

Nonresident Income Allocation And Apportionment

2022 Summer Tax Series

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Overview

1. Residency Refresher
2. Taxing Nonresident Individuals
3. Allocating Compensation
 - Overview
 - Telecommuting & Convenience Rule
 - Employer Withholding
4. Multi-year allocation
5. Allocating Income From Flow-Through Entities
6. Nonresident Corporate Apportionment

Residency Refresher

Types of Residency Tests

- Domicile – home is where the heart is
- Statutory Residency
 - Most Common – Two-part test: (1) permanent place of abode + (2) more than 183 days
 - Other Variations – E.g., “Contact Periods”
- Rebuttable Presumption of Residency

Example: Residency in New York

Two Residency Tests:

1. Domicile

5 Domicile Factors

- Home - Near & Dear
- Time -Family
- Business

2. Statutory Residency

- (1) Permanent place of abode +
- (2) more than 183 days

Tax Based on Resident Status:

- NYC tax: All or nothing
- NYS Residents: worldwide income
- **NYS Nonresidents: NY-source income only**
 - ❖ Today's topic.

Taxing Nonresident Individuals

Source Income

- Nonresidents – pay NYS tax on income from in-state sources.
- What qualifies as “income from in-state sources”?
 - Wages for services performed in-state
 - Income/loss from real property
 - Income/loss from in-state business
- Not all income has a source
 - Think “unearned income” or income from investments/intangibles
 - Generally not taxable for nonresidents
 - Double-taxation possible for dual-residents

Allocating Compensation

The Basics of Allocating Compensation

- If employee is a resident of the state where they work, then 100% of their compensation income is subject to that state's tax, and employer must withhold 100% state tax
- If employee is a nonresident of the state where they work, then state tax still due to the extent of the taxpayer's workdays in the state
- Formula: $[\text{In-State Workdays}] \div [\text{Total Workdays}] = [\text{Workday Percentage}]$
 - Employer must withhold state tax based on that workday percentage
 - Employee reports allocable income based on that workday percentage

The Basics of Allocating Compensation

- What counts as a workday?
 - Typical workdays (Monday-Friday)
 - Weekends? Holidays? Travel days?
- Where is the workday spent?
 - Pre-Covid: Most states using “physical presence” to determine location
 - Easy: Days spent in the state by the nonresident employee on company business
 - Not so easy: Telecommuting and remote work

Allocating “Regular” Wages/Salary

- Allocation is required when a nonresident’s in-state workdays/compensation exceeds the applicable threshold (if any)

- Allocation formula:

$$\frac{\textit{In-State Workdays}}{\textit{Total Workdays}} \times \textit{Total Wages}$$

- “Workday” typically **includes** travel days, days worked from home, days worked on weekends
- “Workday” typically **excludes** holidays, vacations, sick days, weekends

Counting Workdays

Total Days in Year		365
Nonworking days:		
Saturdays/Sundays	104	
Holidays	10	
Vacation Days	14	
Sick Days	5	
Other Nonworking Days	2	
Total Nonworking Days		135
Total Days Worked in Year		230
Total Days Worked Out-of-State		55
Total Days Worked In-State		175

Example: Wage Allocation

Wisconsin Example

Example: You were employed in Colorado and were a resident of that state. Your employer required you to spend 15 days during 2019 at the company's main office in Wisconsin. Your annual salary was \$40,000 which was compensation for 260 days. The amount of wages allocable to Wisconsin is \$2,307.69, computed as follows:

$$\frac{15}{260} \times \$40,000 = \$2,307.69$$

Tax Impact of Telecommuting

- Issues to Consider:
 - Nexus
 - Withholding Changes
 - Convenience of the Employer Rule
 - Before Stay-at-Home Orders and After

Tax Impact of Telecommuting - Nexus

- There must be a link, some “minimum connection between a state and the person, property or transaction” for a state to impose tax
- Does the presence of a telecommuter create nexus for a company?
- In most states and in “normal” circumstances: Yes!
- Most states say that the presence of 1-6 telecommuters in the state will create nexus for a company (See Bloomberg Tax & Accounting, 2021 Survey of State Tax Departments)
- This could mean nexus for employment, income, sales and other taxes!

