NEW YORK STATE | Department of Taxation and Finance

**Technical Memorandum**
**TSB-M-15(7)C, (6)I**
Corporation Tax
Income Tax
December 1, 2015

# Impact of New York State Corporate Tax Reform on New York S Corporations and their Nonresident and Part-Year Resident Shareholders

Corporate tax reform legislation (Part A of Chapter 59 of the Laws of 2014 and Part T of Chapter 59 of the Laws of 2015) significantly amended the Article 9-A apportionment rules and repealed Article 32. This memorandum discusses how these changes impact both the computation of the apportionment factor by a New York S corporation, and the determination of New York source income by Article 22 nonresident and part-year resident shareholders of New York S corporations, for S corporation tax years beginning on or after January 1, 2015.

Corporate tax reform impacted both the computation of the apportionment factor that New York S corporations must provide to their nonresident and part-year resident shareholders, and the determination of New York source income by those shareholders. The Article 9-A apportionment rules have changed substantially; the business apportionment factor is a reflection of a corporation's New York State market-based receipts (for more information see our Corporate Tax Reform webpage at *www.tax.ny.gov*). In addition, all former Article 32 filers file under Article 9-A. Under Article 9-A, income is apportioned to New York using the business apportionment factor only (Tax Law section 210-A); Article 9-A no longer provides for an investment allocation percentage. To determine the amounts derived from New York sources, a nonresident shareholder applies the S corporation's **business apportionment factor** to **all** New York S corporation items of income, gain, loss, and deduction (and to any related Tax Law section 612 modifications) that are included in New York adjusted gross income. For a part-year resident shareholder, this allocation would only apply to the New York S corporation items received during the nonresident period of the tax year (and to any related Tax Law section 612 modifications).

All of the New York S corporation income of a nonresident shareholder of an electing or mandated New York S corporation is subject to the personal income tax imposed under Article 22. The New York source income of a nonresident individual includes the net amount of items of income, gain, loss and deduction entering into his or her federal adjusted gross income (FAGI), derived from or connected with New York sources (Tax Law section 631). Tax Law section 631(a)(1)(B) requires nonresident shareholders of a New York S corporation to include in their New York source income their pro rata share of the S corporation's income, loss and deduction, that is derived from or connected with New York sources as determined under Tax Law section 632. The New York source portion of any related Tax Law section 612 modifications is also included in New York source income (Tax Law section 631(a)(2)).

Tax Law section 632(a)(2) provides that, for a nonresident shareholder of a New York S corporation, the New York source income portion of all New York S corporation items that are in the nonresident shareholder's FAGI is determined in a manner consistent with the applicable

methods and rules for allocation under Article 9-A, regardless of whether or not such items are included in entire net income under Article 9-A for the tax year.

Prior to corporate tax reform, under Article 9-A, business income was allocated at the business allocation percentage and investment income was allocated at the investment allocation percentage. For tax years beginning on or after January 1, 2015, under Article 9-A, income is allocated solely using the business apportionment factor determined under Tax Law section 210-A. As a result, **all** New York S corporation items entering into a nonresident shareholder's FAGI must be allocated to New York using the business apportionment factor, even if there are amounts that would have qualified as exempt investment income or other exempt income for an Article 9-A New York C corporation filer. There is no statutory provision in Article 22 to exempt such income from personal income tax, or to modify FAGI to remove such income.

> **Example:** *A New York S corporation computes a business apportionment factor of 5% for calendar year 2015 using market-based sourcing per Tax Law section 210-A. Shareholder X is a nonresident shareholder of the New York S corporation. Shareholder X receives a 2015 federal Schedule K-1 (1120S) from the S corporation with the items of income, gain, loss, and deduction listed below. Assume there are no related Tax Law section 612 modifications. Shareholder X determines the New York source income portion of **all** S corporation items that are in his or her FAGI by applying the business apportionment factor of 5% to **each** item, regardless of whether or not any amounts would have qualified as exempt investment income or other exempt income for an Article 9-A New York C corporation filer.*

| Shareholder X's 2015 Federal S corporation K-1 items | | Amount entering into shareholder X's FAGI | NY source income portion |
|---|---|---|---|
| Ordinary business income or (loss) | 10,000 | 10,000 | 500 |
| Net rental real estate income or (loss) | (5,000) | (5,000) | (250) |
| Interest income | 1,000 | 1,000 | 50 |
| Ordinary dividend income | 2,000 | 2,000 | 100 |
| Net long-term capital gain or (loss) | (1,200) | (1,200) | (60) |
| Total | 6,800 | 6,800 | 340 |

**Note:** A TSB-M is an informational statement of existing department policies or of changes to the law, regulations, or department policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in department policies could affect the validity of the information presented in a TSB-M.