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In this article, Tourian describes potential incongruities between what New York City's new business corporation tax regulations might look like, keeping in mind the city's different regulations for different tax types, and New York state's recently finalized corporate tax regs.

The opinions expressed here are solely the author's and do not reflect the opinions of BDO USA LLP.

On December 27, 2023, the New York State Department of Taxation and Finance published final regulations implementing comprehensive franchise tax reform enacted in 2014 targeting corporations, banks, and insurance companies. With the finalization of those regulations, New York City's interpretation of its own corresponding corporate tax reform may create a sorites paradox[1] in finding the right balance of discretion between the state regulations and the city's existing and eventual regulations on its various tax types.

This article overviews the types of New York City taxes and the city's conformity requirements with New York state rules. It also discusses the different evidentiary standards for "commissioner's discretion" in New York City, the application of the unusual events test, and the possible reintroduction of cost-of-performance sourcing. Ultimately, finding the right balance when interpreting New York City's myriad rules may be more art than science.

Overview of New York City Tax Types

New York City business taxes are tricky to navigate because the city does not impose a uniform tax on businesses. Instead, it divides its business taxes among entity types doing business therein.

The business corporation tax (BCT), the statutory regime enacted as a result of the city's 2014 corporate tax reform, applies to corporations;[2] the general corporation tax (GCT) applies to S corporations;[3] the unincorporated business tax applies to individuals or

[1] A sorites paradox is one that results from vague predicates. The typical example involves a heap of sand, from which individual grains are removed. Given that removing a single grain doesn't make the heap a non-heap, at what point in removing grains does the heap become a non-heap? *See* Ethan J. Leib, "Contracts and Friendships," 59 *Emory L.J.* 649, 664, n.38 ("One might think 10,000 grains of sand make a heap. Yet, since (1) one grain of sand is no heap and (2) for every n grains of sand that are not heaps, n+1 grains of sand will also not be a heap, there are no heaps."); and *Eatoni Ergonomics Inc. v. Research in Motion Corp.*, 826 F. Supp. 2d 705, 710 (S.D.N.Y. 2011), *aff'd*, 486 F. App'x 186 (2d Cir. 2012) ("Courts need not resolve the sorites paradox and determine precisely how many grains of sand constitute a heap.").

[2] N.Y.C. Admin. Code section 11-651(1).

[3] *Id.* at section 11-602.1(1).

unincorporated entities, such as partnerships;[4] the bank tax applies to taxpayers defined as banks that are also S corporations;[5] and the utility tax applies to all types of businesses that are also defined as utilities.[6] Most taxpayers now subject to the BCT had been subject to the GCT and bank tax before corporate tax reform. Those tax types provide different measurements for taxpayers' tax bases, addbacks, deductions, net operating losses, and apportionment methods.

New York City's Conformity With New York State

There are no applicable regulations for the BCT. Case law provides that "municipalities such as the City of New York have no inherent taxing power, but only that which is delegated by the State." Accordingly, in the absence of express authorization, New York City's BCT must "substantially" conform to and follow New York state.[7]

New York City is expected to finalize its own BCT regulations in 2025. Finalizing the regulations does not necessarily mean identical interpretations, or even identical results, to New York state on identical issues. That becomes more apparent when determining factual issues pertaining to commissioner's discretion.

For instance, according to *Petitions of Leonard I. Horowitz*, New York City may always conduct an independent audit and does not necessarily have to accept federal or state changes.[8] And *Petition of Ethyl Corp.* shows that a taxpayer may be able to dispute a federal or state adjustment, so long as they meet the burden of proof.[9]

In *United Feature Syndicate Inc.*, an administrative law judge said New York City did not have to follow New York state's adjustment to combination. The ALJ found that advance permission to file combined returns with the taxpayer's sister corporation was merely tentative and did not constitute a blanket waiver of the city's right to decombine on subsequent audit. The ALJ further found that the transactions between the taxpayer and its sister corporation were de minimis and therefore inconsistent with finding for the existence of a unitary business. Finally, the ALJ said the city could decombine a taxpayer under N.Y.C. Admin. Code section 11-605(3) when the state makes an adjustment to combine.[10] Those varying results and standards are most pertinent in the context of commissioner's discretion and its application to equalize absurd results.