The “Convenience of the Employer” Rule

The Basic Rule

- In general, if the employee works from home for their own convenience, broadly defined, the workdays at home will be treated as days worked at their assigned work location
- Applications:
 - Nonresident income allocation
 - Withholding
 - Resident credits

The “Convenience of the Employer” Rule

- 5 states (NY, CT, PA, DE, NE) have a “Convenience Rule”
- A 6th state (AR) recently enacted legislation which reversed the state’s policy of employing a “Convenience Rule” as of January 1, 2021. Arkansas Senate Bill 484 (2021)
- Nuances:
 - CT’s rule only applies if the other state is a “Convenience State”
 - Several states (GA, MA, ME, MS, NE, NY, PA, RI, SC) issued guidance or temporary legislation during pandemic that required that days worked at home continue to be treated as if worked the employee’s regular place of work

Convenience Rule States

<p>Connecticut Conn. Gen. Stat. § 12-711(b)(2)(C)</p>	<p>“For purposes of determining the compensation derived from or connected with sources within this state, a nonresident . . . shall include income from days worked outside this state for such person's convenience if such person's state of domicile uses a similar test.”</p>
<p>Delaware 2020 Schedule W</p>	<p>For nonresidents, non-Delaware workdays “must be based on necessity of work outside . . . Delaware in performance of duties for the employer, as opposed to solely for the convenience of the employee. Working from [a home office] does not satisfy the requirements of ‘necessity’ of duties for your employer and is considered for the convenience of the employee <u>unless working from home is a requirement of employment with your employer.</u>”</p>

Convenience Rule States - *continued*

<p>Nebraska 316 Neb. Admin. Code 22-003.01C(1)</p>	<p>“If the nonresident's service is performed without Nebraska for his or her convenience, but the service is directly related to a business, trade, or profession carried on within Nebraska and except for the nonresident's convenience, the service could have been performed within Nebraska, the compensation for such services shall be Nebraska source income.”</p>
<p>New York 20 NYCRR 132.18(a) TSB-M-06(5)I</p>	<p>“any allowance claimed for days worked outside New York State must be based upon the performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the service of his employer”</p>
<p>Pennsylvania 61 Pa. Code § 109.8</p>	<p>If a nonresident employee (including corporate officers but generally excluding salesmen) performs services both within and without PA, their PA-sourced income includes the ratio of PA workdays over total workdays. For this ratio, Non-PA workdays include days worked out-of-state performing services “which, of necessity, obligate the [employee] to perform out-of-State duties in the service of his employer.”</p>

Example: New York to Florida Move

■ Facts

- Taxpayer lives and works in New York City, but she has decided to give up New York City lease and move to Florida for good.
- Taxpayer's employer is based out of NYC and doesn't have a Florida office, but OK with remote work indefinitely, with some visits to the New York City office here and there.
- So, taxpayer telecommutes from her home office in Florida.

■ Issues

- Easy domicile case, and NYC tax savings.
- But...NYS nonresident allocation?
 - Wages will still be subject to NYS tax based on "convenience rule"
 - Employer still required to withhold 100% NY tax

The “Convenience of the Employer” Rule in NY


- New York is sending out desk audit notices to taxpayers who previously allocated all of their W-2 income to New York or whose allocation percentage decreased from 2019-2020/2021.
- Some of the notices say:

If you are a nonresident or part-year resident whose assigned primary work location is in New York State, days you worked at a location outside New York State may be considered New York State work days. In particular, days you telecommuted from a location outside New York State are considered New York State work days unless your employer has established a bona fide employer office at your telecommuting location.

The “Convenience of the Employer” Rule After COVID-19

- Telecommuting is likely to become even more prevalent now that stay-at-home orders have been lifted. Telecommuting is likely the new normal for many workplaces.
- Convenience Rule issues will take center stage.
- What happens if an employer no longer has a physical office?
- Employers need to be careful about nexus and Convenience Rule issues if they continue to allow employees to work from home.

2020 Requests for Information – Excerpts

 Department of Taxation and Finance Audit Division-Income/Franchise Desk W A Harriman Campus, Albany NY 12227	Request for Information Notice date: 3/23/2021 Tax type: Personal Income Tax DLN: Case ID: Tax year: 2020 Form number: IT-203
21005142347900-A000	

We need more information by April 22, 2021 about your 2020 New York State income tax return.

