KAYE SCHOLER LLP

TAX DEPARTMENT AND TRUSTS
& ESTATES DEPARTMENT

APRIL 2007

Tax and Trusts & Estates Update

NEW YORK BUDGET LEGISLATION INCLUDES NUMEROUS TAX LAW CHANGES

On April 1, 2007, New York enacted the state budget for the fiscal year 2007-2008. The budget includes various changes to the tax law. In addition to tax law changes affecting personal income and property taxes, the budget eliminates several business tax loopholes, includes targeted business tax relief through a reduction in the corporate franchise tax rate and other tax relief for certain manufacturers, and implements a business allocation based on the single sales factor.

Elimination of Business Tax Loopholes

For taxable years beginning on or after January 1, 2007, related U.S. corporations must file a combined report if there are substantial intercorporate transactions among the related corporations, regardless of the pricing used in such intercorporate transactions. In determining whether there are substantial intercorporate transactions, all activities and transactions of the taxpayer and its related corporations must be considered. Activities and transactions that will be considered include, but are not limited to: (i) manufacturing, acquiring goods or property, or performing services, for related corporations; (ii) selling goods acquired from related corporations; (iii) financing sales of related corporations; (iv) performing related customer services using common facilities and employees for related corporations; (v) incurring expenses that benefit, directly or indirectly, one or more related corporations; and (vi) transferring assets, including such assets as accounts receivable, patents or trademarks, from one or more related corporations.

For taxable years beginning on or after January 1, 2007, a real estate investment trust (REIT) or a regulated investment company (RIC), where substantially all of the capital stock is owned or controlled (80%) directly or indirectly by certain corporations, is required to file a combined report under the corporate franchise tax law with its controlling corporation. Moreover, the exclusion for certain dividends and gains from a REIT or RIC subsidiary under the bank franchise and insurance franchise taxes is now disallowed.

These changes were designed to prevent companies from using complicated tax strategies to shelter income from New York State taxation by, among other strategies, shifting income out of the state or by using REITs artificially to lower their New York taxes.

Tax Rate Reductions

The enacted state budget provides $150 million worth of targeted business tax relief in the form of a tax rate cut for all corporations, banks and insurance companies, and targeted relief for manufacturers. For tax years beginning on or after January 1, 2007, the general corporation franchise tax rate is reduced for all corporations from 7.5% to 7.1%. For certain manufacturers, the overall tax on manufacturing income is lowered from 7.5% to 6.5% and the alternative minimum tax, which generally has a disproportionate impact on manufacturers, is lowered from 2.5% to 1.5%.

Business Allocation Percentage Based On Receipts From In-State Sales

The new legislation accelerates the scheduled change in the method for computing the New York State business allocation percentage for the purpose of allocating entire net income under the corporate franchise tax. The new method is based solely on receipts from in-state versus total sales. Specifically, for tax years beginning on or after January 1, 2007, corporate franchise taxpayers will compute their business allocation percentage based solely on in-state receipts. Under prior law, the single-factor allocation formula was to be phased-in, and not based solely on receipts from sales until tax years beginning on or after January 1, 2008. This approach could result in multiple state taxation of the same income because most states use an allocation of income formula based on three factors: sales, property and payroll.

Deemed S Corporation Election

For taxable years beginning on or after January 1, 2007, the shareholders of certain S Corporations that have not elected to be treated as New York S Corporations are deemed to have made the election effective for the S Corporation's entire current taxable year if the S Corporation's investment income for the current taxable year is more than 50% of its gross income for the year.

APRIL 2007 FEDERAL INTEREST RATES

The annual short-term, mid-term and long-term applicable federal interest rates for April are 4.90%, 4.61% and 4.81%, respectively (down from 5.06%, 4.86% and 5.01%, respectively in March). The Section 382 adjusted federal long-term rate for April is 4.04% (down from 4.18% in March) and the long-term tax-exempt rate for ownership changes in April remains at 4.18%. The Section 7520 rate is 5.6% (down from 5.8% in March). For the calendar quarter beginning April 1, 2007, the interest rate on overpayments is 8% (7% in the case of a corporation and 5.5% in the case of corporate overpayments exceeding $10,000) and the underpayment rate is 8% (10% for large corporate underpayments). Different interest rates apply for different purposes. Please consult with a member of the Tax Department to assess the potential imputed interest in connection with any debt instruments or to assess the potential limitation on the use of net operating losses following a change of ownership of a corporation.

TAX DEPARTMENT PARTNERS/COUNSEL

General Tax
Sydney E. Unger
(212) 836-8471

Willys H. Schneider
(212) 836-8693

Michael D. Fernhoff
(310) 788-1374

Gary J. Gartner
(212) 836-8358

Louis Tuchman
(212) 836-8267

Jeffrey D. Scheine
(212) 836-8289

Laurie Abramowitz
(212) 836-7038

Employee Benefits
Arthur F. Woodard
(212) 836-8005

Kathleen M. Faccini
(212) 836-8766

TRUSTS & ESTATES DEPARTMENT PARTNERS/COUNSEL

David J. Stoll
(212) 836-7259

Arlene Harris
(212) 836-8816

Dana L. Mark
(212) 836-7673

Abraham Mora
(561) 868-7510

Donald J. Currie
(212) 836-8061

Stanley Rosenberg
(212) 836-8115