Different Standards for Commissioner's Discretion — A Difference Between Cogent and Convincing?

The BCT provides several instances in which commissioner's discretion is warranted.[11] Like New York state, the only instance in which the statute articulates the standard for commissioner's discretion pertains to the royalty expense addback provisions, which require a taxpayer to provide "clear and convincing" evidence.[12]

New York state's regulations provide that the standard for commissioner's discretion is clear and convincing,[13] but historically neither New York City's statutes[14] nor its regulations[15] have defined the standard for that discretion for

[4] *Id.* at section 11-502(a).

[5] *Id.* at section 11-639(2).

[6] *Id.* at section 11-1102(a).

[7] *Castle Oil Corp. v. City of New York*, 89 N.Y.2d 334, 339-340 (N.Y. 1996).

[8] *In the Matter of the Petitions of Leonard I. Horowitz*, TAT(H) 99-3(UB), at n.2 (Sept. 15, 2004).

[9] *Matter of the Petition of Ethyl Corp.*, TAT(H)93-97(GC), at 35-36 (Aug. 6, 1997).

[10] *Matter of United Feature Syndicate Inc.*, TAT(H) 93-95(GC), at n.6 (Mar. 6, 1996).

[11] Commissioner's discretion may be warranted for interest deductions attributable to exempt unitary corporate dividends (N.Y.C. Admin. Code section 11-652(5-a)(c)); timing of income items and deductions (N.Y.C. Admin. Code section 11-652(8)(d)); royalty expense addback (N.Y.C. Admin. Code section 11-652(8)(n)(2)(ii)(D)); income allocation for taxpayers subject to the utility tax (N.Y.C. Admin. Code section 11-653(4)(c)); business allocation percentage (N.Y.C. Admin. Code section 11-654(9)); receipts factor (N.Y.C. Admin. Code section 11-654.2(11)); and combined reports (N.Y.C. Admin. Code section 11-655(5)).

[12] N.Y.C. Admin. Code sections 11-652(8)(n)(2)(ii)(A)-(C); N.Y. Tax Law sections 208.9.(o)(2)(B)(i)-(iii).

[13] Royalty modification (section 3-3.4, pertaining to N.Y. Tax Law section 208(9)(o)); business apportionment factor (section 4-1.6(c)(5), pertaining to N.Y. Tax Law section 210-A(11)); digital products (section 4-3.2(e)(1) and (2), pertaining to N.Y. Tax Law section 210-A.4.(b)); receipts from services and other business activities (section 4-4.2(e)(1) and (2), pertaining to N.Y. Tax Law section 210-A(10)); combination (section 6-2.3(c), pertaining to N.Y. Tax Law section 210-C).

[14] N.Y.C. Admin. Code section 11-604(8)-(9), pertaining to the receipts factor.

[15] N.Y.C. R. section 11-67, pertaining to the city's business allocation percentage.

corporate tax purposes. However, case law has said the standard for determining commissioner's discretion is "clear and cogent."[16]

In Illinois, the terms "cogent" and "convincing" are interchangeable.[17] In Missouri[18] and Washington state,[19] the burden of proof requires all three elements of clear, cogent, and convincing. The treatise on state income taxation and other business taxes recognizes that the "clear and convincing" standard is different than the "clear and cogent" standard.[20]

Merriam-Webster's definition of the word "cogent" stresses the "weight of sound argument and evidence or lucidity of presentation"; its definition of the word "convincing" suggests "a power to overcome doubt, opposition, or reluctance to accept."[21]

Let's conceptualize that difference with an example involving two individuals, Ira and Bill. Assume Ira is in a room with no windows. If Bill comes in wearing wet clothes and with a wet umbrella, he could use that evidence to convince Ira that he was late to work because it was raining. Bill presenting a cogent argument to Ira would require taking Ira outside to show that it was actually raining.