If you either: (A) are domiciled in New York State, OR (B) maintained a permanent place of abode AND spent 184 days or more in New York State, you must file a resident tax return, Form IT-201, regardless of the location where you may have been working or telecommuting from in 2020.

If you are a nonresident or part-year resident whose assigned primary work location is in New York State, days you worked at a location outside New York State may be considered New York State work days. In particular, days you telecommuted from a location outside New York State are considered New York State work days unless your employer has established a bona fide employer office at your telecommuting location.

What must you do?

1. You must complete the enclosed Nonresident Audit Questionnaire (Form AU-262.3) to explain your residency status in New York City and/or New York State.

You must also verify your income allocation by providing the following (for each taxpayer if a joint return):

- A copy of your federal W-2, *Wage and Tax Statement*, for each employer;
- A completed *Income Allocation Questionnaire* (Form AU-262.55, enclosed) for each employer; and
- A full description of the composition of your wages (base compensation, bonuses, stock options, sick pay, vacation pay, severance pay, gambling income, unemployment compensation, etc.).

2020 Requests for Information – Excerpts

What happens after you send in the required information?

We will attach the information you provide to the return you already submitted, then we will continue processing your return. There may still be other changes to your return. If we need additional information to continue processing your return, would you like us to contact you by phone? If so, please include a daytime phone number:

Daytime phone number _____ Taxpayer name _____

What happens if you do not send all the information we need by April 22, 2021?

We will process your return without this information. That may reduce your refund or increase the amount of tax you owe.

Options to Avoid New York's Convenience Rule

- **Option #1: Assign to Non-NY Office**
 - But be careful that this assignment is real! (see next slides)
 - Should be used regularly, paid for by employer, etc.
- **Option #2: Bona-Fide Home Office**
 - TSB-M Factors
- **Option #3: No NY Workdays**
 - Year-by-year test
 - Even a few New York workdays, probably too many (Huckaby).
 - Should be in writing (employee told that they are not required to come to the NY office and employee indicates that they are not planning to come to NY during the calendar year)
 - Should be documented (for withholding purposes, T&E should reflect that no travel to NY)
- **Watch out for changes**
 - Something in the works in New York?
 - Congress step-in?

Reassignment to a Non-New York Office

- No written guidance as to what constitutes an individual's primary office
- On Audit, NY has looked at facts, such as:
 - Office that individual visits more than any other
 - Where is employee's administrative support?
 - Where does the employee's supervisor, managers, or "team" sit?
 - Does the employee still have designated office space in NY?
 - What do employer HR records designate as primary office?
- There must be evidence other than geographical proximity to reassign an employee to another office

The TSB-M Factors

Step 1: Primary Factor: Employee's duties require the use of special facilities that cannot be made available at the employer's place of business, but those facilities are available at or near the employee's home

If the home office does NOT satisfy the primary factor, proceed to Step 2

Step 2: The Secondary and "Other" Factors: The home office may still qualify as a "bona fide employer office" if it meets four out of the six Secondary Factors PLUS three out of the ten "Other" Factors

Secondary Factors (4 out of 6)

1. Home office is a requirement or condition of employment
2. Employer has a bona fide business purpose for the employee's home office location.
3. Employee performs some core duties at the home office.
4. Employee meets with clients, patients, or customers at the home office.
5. Employer does not provide the employee with office space or regular work accommodations.
6. Employer reimburses expenses for the home office.

"Other" Factors (3 out of 10)

1. Employer maintains a separate telephone line and listing for the home office.
2. Employee's home office address and phone number are on the employer's business letterhead and/or cards.
3. Employee uses a specific area of the home exclusively for the employer's business.
4. Employee keeps inventory of products or samples in the home office.
5. Employer's business records are stored at the home office.
6. Employer signage at the home office.
7. Home office is advertised as employer's place of business.
8. Home office covered by a business-related insurance policy.
9. Employee properly claims a deduction for home office expenses for federal income tax purposes.
10. Employee is not an officer of the company.

Example: But my NYC office was closed!

