 861: Imposition and tax rate

- A tax rate of 5% is imposed on the UBTI of all affected partnerships.
- UBNI of the affected partnership is allocated to NYS by multiplying the UBNI by a three-factor allocation percentage that accounts for property, payroll and receipts factors of the affected partnership in NYS.

Tax Law § 862: Unincorporated business credit provisions

- There are three UBT credit provisions. The first is for a credit, called the Unincorporated Business Credit (“UBC”), that will be utilized by an affected partnership that is a partner in a lower-tier partnership against its UBT liability. The other two credits, called the Credit for Unincorporated Business Tax, will mirror each other and be used to offset the income and franchise tax of individual and corporate partners, respectively.
- Any affected partnership that receives income from a lower-tiered partnership that has already paid UBT will calculate a UBC under this section to offset its own UBT liability. This provision will prevent NYS from collecting UBT twice on the same income.
- An affected partnership’s UBC is generally the affected partnership’s proportionate share of the UBT of the lower-tier entity.
- If the UBC exceeds the UBT because the affected partnership has a loss, no refund will be given to the affected partnership. In addition, the credit will not carry forward for use by that affected partnership in subsequent years. Instead, the affected partnership’s partners will receive the benefit of their distributive shares of the full UBC in calculating their own credits, even the portion the affected partnership was not able to use. By giving the next partnership in the chain the full benefit of the UBC of the lower-tier partnership, the credit will fully account for any UBT paid by all lower-tier partnerships and will ensure that the ultimate taxpayer has the necessary information to calculate its Credit for Unincorporated Business Tax under Article 22 or 9-A.

Tax Law § 863: Estimated tax provision

- This section requires affected partnerships to make estimated payments towards their UBT liability.

Tax Law § 864: Filing of return and payment of tax

- Each affected partnership will calculate and report its UBT liability on its IT-204 partnership return, which is due (for a calendar year partnership) on March 15.
- The partnership will also be required to include additional information on the IT-204-IP and IT-204-CP forms (New York State K-1s) that it issues to its partners. In addition to the other information already provided on these forms, the partnership will need to provide each partner with the partner’s distributive share of the UBNI, UBTI, the UBT of the affected partnership and the UBT credit of the affected partnership.
- Each affected partnership will be required to remit the balance of tax due with its return.

Tax Law § 866: Notable procedural provisions

- The secrecy provision under Article 22 will apply generally to the UBT.
- However, the Department can disclose any information about UBT tax calculations, credit calculations, or tax remitted to the Department to any partnerships in a tiered chain or to the ultimate taxpayer partner under Article 22 or 9-A for audit and enforcement purposes.
- Only the affected partnership can be held liable for UBT.

Tax Law §§ 606(bbbb) & 606(i)(B)(1)(xliv): Personal income tax credit

- Any Article 22 taxpayer who is a partner in an affected partnership will be able to calculate a credit for its share of UBT tax paid on income that ultimately flows to that partner.
- The credit is generally 93% of the partner's proportionate share of the UBT of the affected partnership. In the event that an affected partnership's UBC exceeded its UBT, the partner's credit will be calculated based on the UBC instead of the UBT.
- The credit is nonrefundable and can be carried forward indefinitely.
- If the ultimate partner is a New York S corporation, the corporation cannot take the credit against its Article 9-A liability, but will pass the credit on to its shareholders based on the shareholders' distributive shares of ownership.

Tax Law § 210-B(53): Corporation franchise tax credit

- Any Article 9-A taxpayer who is a partner in an affected partnership will be able to calculate a credit for its share of UBT tax paid on income that ultimately flows to that partner.
- This credit has the same formula and limitations as the PIT credit, but cannot be applied against the fixed dollar minimum.

Unincorporated Business Tax Examples

Example 1: Partnership A has two individual partners who each own 50% of the partnership. Partnership A has no income or loss from lower-tiered partnerships (IT-204, line 6) and has \$1 million of ordinary business income (IT-204, line 26) so Partnership A's UBNI is \$1,000,000.¹ Partnership A then applies a 3-factor apportionment formula to its income and determines that its BAP is 25% and its UBTI is \$250,000 ($\$1,000,000 \times .25 = \$250,000$). Partnership A would calculate its UBT to be \$12,500 ($\$250,000 \times .05 = \$12,500$). Because Partnership A has no income or loss from lower-tiered partnerships it would have no Unincorporated Business Credit and would remit the full amount to NYS (through estimated payments and with its IT-204) and then report to each individual partner the distributive share of the UBT, \$6,250, and the distributive share of the UBT credit, 0, attributed to each partner.

