

New York City Announces Anticipated Deviations from Recently Promulgated New York State Corporate Tax Regulations

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The New York City Department of Finance (“Department”) has recently announced on its [website](#) that its still-pending business corporation tax regulations under City corporate tax reform legislation enacted in 2015 are expected to contain several notable deviations from the New York State corporate tax reform regulations that were promulgated at the end of 2023. Although City regulations have not yet been released to the public, the Department states that its regulations will “substantially parallel” the comprehensive State regulations, which were the culmination of a nearly nine-year project. **However, the Department has identified five major areas where it is likely to deviate from the State regulations:**

1. ***Application of unincorporated business tax (“UBT”) sourcing rules for corporate partners that receive a distributive share of partnership income.*** The most controversial deviation from the State regulations would involve how the City taxes corporate partners that receive a distributive share of partnership income. The State’s regulations generally apply the “aggregate method” of taxation, which treats the corporate partner as having directly earned its distributive share of partnership receipts. For State corporate tax purposes, the corporate partner includes its distributive share of the partnership’s business receipts in its own apportionment factor and applies the corporate tax customer-based sourcing rules in computing its apportionment factor.

In its announcement, the Department states that it will not follow that regulation but instead will use New York City UBT sourcing—which does not apply customer-based sourcing—to apportion the corporate partner’s distributive share of partnership income for City corporate tax purposes. Any non-partnership business income earned by the corporate partner would be separately apportioned using customer-based sourcing rules. It should be noted that the Department is already applying UBT sourcing to corporate partners on audit, notwithstanding the absence of a regulation, although the bifurcated apportionment method between partnership and non-partnership business income is a new development. Litigation has already commenced on this issue.

The Department states that the City law affords it great flexibility in determining how a corporate partner’s distributive share of partnership income is included in the partner’s

income. It also points out that unlike the State, the City imposes an entity-level UBT on partnerships. The Department's announcement does not explain, however, how the aggregate method—under which the corporate partner is treated as directly earning the partnership's receipts—authorizes the application of UBT sourcing to the corporate partner's share of those receipts.

2. ***Authorize deviating from statutory apportionment methods based on individual facts and circumstances.*** The Department is considering deviating from the State's regulations regarding evidentiary standards, which provide, for example, that the party seeking to vary from the statutory apportionment formula or to overcome a presumption under an allocation method hierarchy must establish entitlement to such variance by "clear and convincing evidence." Instead, the Department is considering a more general "individual facts and circumstances" standard, claiming that a "clear and convincing standard" is excessively burdensome on both the City and taxpayers.
3. ***Allocation of income from passive investment customers using 8% fixed allocation where the location of investors is unknown.*** The Department intends to follow the State's regulations regarding the allocation of receipts from management, distribution and administration services provided to "passive investment customers" based on the location of the underlying investors in the non-corporate investment funds, similar to how such receipts are sourced when earned from mutual funds. It intends to deviate from the State's regulation where the locations of those investors are unknown, under which those receipts are sourced based on where the contract with the service provider is "managed" by the passive investment customer. Instead, where investor locations are unknown, the City intends to use an 8 percent fixed allocation.
4. ***Increase threshold for taxpayers to use billing address "safe harbor."*** The State's regulations provide a customer billing address "safe harbor" for sourcing where the taxpayer has at least 250 business customers that purchase substantially similar products or services and no more than 5% of such receipts are from any particular customer. The Department intends to significantly limit the "safe harbor" by setting the threshold at 1,000 customers.
5. ***Retain excess inclusion in income for holders of residual interests in real estate mortgage investment conduits ("REMICs").*** The Department intends to depart from the State's regulation which excludes from entire net income ("ENI") the amount of excess inclusion of a holder of a residual interest in a REMIC that is required to be reported under IRC § 860E, asserting that there is no statutory authority for its exclusion from ENI.

City officials now say that they expect to formally propose corporate tax reform regulations in early 2025.

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National Law Review, Volume XIV, Number 137

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