▪ Facts

- Taxpayer worked in his employer's NYC office prior to pandemic.
- When the pandemic hit in March 2020, the employer closed its NYC office and mandated employees work from home indefinitely.
- From March 2020 through September 2021, all employees, including the taxpayer, worked 100% of their time remotely.
- In March 2022, the NYC office reopened.
- Taxpayer decided to move to Florida in mid-2020 and has been working remotely from home in Florida ever since.

▪ Issues

- Taxpayer spent some part of 2020 (January-mid March) all of 2021 working remotely. What result?
- Different result if?
 - The NYC office was technically open (maybe with limited capacity) beginning September 2020, but employer didn't mandate employees come into office and taxpayer chose to work remotely for balance of 2020.
 - Taxpayer spent 3-5 days working from NYC between March-December 2020 or January-December 2021 (i.e., client meetings, events, etc.)?
 - The employer eliminated the employee's assigned office space in the NYC office and relocated him to a non-New York office of the company? Close to new home in FL? In some other place?

Example: Double Tax on Remote Work?

■ Facts

- Clark (a New York resident) usually works in NYC for his employer.
- Since March 2020, he has been working remotely from his ski home in Colorado for his New York employer.
- He hopes to be back to NY later this year.

■ Issues

- Clark is a NY resident, so NY withholding must continue.
- Colorado's rules require Clark to source his wage income to Colorado based on his physical work location in Colorado.
 - Does employer have CO withholding requirement?
- New York, on the other hand, calls those Colorado physical presence workdays New York workdays under its convenience rule.

Allocating Multi-Year & Deferred Compensation

Multi-Year Allocations – In General

- Multi-year allocations are triggered when a taxpayer receives compensation attributed to services performed in a different tax year
- Common sources of deferred comp:
 - Deferred bonuses
 - Equity awards (RSUs/Stock Options)
 - Severance/termination pay

Deferred Bonuses

- Bonuses received by a nonresident for services performed in a previous taxable year
 - Example: Bonus received 4/1/2021 for performance in 2020 is allocated based on 2020 allocation percentage (not 2021)
- This can be particularly important when bonus is received in the year of a change in residence

Restricted Stock

- Generally taxable for federal purpose as ordinary income in the year of vesting
- The taxable amount equals the difference between the amount paid (if any) and the FMV at the time of vesting (unless I.R.C. § 83(b) election is made)
- The amount taxable as ordinary income for federal purposes can represent taxable compensation to a nonresident for state income tax purposes
- Generally allocable to the extent that the compensation is taxable for federal income tax purposes and where it is earned

Example: New York RSU Allocation

- Employee works in Employer's FL office and is a NY nonresident ever year. In 2019, Employer informs Employee that he'll receive an RSU award valued at \$200,000 which will be granted on 4/1/2020 and will vest over the next five years on the following schedule:
 - 10% on the 1st anniversary of the grant date (4/1/2021) - \$20K
 - 10% on the 2nd anniversary of the grant date (4/1/2022) - \$20K
 - 20% on the 3rd anniversary of the grant date (4/1/2023) - \$40K
 - 30% on the 4th anniversary of the grant date (4/1/2024) - \$60K
 - 30% on the 5th anniversary of the grant date (4/1/2025) - \$60K
- From 2020 through 2025, Employee has 240 workdays for Employer each year and he works in NY on 10% of those days (24 days/year) except that he worked an extra 5 days in NY in May 2021 (29 total for 2021).
- In 2021, Employee will receive W-2 compensation based on his 10% vesting (\$20K) in wages, plus any appreciation that has occurred between the grant and vest dates) which will be allocated to NY based on the amount of work days between the date of grant (4/1/2020) and the date of vest (4/1/2021). Thus, in 2021, \$2,000 (or 10% of the \$20K, plus appreciation) will be sourced to and taxable by New York.

