taxnotes® state

Volume 103, Number 9 ■ February 28, 2022

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Reprinted from *Tax Notes State*, February 28, 2022, p. 951

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In this installment of Noonan's Notes, Noonan and Tantillo review the New York State Department of Taxation and Finance's change to its statutory residency test to define "substantially all of the year" as 10 months rather than 11 months — outlining its history and considering whether it's the right move.

Without even a hint of fanfare, the New York State Department of Taxation and Finance recently released a new version of its audit guidelines for nonresidents.[1] Given that the last update was in 2014, we easily excited tax lawyers cracked them open to find out what had changed. But when we dug into the new guidelines, we were disappointed to see only minor stylistic edits.

There was, however, one interesting nugget regarding New York's statutory residency test: The department changed its view on what it means to maintain a permanent place of abode for "substantially all of the taxable year." For decades this has been interpreted to be 11 months, but it's now only 10. Here, we'll outline some of the history, explain the change, and discuss whether making such an amendment through audit guidelines was the right way to go.

Statutory Residency: Background on the 11-Month Rule

Statutory residency is one of two tests in New York to determine whether a taxpayer is subject to tax as a resident. Unlike the domicile test, which has some level of subjectivity, statutory residency is generally a more mechanical test with two parts: (1) presence in New York for more than 183 days per tax year, and (2) maintenance of a "permanent place of abode" (PPA) in New York for substantially all of the year.[2] In this regard, the regulations define "substantially all of the taxable year" as "generally, the entire year disregarding small portions of the year."[3] Noticeably, the regulations stop short of providing a numerical — or any — definition of the term "substantially all of the taxable year." So how does a taxpayer really know when they have crossed the substantial threshold?

For decades, the term "substantially all of the taxable year" was understood to mean more than 11 months of the year. In fact, several publications by the department, including the prior version of the audit guidelines for nonresidents and the instructions for nonresident income tax returns, interpreted

[1] New York State Department of Taxation and Finance, "2021 Nonresident Audit Guidelines" (Dec. 2021).

[2] N.Y. Tax Law section 605(b)(1)(B); N.Y. Comp. Codes R. & Regs. tit. 20, section 105.20(a)(2).

[3] N.Y. Comp. Codes R. & Regs. tit. 20, section 105.20(a)(2).

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"substantially all of the taxable year" to mean a period exceeding 11 months.[4] The Tax Appeals Tribunal has agreed that "substantially all of the taxable year means a period exceeding eleven months."[5] The 2014 audit guidelines for nonresidents stated explicitly that "substantially all of the taxable year . . . is generally interpreted to mean a period exceeding 11 months."[6] The income tax instructions for nonresidents explain that the second prong of statutory residency means "maintaining a permanent place of abode in New York State for more than 11 months of the year."[7] Further, Tax Bulletin IT-690 states, "generally, you maintain a permanent place of abode for substantially all of the tax year if you maintain it for more than eleven months during the year."[8] So the 11-month rule was more or less an established principle, and taxpayers have operated based on this interpretation for years.

That said, the 2014 nonresident audit guidelines explained that Audit Division policy considers the "substantial part of a year" rule to be a general rather than absolute rule.[9] But this change was made largely to curb abuse, as illustrated by an example:

> Suppose a couple rents an apartment in New York annually, but each year they sublet the apartment to their son for the month of December. If the 11-Month rule were absolute, that couple would not be maintaining a PPA in New York since they didn't have the place for more than 11 months. But the Audit Division thought it would be improper to allow taxpayers to avoid statutory residency through the illustrated manner.[10]

The 2014 guidelines also referred to an administrative law judge decision, *Matter of Brodman*, in which the ALJ ruled that the taxpayer's maintenance of a New York City apartment for 10 and a half months during the year was enough to qualify as "substantially all of the year."[11] But again, consistent with the new example, the taxpayer in *Brodman* was trying to circumvent the 11-month rule by renting out his place for six weeks (and to a relative at that). The ALJ accepted the Audit Division's characterization of the 11-month rule as a general rather than absolute rule, explaining that "defining substantially by the implementation of an absolute 11-month rule in every instance . . . would allow the statutory resident provisions of the Administrative Code . . . to be easily circumvented by the simple expedient of giving exclusive use of one's place to another person for a period in excess of one month for any reason."[12]

But even with this "general but not absolute" qualification, there's never been a suggestion or debate that "substantially all" was anything less than 11 months — until, that is, we cracked open the new guidelines.

Moving to a 10-Month Rule by Fiat

Tucked on page 49 of the new guidelines, the department dropped in the only substantive change to the entire document:

> Beginning with tax year 2022, Audit Division policy will define "substantially all of the year" to generally mean a period **exceeding 10 months**.[13]

The balance of the new text repeats some of the old conventions from the prior version of the guidelines. Namely, that the department will apply the 10-month rule to years when a taxpayer either acquires or disposes of their residence (to curb the midyear rental issue), and that the taxpayer doesn't need to maintain the

[4] New York State Department of Taxation and Finance, "2014 Nonresident Audit Guidelines," at 63 (June 2014); *see also Matter of Tweed*, Tax Appeals Tribunal, May 23, 1996; 2019 Form IT-203 instructions.

