

# New York Appellate Court: No Credit for Taxes Paid on Intangible Income

Posted on Jun. 29, 2018

By Andrea Muse

New York's denial of a credit for tax paid to other states on intangible investment income did not violate the dormant commerce clause, according to a state appellate court.

The Supreme Court of the State of New York, Appellate Division, held June 26 in [Edelman v. Department of Taxation and Finance](#) that New York's tax scheme permitting both New York and Connecticut to tax intangible investment income without a credit for taxes paid to Connecticut did not affect interstate commerce and was constitutional.

The court held that intangible investment income is not out-of-state income because it cannot be traced to any jurisdiction outside New York and is subject to taxation by New York as the state of residence.

Timothy Noonan of Hodgson Russ LLP, who represented the taxpayers, said they were "disappointed with the decision but [were] looking forward to the next step on appeal."

"This case involves an important constitutional issue and we think it is important that New York's highest court addresses it," Noonan said.

In the case, Samuel and Louise Edelman were domiciled in Connecticut and had income from investments and intangible sources. The income was taxed by New York after an audit determined that the Edelmanns were statutory residents of New York because they had a permanent place of abode and spent more than 183 days per year in the state.

Though New York allows a credit for taxes paid to other states on income earned in that state, the taxpayers were denied a credit for the taxes on income from investments and intangibles paid to Connecticut because the income was not earned in Connecticut.

In a 1998 decision on similar facts, [Matter of Tamagni v. Tax Appeals Tribunal of New York](#), the state's highest court ruled that the disallowance of the credit for investment and intangible income was constitutional because the commerce clause wasn't implicated by a tax based on residency and that even if the commerce clause was implicated, the tax didn't facially discriminate against interstate commerce.

The Edelmanns challenged the denial of the credit, arguing that the U.S. Supreme Court's 2015 decision in [Comptroller of the Treasury of Maryland v. Wynne](#) abrogated the state's decision in *Tamagni*.

The Supreme Court ruled in *Wynne* that Maryland's failure to provide a credit for the local

portion of a couple's individual income tax for taxes paid to other states was unconstitutional under the dormant commerce clause because it failed the internal consistency test. That test asks whether interstate commerce would be burdened more than intrastate commerce if every state imposed a tax identical to the one in question.

The Edelmans claimed that New York's tax scheme burdens interstate commerce and is internally inconsistent. They argued it burdens interstate commerce by inhibiting free movement to work and buy or lease a home because of the risk of being deemed New York residents and subject to double taxation of their intangible income by New York and Connecticut.

The Supreme Court of the State of New York, New York County, however, held that *Wynne* didn't apply to the facts of this case and that under *Tamagni*, the denial of the credits was constitutional.

The appellate court agreed, finding that *Wynne* did not involve individuals who faced double taxation on intangible investment income because they are domiciled in one state and statutory residents of another, like in this case and *Tamagni*.

Noting the taxpayers' argument that *Wynne* made clear that "a tax scheme is not immune from Commerce Clause scrutiny simply because it is 'residency-based,'" the court found that "the income subject to tax in *Wynne* was not intangible investment income, but business income, traceable to an out-of-state source." The court added that New York provides for a credit for taxes paid to another state for such out-of-state business income.

The court said *Tamagni* determined that the statute required some level of dormant commerce clause scrutiny and engaged "in a thorough analysis that concluded that the taxation scheme did not violate the dormant Commerce Clause," but the court also acknowledged that *Tamagni* found the dormant commerce clause analysis inapplicable to state resident income taxation — which is inconsistent with *Wynne*.

The court ruled that *Wynne*'s holding that the internal consistency test must be applied wherever there is commerce clause scrutiny did not abrogate *Tamagni*'s holding that there was no reason to apply the test to this tax scheme even if commerce clause scrutiny was necessary.

"Where Commerce Clause scrutiny reveals that the statute at issue does not affect interstate commerce, there is no need for a test determining whether the statute unduly burdens interstate commerce," the court ruled.

Alysse McLoughlin of McDermott Will & Emery told Tax Analysts June 27 that she found it "quite disappointing that the appellate division declined to thoroughly consider the underlying constitutional issue."

"There is no question that *Wynne* considered investing in a business conducted partially in another state to be interstate commerce," McLoughlin said. "Accordingly, having a home in one state, and spending time in another state for business or economic purposes also must implicate the commerce clause."

McLoughlin said she was hopeful that "just as the U.S. Supreme Court in *Wayfair* recognized the error it had made in *Quill*, the New York Court of Appeals will recognize the error that it

made in *Tamagni*.”

A [second case](#) on this issue, *Chamberlain v. Department of Taxation and Finance*, is still pending before the appellate division after the Supreme Court of the State of New York, Albany County, also rejected the taxpayers' argument.