Example: New York RSU Allocation *continued*

The 2022 allocation will be computed as follows:

	NY	Total
Work days 4/1/2020 – 3/31/2021	24	240
Work days 4/1/2021 – 3/31/2022	29	240
Total workdays Grant-to-Vest Period	53	480
NY Allocation % $(53 \div 480) = 11\%$		
Total vested in 2022 (assume no appreciation) = \$20K (10% of \$200K)		
Amount sourced to/taxable by NY = \$2,200 (11% of 20K that vested in 2022)		

Stock Options

- Statutory/Qualified Options (e.g., incentive stock options or ISOs) are generally taxed only once (when sold) and the character of the gain is capital in nature
- Non-statutory/Non-Qualified are taxed twice: at the exercise date (ordinary income on W-2) and when sold (capital gain)

Allocating Equity Awards

- Allocation methodologies vary
- Most (but not all) states tax a nonresident on option income when and where it was earned vs. when it was received. Doesn't matter if the individual was a resident of the state when it was earned.
 - Workdays from Grant-to-Vest – *E.g.*, NY, GA, ID
 - Workdays from Grant-to-Exercise – *E.g.*, AZ, CA, CT, NJ, PA
 - Exceptions:
 - Five-Year – IL
 - Location of Grant Rule – NC
 - “Degree of Appreciation” – OH

Equity Awards – Key Dates

- Grant Date – When Employee is granted option to purchase stock from Employer at fixed price within a set period
- Vest Date – When Employee satisfies all employment-related conditions, making the options exercisable
- Exercise Date – When Employee actually buys the stock
- Sale Date – When Employee sells the stock

Termination/Severance Pay

- Generally allocated based on prior in-state services, but with varying periods
- New York: Allocated based on the year of termination and three prior years. Note that New York uses a “comp-to-comp” method for this period.
 - Example: *If I separate from employment in 2022 and receive a severance, I measure total New York compensation and total everywhere compensation in 2019, 2020, 2021, and 2022 and compute the allocation percentage using a total New York compensation over total everywhere compensation fraction over that period*
- Minnesota: Allocated based on the percentage of time worked in the state in total.
 - Example: *I worked nine years in Minnesota and one year in Florida. I am a Florida resident when receiving my severance payment. I must allocate 90% of my severance pay to Minnesota.*

Allocating Director's Fees

- Generally allocated based on location of board meetings
 - New York requires nonresidents to allocate board compensation like a W-2, salaried employee (days in/out during the current year)
 - However, generally only count the days where there are board meetings and not time spent preparing for board meetings
 - Some inconsistency in audit treatment here, but seems most auditors do not count out-of-state attendance by telecommuting as a New York day
 - California recently issued Chief Counsel Ruling 2019-03 expressing a similar view
- Non-wage income, so no convenience rule issues

Example: Director's Fees Allocation

- **Facts:**

- Jane is on the Board of a multinational company
- She received director's fees totaling \$100k in 2021
- The Board held 8 meetings in 2021
 - 4 meetings in New Jersey
 - 3 meeting in New York
 - 1 meeting in California

- **Allocation:**

- \$50K (50%) to New Jersey
- \$37.5K (37.5%) to New York
- \$12.5K (12.5%) to California

Pensions & Retirement Income

- Many are exempt from state tax under state/federal law
- Formula for taxable pensions/retirement income: comp-to-comp method for the allocation period
- Allocation period: the tax year before retirement, plus three immediately preceding tax years

State Withholding Obligations

State Withholding Obligations of the Employer

- Generally, states require employers to withhold personal income taxes on behalf of their employees
- Withholding amount is meant to reasonably approximate the amount of tax the individual would owe to a state or states on their compensation from the employer
- Employer withholding requirements differ widely among the states