Assuming a 93% discount factor, each individual partner calculates his or her personal income tax credit to be \$5,812.50 ($\$6,250 \times .93$).

¹ These examples assume no guaranteed payments to partners. All form references are to 2017 tax returns.

Example 2: Partnership B has two partners, Individual C and Partnership D. Individual C owns 25% of Partnership B and Partnership D owns the other 75%. Partnership D has two partners, Individual C and Individual E, who each own 50% of Partnership D.

Partnership B has no income or loss from lower-tiered partnerships (IT-204, line 6) and has \$10 million of ordinary business income (IT-204, line 26), so Partnership B's UBNI is \$10,000,000. Partnership B then applies a 3-factor apportionment formula to its income and determines that its BAP is 10% resulting in a UBTI of \$1,000,000 ($\$10,000,000 \times .1 = \$1,000,000$). Partnership B would calculate its UBT to be \$50,000 ($\$1,000,000 \times .05 = \$50,000$). Because Partnership B has no income or loss from lower-tiered partnerships it would have no Unincorporated Business Credit and would remit the full amount to NYS (through estimated payments and with its IT-204). Partnership B would then report a distributive share of the UBT in the amount of \$12,500 ($\$50,000 \times .25$) to Individual C and a distributive share of the UBT in the amount of \$37,500 ($\$50,000 \times .75$) to Partnership D.²

On its IT-204-IP Partnership D reports \$7,500,000 of ordinary business income from Partnership B ($\$10,000,000 \times .75 = \$7,500,000$, IT-204-IP, line 1B)³ and \$750,000 of that income was sourced to New York ($\$7,500,000 \times .1 = \$750,000$, IT-204-IP, line 1C). Partnership D also has \$250,000 of ordinary business income from its own activities, so Partnership D's UBNI is \$7,750,000 ($\$7,500,000 + \$250,000 = \$7,750,000$, IT-204, line 26). Partnership D applies a 3-factor apportionment formula to its \$250,000 of income and determines that its BAP is 100%, resulting in \$250,000 of New York sourced income. Partnership D adds this to the New York sourced income it received from Partnership B for a UBTI of \$1,000,000 ($\$750,000 + \$250,000 = \$1,000,000$).

Partnership D calculates its UBT to be \$50,000 ($\$1,000,000 \times .05 = \$50,000$). Partnership D also has a UBC received from Partnership B in the amount of \$37,500. Therefore, Partnership D is responsible for remitting \$12,500 in UBT ($\$50,000 - \$37,500 = \$12,500$) (through estimated payments and with its IT-204). Partnership D then reports to each partner the distributive share of the UBT, \$25,000, and the distributive share of UBC, \$18,750 distributed to each partner.⁴

Assuming a 93% discount factor, Individual E calculates his or her personal income tax credit to be \$23,250 ($\$25,000 \times .93$).

Individual C calculates his or her personal income tax credit to be \$34,875 ($\$23,250$ from Partnership D [$\$25,000 \times .93 = \$23,250$] + $\$11,625$ from Partnership B [$\$12,500 \times .93 = \$11,625$]).

Public Comment

The Department respectfully requests comments on the discussion draft. For example, the Department would welcome comment on the tax base to which the UBT should apply; the types of business entities to which the UBT should apply (such as potential inclusion of New York S

² Since Partnership B had no UBC, there is no credit to distribute to the partners.

³ Partnership D will also report this number on IT-204 on line 6.

⁴ Because the UBT exceeds the UBC, each partner will utilize the UBT amount to calculate its own credit.

corporations); the appropriate tax rate for the UBT; whether to exempt income below a specified threshold from the UBT; whether any categories of income should be exempt; whether consideration should be given to creating an opt-in system for the UBT; and any other issues relating to the discussion draft or a potential UBT in New York State. Please submit comments on this draft by emailing federal.tax.response.comments@tax.ny.gov. Comments are due by July 16, 2018.

If the State moves forward in enacting a UBT, it may also propose pledging a portion of UBT revenue to Personal Income Tax bonds, depending on the potential impact of any final legislation on the PIT liability base.