Internal Consistency an Issue With New York's Residency Credit

POSTED ON MAY 14, 2018

By

ANDREA MUSE
Contact Author

New York's denial of a resident credit for tax paid to other states on unearned income fails the internal consistency test and is unconstitutional under a 2015 U.S. Supreme Court decision, according to one practitioner.

Timothy Noonan of Hodgson Russ LLP said there are two cases pending in New York in the aftermath of the 2015 *Comptroller of the Treasury of Maryland v. Wynne* decision arguing that the state's tax scheme is unconstitutional. Both cases are on appeal after trial courts found in favor of New York, citing a 1998 decision by the state's highest court in *Matter of Tamagni v. Tax Appeals Tribunal of New York*. Noonan, whose firm represents the taxpayers in the pending cases, said New York's tax scheme is internally inconsistent, which is unconstitutional under *Wynne*.

Noonan's comments came during the State and Local Taxes session of the American Bar Association Section of Taxation meeting in Washington May 11.

The Supreme Court ruled in *Wynne* that Maryland's failure to provide a credit for the local portion of its individual income tax for taxes paid to other states was unconstitutional under the dormant commerce clause. The case involved a challenge by a couple who was denied a Maryland county income tax credit for taxes paid to other states on income received from an investment in an out-of-state S corporation.

Ruth Mason, professor of law at the University of Virginia School of Law, said during the panel discussion that after *Wynne*, the internal consistency test became one of whether a state tax is discriminatory within the meaning of the commerce clause. The test asks whether, if every state imposed a tax identical to the one in question, interstate commerce would be burdened more than intrastate commerce. If the tax fails the test — that is, if the commerce burdens are unequal — the tax is unconstitutional.

In *Chamberlain v. Department of Taxation and Finance* and *Edelman v. Department of Taxation and Finance*, the taxpayers are challenging the state's denial of credits for taxes paid to Connecticut on income from investments and intangibles because the income was not earned in Connecticut.

Though the taxpayers are domiciled in Connecticut, they are considered residents of New York because they have a permanent place of abode and spent more than 183 days per year in the state. Both Connecticut and New York taxed 100 percent of their income, but New York allows a credit for taxes paid to states only on income earned in that state.

Noonan said the 1998 decision held that the disallowance of the credit for investment and intangible income was constitutional, ruling that the commerce clause wasn't implicated by a tax on the basis of residency and that there was no need to apply the internal consistency test.

But Noonan argued that the question isn't whether interstate commerce is being taxed, but whether the tax affects interstate commerce. If it does, the court must apply the internal consistency test under *Wynne*, Noonan continued.

Noonan added that the problem with the state's tax scheme isn't the low threshold that New York has enacted for residency, but the failure to provide credits for taxes paid to other states to remedy the multiple taxation.

DOCUMENT ATTRIBUTES

JURISDICTIONS	UNITED STATES NEW YORK
SUBJECT AREAS / TAX TOPICS	CREDITS INDIVIDUAL INCOME TAXATION LITIGATION AND APPEALS
AUTHORS	ANDREA MUSE
INSTITUTIONAL AUTHORS	TAX ANALYSTS
TAX ANALYSTS DOCUMENT NUMBER	DOC 2018-20254
TAX ANALYSTS ELECTRONIC CITATION	2018 STT 93-2