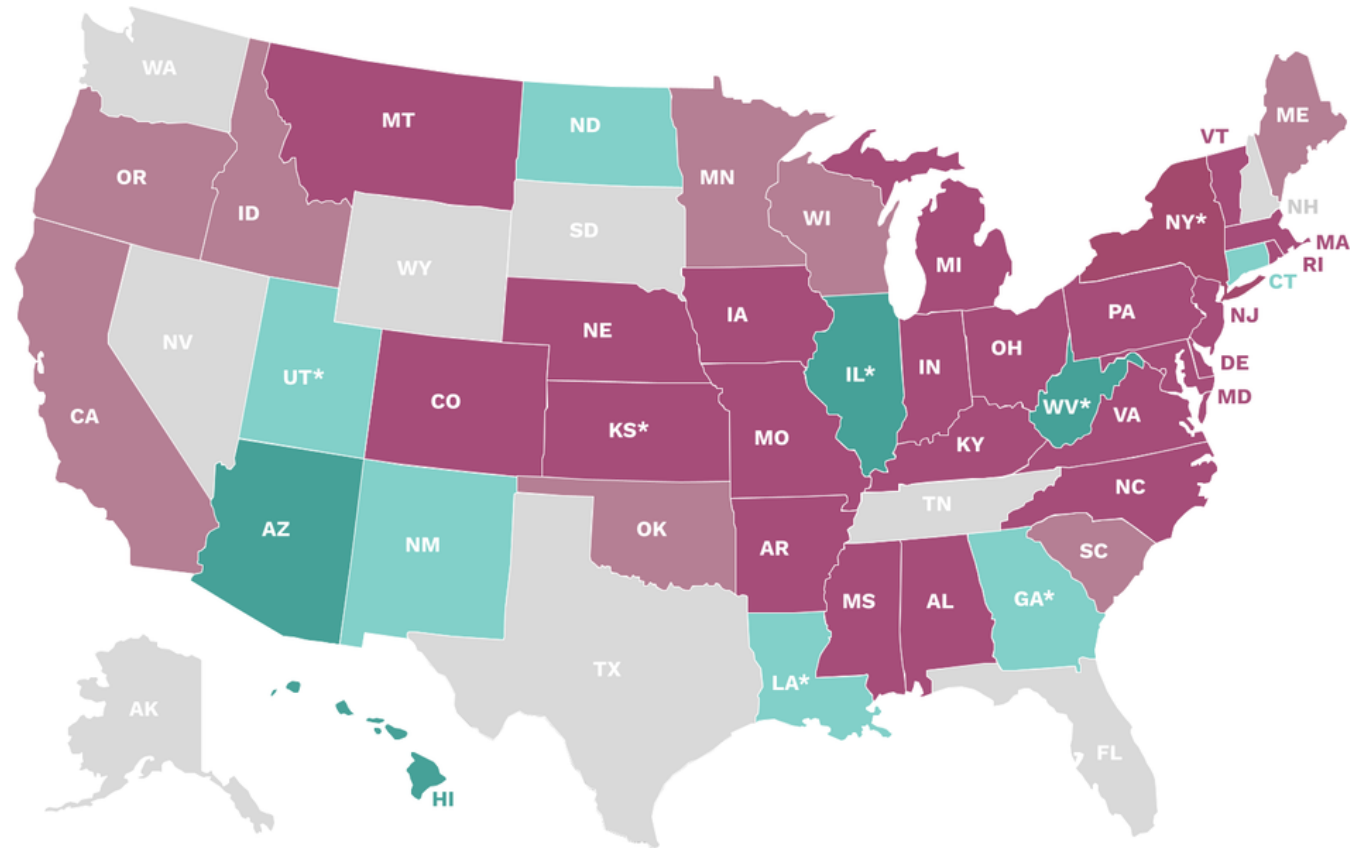
Withholding Thresholds

- States generally adopt 1 of 3 types of thresholds:
 1. Number of Days In-State (E.g., 60 days/year for AZ and HI; 15 days/year for CT; 14 days/year for NY)
 2. In-State Wages (E.g., WI is \$1,500/year; ID and SC are both \$1,000/year)
 3. No Threshold (E.g., CO, IN, MI, NC)
- Some states adopt hybrid thresholds, for example:
 - Maine's threshold is 12 days/year and gross income of \$3,000
 - Georgia's threshold is 23 days/quarter and the GA wages can't exceed \$5,000 or 5% of total income

Withholding Tax Rules (Source: Mobile Workforce Coalition)

Which states are the most friendly to mobile workers and their employers?

- **Very Friendly.** State allows employees to work within the state for 30 or more days before employer is subject to withholding (AZ, HI, IL, WV).
- **Moderately Friendly.** State allows employees to work in the state between 15 and 29 days before employer subject to withholding (CT, GA*, LA*, NM, ND), or has other accommodating provisions (UT*).
- **Unfriendly.** State only allows employees to work in the state between 2 and 14 days before employer is subject to withholding (ME), or has a wage-based threshold (CA, ID, MN, OK, OR, WI).
- **Very Unfriendly.** State requires employer withholding on first day an employee works within the state (24 states), or requires an individual to file on first day even if employer isn't required to withhold on first day (NY).
- **Not applicable.** No state income tax.