[5] *Matter of Tweed*, *supra* note 4 ("substantially all the taxable year means a period exceeding eleven months").

[6] 2014 Nonresident Audit Guidelines, *supra* note 4, at 64.

[7] New York State Department of Taxation and Finance, 2019 Form IT-203 instructions, at 47 (available at New York State Department of Taxation and Finance, "2019 Personal Income Tax Forms," updated Dec. 13, 2021).

[8] New York State Department of Taxation and Finance, "Permanent Place of Abode," Tax Bulletin IT-690 (Dec. 15, 2011).

[9] 2014 Nonresident Audit Guidelines, *supra* note 4, at 63.

[10] *Id.*

[11] *Matter of Michael Brodman and Karen Grimm*, DTA No. 818594.

[12] *Id.* at No. 3.

[13] 2021 Nonresident Audit Guidelines, *supra* note 1, at 49 (emphasis added).

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same PPA for substantially all of the year; rather, two or more leases can be strung together to reach the threshold for "substantially all of the taxable year."[14] On the latter point, the department includes an example in which an individual who rents an apartment in Brooklyn until June 30 — and then another apartment in Westchester County from July 1 until November 30 — would be deemed to be maintaining a permanent place of abode for substantially the entire tax year.

The department also illustrates the new rule with several simple examples. In one, a taxpayer is domiciled in Connecticut but works in New York City throughout the year. If that taxpayer acquires a permanent place of abode on February 21 of the tax year and spends 184 days in New York, they will be taxed as a resident under the new 10-month rule. In contrast, under the old 11-month rule, the taxpayer in that scenario would not be subject to tax as a resident. In the other example, suppose a taxpayer maintains a PPA in New York and spends 184 days there but disposes of the residence on November 3. Under the old rule, the taxpayer would not be subject to statutory residency because they did not maintain the PPA for more than 11 months. But under the new rule, that same taxpayer would trigger statutory residency, at least if this guidance holds.

Parting Thoughts

It's unclear where the impetus for this change came from. We're involved in hundreds of residency audits every year, and have probably handled thousands of them since the last version of the guidelines came out. And while occasionally we'd have a taxpayer flying really close to the sun in a statutory residency case (that is, selling their apartment on November 27), it's not like this was a constant source of confusion or controversy. We imagine that the department is not obligated to explain why it changed its interpretation, but the rationale behind this somewhat sudden, unannounced change is unclear.

Also, tying into the next point, it's a little odd to prospectively change an interpretation. To be fair, this is likely done as a taxpayer friendly move to avoid a retroactive application of an obvious change in the rules. But nothing has changed in the law, the regulations, or any of the case law. So it's strange to have "substantially all" mean 11 months in December 2021 but 10 months a few weeks later.

Lastly, as we pesky lawyers like to do, we also need to poke at the legality of a change like this. As is self-evident, the nonresident audit guidelines are just that: guidelines. And while the Tax Appeals Tribunal has referred to them in its decisions — noting that the guidelines may be relevant for the limited purpose of guiding a determination of what a phrase means — they aren't binding on anyone.[15] And they can't be cited as authority in the way statutes and regulations can. So a taxpayer who maintains a place of abode for 10 and a half months in 2022 can still argue that they didn't maintain a place of abode for substantially all of 2022, and that taxpayer would have decades of history to point to in which the department interpreted this phrase to mean an 11-month period.

Indeed, if the department wants to create a new, legally binding rule, it is not supposed to do so through guidelines or technical memoranda. Instead, the proper way to promulgate a new rule is through the creation and issuance of regulations, or through the enactment of new statutory provisions appropriately passed by the Legislature. And there's a whole body of case law surrounding the concept that if a governmental agency wants to impose new rules, it can only do so by issuing regulations promulgated according to New York State Administrative Procedure Act.[16] Anyone paying attention to the controversy around New York's mask mandates is likely familiar with this line of thinking, and the same concept has popped up in other tax cases in which the department has tried to enforce new

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[14] *Id.* at 50.

[15] *Matter of Tweed*, *supra* note 4.

[16] *Homestead Funding Corp. v. State Banking Department*, 944 N.Y.S.2d 649, 653 (3d Dept. 2012). *See also Schwartfigure v. Hartnett*, 83 N.Y.2d 296 (1994).

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so-called rules through technical memos instead of new regulations.[17]

For now, this new "rule" only goes into effect as of January 1, so we won't see any actual audits of this issue for quite some time. But rest assured, we'll keep a close eye on this. We suspect this won't be the last we hear of the 11-month rule. ■

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[17] *Matter of Stuckless*, Tax Appeals Tribunal (Aug. 17, 2006).

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