10. Terms Redefined
    a. The legislation revises the definitions of
        i. "business capital,"
        ii. “business income,”
        iii. "investment capital," and
        iv. "investment income."

Prior to the changes in law, taxpayers computed the tax on capital base by:

1. allocating investment capital (less attributable liabilities, including debt and other liabilities) by the Investment Allocation Percentage,
2. allocating business capital (less attributable liabilities) by the Business Allocation Percentage, and
3. computing tax on the sum of those two amounts.

The new law removes “investment capital” from the computation of the capital base. As such, investment capital is no longer taxable (the tax will be computed based solely upon business capital). However, the definition of investment capital has been altered, and narrowed. Since business capital is defined by reference to investment capital, the new definition of investment capital means that business capital will now include more items of income than it did under the current rules.

“Business income” is defined as entire net income minus investment income and other exempt income. In no event will the sum of investment income and other exempt income exceed entire net income. The new law provides for an election under Tax Law §210-A(5)(a)(1) to apportion income from qualified financial instruments (“QFIs”) at 8% and, if the election is made, then QFI income will be treated as business income.

The definition of “investment income” (which had been defined as income from investment capital) will, as of tax years beginning January 1 2015, only include “investments in stock that are held by the taxpayer for more than six consecutive months, but not held for the sale to customers in the regular course of business.” (There is a presumption that stock acquired during the second half of a tax year, which necessarily has not met the six-month holding period, will be held for six months. However, if the stock is disposed of during the following year and the holding period was actually less than six months, taxpayers are required to adjust business capital and business income in that following tax year.) Note stock of unitary corporations, stock in a corporation that is included in a combined report, bonds, or other corporate or governmental securities cannot qualify as investment income, regardless of holding period. (Taxpayers directly or indirectly owning less than 20% of the voting power of a corporation are presumed to be non-unitary.)

Any interest deductions directly or indirectly attributable to investment capital or income must be subtracted in determining investment income. Alternatively, instead of direct or indirect attribution for interest expenses, taxpayers can elect to reduce their investment income by 40% under a new safe-harbor election provision.

Further, the new law creates an “other exempt income” category. “Other exempt income” is defined as the sum of exempt “controlled foreign corporation” (CFC) income and exempt unitary corporation dividends. As above, other exempt income is reduced by interest expense directly or indirectly attributable to that income with the safe harbor election also available. (Taxpayers that elect under the 40% safe-harbor provisions are required to elect the same for both investment income and other exempt income.)

The law makes clear that investment income and other exempt income may not exceed entire net income. Thus, the excess of any interest or other deductions over other exempt income or investment income must be added back when computing entire net income for purposes of computing the business income base.