Because historic precedent still applies to the GCT and unincorporated business tax, the standard for deviating from the usual formula could be lower for the BCT were New York City to adopt New York state's clear and convincing standard rather than the historic clear and cogent standard. The problem would then be articulating those different burdens at the New York City audit level.

Whether to Adopt the Unusual Events Test

One of the mysteries about the final New York City BCT regulations is whether they will adopt the "unusual events" test. That test excludes from the receipts factor substantial amounts of gross receipts arising from an occasional sale of a fixed asset or other property held or used in the regular course of the taxpayer's trade or business that is not necessarily held for sale to customers. For example, if they are substantial the gross receipts from the sale of a factory that produces goods would be excluded from the receipts factor. The GCT uses the unusual events test.[22]

N.Y.C. Admin. Code section 11-654.2(2)(d) provides that only net gains (that are not less than zero) from real property are included in the receipts factor, and section 11-654.2(3)(b) provides that cost of performance should be used for intangibles such as royalties, patents, copyrights, and trademarks.

New York state's proposed regulations on the apportionment of business receipts excluded from the receipts factor receipts from unusual events and included examples applying the rule.[23] However, the state removed the unusual events test from the final regulations.

So herein lies the problem with the unusual events test and discretionary adjustments: The rule is not statutory but is instead a departmental interpretation of what warrants a discretionary adjustment. The New York City GCT excludes gross receipts from unusual events, but New York state has taken the position that those receipts should not be excluded.

New York state's position is probably based on the statute, which includes in the receipts factor only net gains from the sale of real property; ultimately, a discretionary adjustment would most likely emanate from adding back receipts for purposes of New York realty. Further, the unusual

[16] *Matter of British Land (Maryland) Inc.*, 85 N.Y.2d 139, 147 (N.Y. Ct. App. 1995).

[17] *Department of Revenue of the State of Illinois v. Ponderosa Foods Inc.*, Administrative Hearing Decision No. IT 03-5 (1993).

[18] *Torode v. Muehlheausler*, Appeal No. 01-10067 (Mo. State Tax Comm'n 2002).

[19] *Rosen Properties v. Noble*, Nos. 67339, 67340 (Wash. BTA 2008).

[20] Kathleen K. Wright, Ben Miller, and Chris Whitney, "Relief From the Standard Apportionment Formula," in *State Taxation of Income and Other Business Taxes* (2024), at section 9.03[F][4].

[21] *Cogent*, Merriam-Webster (n.d.); *see also Convincing*, Merriam-Webster (n.d.).

[22] N.Y.C. R. section 11-65(e)(2).

[23] Prop. reg. section 4-4.1(d), examples 2 and 3 ("Example 2: Corporation B sells all the assets of one of its divisions for a gain, which is properly reported as business income. The gain from the sale of these assets is not included in Corporation B's New York receipts or everywhere receipts because the sale is an unusual event; Example 3: Corporation C, a consulting firm, sells its office building and the accompanying parcel of land for a gain, which is properly reported as business income. The gain is not included in Corporation C's New York receipts or everywhere receipts because the sale is an unusual event.").

events test — like the substantial and occasional sales test in California[24] — historically made sense when there was a property and payroll factor and when an usual event such as a substantial and occasional sale did not properly reflect the business activities that took place in a state. Business activity used to be measured using three metrics (property, payroll, and sales), with the option to add or remove other metrics to fairly measure a taxpayer's business activity in a state.

For New York City purposes, a discretionary adjustment would be a balancing act of when to apply the unusual events test between the GCT and BCT, especially because both the GCT and BCT use the receipts factor rather than the payroll or property factor for allocation purposes.