Notes: Data as of Feb. 2022. In **Georgia**, employer must withhold if the employee is in the state for more than 23 days in a calendar year, or if \$5,000 or more or 5% or more of total income is attributable to Georgia. In **Illinois**, the 30-day threshold applies for tax years beginning after December 31, 2020 (this is the result of legislation enacted in 2019). In **Louisiana**, legislation was enacted in 2021 that moves the state to a 25 day threshold (SB 157). **West Virginia** lawmakers enacted HB 2026 in 2021, imposing a 30-day threshold. This takes effect on June 28, 2021. In **Utah**, employer must withhold if the employer (not the employee) does business in the state for more than 60 days in a calendar year. ***Kansas** considered 30-day legislation in 2020.

Withholding in the remote work era

- How do companies handle withholding and employment taxes while their employees telecommute from other states in the absence of clear state guidance?
- When should a company start withholding in the employee's home state or continue to withhold in the employee's traditional work state?
- What obligations does an employer have to know where an employee is working?

Employer Withholding Tax Audits

- States are becoming increasingly aggressive in enforcing withholding tax requirements
- Viewed as a new revenue source
- Many challenges associated with withholding for a mobile workforce, for example:
 - Insufficient payroll system capabilities
 - Burdens placed on employees to document travel
 - Lack of uniformity across states and localities

Audit Risk

- New York withholding tax audit risk is growing

\$95 million

Collected from NYS
withholding tax audits in FY
2018

226%

Audit \$ collected in FY 2018
vs. FY 2015

Source: NYS FOIL response provided to Monaeo

Allocation and Apportionment of Business Income

Proprietorships, Partnerships and S Corporations

- New York taxes nonresidents on business income they receive from New York sources
- New York has two different methods for allocating and apportioning income from businesses
 - Income from Proprietorships and Partnerships is subject to the same general approach
 - Income from S corporations is subject to a different approach
- Certain items of business income are subject to special rules

Income from Proprietorships and Partnerships

- The rules here are antiquated and arcane and require a “fair and equitable” sourcing of income to New York
 - Outside of special circumstances, “Direct accounting” is the preferred sourcing method
 - 20 NYCRR § 132.15(b)
 - “If the books of the business are so kept as regularly to disclose, to the satisfaction of the Tax Commission, the proportion of the net amount of the items of income, gain, loss and deduction derived from or connected with New York State sources, the New York State nonresident personal income tax return of the taxpayer must disclose the total amount of such items, the net amount of such items allocated to New York State, and the basis upon which such allocation is made.”

Income from Proprietorships and Partnerships

- And if the books and records aren't clear?
- 20 NYCRR § 132.15(b)
 - “If the books and records of the business do not disclose, to the satisfaction of the Tax Commission, the proportion of the net amount of the items of income, gain, loss and deduction attributable to the activities of the business carried on in New York State, such proportion will, except as provided in section 132.16 of this Part and section 112.7(b) of this Title, be determined by multiplying (1) the net amount of the items of income, gain, loss and deduction of the business by (2) the average of the percentages described in subdivisions (d) through (f) of this section.”
 - This requires a somewhat traditional three-factor formulary apportionment

Income from Proprietorships and Partnerships

- Property percentage: average gross value of hard assets in NYS/gross value of hard assets everywhere
 - $BOY + EOY/2$
 - Rented assets are capitalized at gross rents “payable” for the year x 8

Income from Proprietorships and Partnerships

- Payroll percentage

- 20 NYCRR § 132.15(e):

- “The payroll percentage is computed by dividing (1) the total wages, salaries and **other personal service compensation** paid or incurred during the taxable year to employees, **in connection with business carried on within New York State**, by (2) the total of all wages, salaries and other personal service compensation paid or incurred during the taxable year to employees in connection with the business carried on both within and without New York State.”
 - Auditors sometimes try to pile on non-employee compensation

Income from Proprietorships and Partnerships

- Gross income percentage:

- 20 § 132.15(f)

- “The gross income percentage is computed by dividing (1) the gross sales or charges for services performed by or through an office, branch or agency of the business located within New York State, by (2) the total of all gross sales or charges for services performed within and without New York State. **The sales or charges to be allocated to New York State include all sales negotiated or consummated, and charges for services performed, by an employee, agent, agency or independent contractor chiefly situated at, connected by contract or otherwise with, or sent out from, offices, branches of the business, or other agencies, situated within New York State.**”