Where Value Is Accumulated: A Reintroduction of Cost of Performance

New York state regulations specify that complete transfers of intangibles are transactions not addressed under N.Y. Tax Law section 210-A(1)-(9) and should be addressed as other business receipts under N.Y. Tax Law section 210-A(10).[25] They further state that sales of intangibles are sourced to the location where the value of those intangibles accumulated.[26]

While it remains to be seen whether New York City will adopt New York state's position that the complete transfer of intangibles should be classified as another business receipt under N.Y.C. Admin. Code section 11-654.2(10), what is interesting is the state's approach of assigning the value of the sale of assets to the place where they accumulated. That approach is like the historical cost-of-performance method.[27] If New York City adopts that approach, there is potential for endless inquiries regarding what costs — including direct and indirect costs — should be taken into account.

The door to that inquiry was opened in *Gerson Lehrman Group*, which addressed how to allocate subscription-based services under N.Y.C. Admin. Code section 11-604.3(a)(2)(B).[28] N.Y.C. R. section 11-65(b)(3)(i) provides that such values are "to be determined on the basis of the relative values of, or amounts of time spent in performance of, such services within and without New York City, or by some other reasonable method."

The appellate division rejected the corporation's argument and held that the New York City Tax Appeals Tribunal correctly focused its inquiry on (1) the nature of the corporation's business and the personnel — including salespeople, IT staff, and consulting managers — who contributed to the performance of the service the corporation provided, and (2) that the compensation for those employees must be accounted for in determining the corporation's receipts factor.

In the digital age, the problem is where the value of an intangible accumulated. For example, if the New York Yankees were sold, how much of the sale allocated to the Yankees' "NY" insignia should be allocated to New York City? One could argue 50 percent, based on the fact that 50 percent of Yankees games are played there.

Then again, the Yankees are Major League Baseball's most valuable team,[29] and not just because New York City is the most populous U.S. city. The Yankees are popular all over the United States.[30] The value of a trademark is highly dependent on its social value, and no one should underestimate that inherent value when even West Coast rappers like O'Shea Jackson, also known as Ice Cube, wear Yankee paraphernalia during their concerts.[31]

The question then becomes where to draw the line of what relationships and factors contribute

[24] Cal. Code Regs. tit. 18, section 25137(c)(1)(A).

[25] Reg. section 4-4.3(e)(1).

[26] Reg. section 4-4.3(e)(1)-(3).

[27] William J. Pierce, "The Uniform Division of Income for State Tax Purposes," 35 *Taxes* 747, 780 (1957) ("Another problem arises in conjunction with sales other than sales of tangible personal property. Section 17 of the uniform act attributes these sales to the state in which the income-producing activity is performed. If the activity is performed in more than one state, the sales are attributed to the state in which the greater proportion of the activity was performed, based upon costs of performance. In many types of service functions, this approach appears adequate.").

[28] *In the Matter of Gerson Lehrman Group Inc.*, TAT(H)-08-79-(GC) (N.Y. Tax App. Trib. Oct. 4, 2016), *aff'd by* TAT(E)-08-79-(GC) (N.Y. Tax App. Trib. Dec. 28, 2017).

[29] Mike Ozanian and Justin Teitelbaum, "Baseball's Most Valuable Teams 2023: Price Tags Are Up 12% Despite Regional TV Woes," *Forbes*, Mar. 23, 2023.

[30] Caroline Sikes, "Facebook's MLB Fan Map Reminds Us Yankees Fans Are Everywhere," *The Sporting News*, Apr. 1, 2015.

[31] Ralph Warner and Elias Ahmed, "The 25 Best Yankees Rap References of All Time," *Complex*, Apr. 13, 2012.

to accumulated value. Where the GCT has opened that door to secondary costs, will the BCT close it?

Conclusion

It will be interesting to see what rules New York City adopts from New York state — and more importantly, how the city will balance its rules for its various tax types and the state's regulations when adopting its own final BCT regulations. ■