Income from Proprietorships and Partnerships

- **Business** income x rate x apportionment percentage
- Apportionment percentage is the unweighted average of
 - Property factor
 - Payroll factor
 - “Origin-based” Gross receipts factor
- Business income does not include investment income (income from intangible assets not used in a trade or business).
 - Exception for interests in condos and coops
 - Exception for sales of ownership interests in entities primarily owning New York State real property
 - Exception for sales of partnership interests subject to IRC § 1060

Income from Proprietorships and Partnerships

- Special situations:
 - Income from real and tangible personal property located in New York
 - Allocated, not apportioned
 - Exception for tangible property only in New York for the purpose of being sold (e.g. at a Sotheby's auction); See Audit Manual of the Division of Taxation; *but see Matter of Ittleson* (Aug. 25, 2005)
 - The opposite should likewise be true—i.e. that rents and gains from property outside of New York should be treated as not having New York source (note: income from sales of inventory have traditionally been apportioned and not allocated, although there does not appear to be any direct support for that approach in Tax Law § 631[b][1][A])

Income from S Corporations

- All income is sourced using the corporate tax (Art. 9-A) rules
 - Single-factor, receipts-only apportionment using a customer-based sourcing method for sourcing receipts
 - Apportionment fraction = NY receipts/Total receipts
- “All” income?
- Even investment income?

Income from S Corporations

■ Article 9-A uses a classification approach to sourcing receipts

1. Sales of tangible personal property, electricity and real property;

- Destination and location of real property (same as prior law)

2. Rentals and royalties;

- Location of property or location of use (same as prior law)

3. Digital products;

- Hierarchical sourcing method (see later slides)

4. Financial transactions;

- Fixed percentage (8%) election method or customer-based sourcing (detailed rules for “Financial Instruments” and “Broker/Dealer Activities” in draft regs)

5. Global intangible low-taxed income (“GILTI”);

- C corps = 0% in numerator; 5% in denominator
- S corps = 0% in numerator; 100% in denominator

6. Receipts from railroad and trucking business;

- Amount of receipts multiplied by fraction of miles travelled within NYS/NYC divided by miles everywhere

Income from S Corporations

7. Receipts for the operation of vessels;

- Aggregate number of working days of vessels within NYS/NYC divided by working days everywhere

8. Receipts from aviation services;

- Air freight = 100% if both pick-up and delivery done in NYS/NYC; 50% if either pick-up or delivery

9. Receipts from sales of advertising

- Newspapers & Periodicals = receipts multiplied by number of newspapers/periodicals delivered in NYS/NYC divided by number all newspapers/periodicals delivered everywhere
- Other = receipts multiplied by number of NYS/NYC viewers/listeners divided by number of viewers/listeners everywhere

10. Receipts from transportation or transmission of gas through pipes;

- Receipts multiplied by taxpayer's "transportation units" within NYS/NYC divided by "transportation units" everywhere

11. Receipts from other services and business receipts

- Hierarchical sourcing method (see later slides)

Income from S Corporations

- Special situations involving sale of S corporation shares
 - Gain from sale of shares generally is not sourced to New York
 - Exceptions
 - IRC § 338(h)(10) elections
 - IRC § 453(h)(1)(A) situations
 - S corporations with a majority of their gross asset value in New York real estate

Planning Opportunities

- Under the right circumstances nonresidents may choose!
 - If operating entity is a tax-partnership, nonresidents can “pick their poison” by either having the entity “check the box” and make federal and New York State S elections
 - Or, maybe just contribute their partnership interest into their wholly-owned S corporation
 - Of course, this would require a fact-specific analysis to determine whether this makes sense
 - Nonresident owners of profitable New York-based businesses with lots of non-New York customers will often want the S corporation structure
 - Nonresident owners of profitable businesses based outside of New York, but with significant new York customers will often want a partnership structure to take advantage of the non-New York property and payroll factors and the origin-based gross income factor
 - Or, federal S, New York C?

Q&A

You have

Questions

We have

Answers

Thank You for
Attending
Today's Program



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