

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-06(1)I
Income Tax
March 3, 2006

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I050209A

On February 9, 2005, a Petition for Advisory Opinion was received from Keith R. Bookbinder, CPA, 300 Corporate Parkway, Suite 200N, Amherst, New York 14226.

The issue raised by Petitioner, Keith R. Bookbinder, CPA, is whether income recognized for federal income tax purposes resulting from a decrease in a nonresident partner's share of liabilities of a New York investment partnership is New York source income for New York State personal income tax purposes.

Petitioner submits the following facts as the basis for this Advisory Opinion.

A taxpayer, as a resident of New York State, invested in four partnerships that leased equipment to third parties. The partnerships generated significant operating losses. The taxpayer's capital contribution and share of partnership recourse debt was generally sufficient to provide the taxpayer with adequate basis in the partnership for federal income tax purposes to deduct these partnership losses.

In 1979 and 1980, many of the equipment leases held by the partnerships reached maturity and the partnerships' managers decided to discontinue the leasing business. The managers sold off the old equipment, purchased various U.S. Treasury obligations and used margin debt (i.e., a loan against the value of the obligations) to pay off the partnership's outstanding equipment loans. These investments and their accompanying debt have generated interest income and investment interest expense for the entities.

In 1982, the taxpayer moved out of New York State.

In 2003, the partnerships' management decided to pay down a portion of the partnerships' liabilities. Pursuant to sections 731 and 752 of the Internal Revenue Code (IRC), the taxpayer recognized a gain to the extent the amount of the pay down of the partnership liabilities exceeded the adjusted basis of the taxpayer's interest in the partnership.

Applicable law and regulations

Section 705(a) of the IRC provides, in part:

General Rule. The adjusted basis of a partner's interest in a partnership shall, except as provided in subdivision (b), be the basis of such interest determined under

section 722 (relating to contributions to a partnership) or section 742 (relating to transfers of partnership interests)

(1) increased by the sum of his distributive share for the taxable year and prior taxable years of

(A) taxable income of the partnership as determined under section 703(a),

(B) income of the partnership exempt from tax under this title, and

(C) the excess of the deductions for depletion over the basis of the property subject to depletion;

(2) decreased (but not below zero) by distributions by the partnership as provided in section 733 and by the sum of his distributive share for the taxable year and prior taxable years of

(A) losses of the partnership, and

(B) expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account; and

(3) decreased (but not below zero) by the amount of the partner's deduction for depletion for any partnership oil and gas property to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such partner under section 613A(c)(7)(D).

Section 731(a) of the IRC provides:

Partners. In the case of a distribution by a partnership to a partner

(1) gain shall not be recognized to such partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution, and

* * *

Any gain or loss recognized under this subsection shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner.

Section 733 of the IRC provides:

Basis of distributee partner's interest

In the case of a distribution by a partnership to a partner other than in liquidation of a partner's interest, the adjusted basis to such partner of his interest in the partnership shall be reduced (but not below zero) by –

(1) the amount of any money distributed to such partner, and

(2) the amount of the basis to such partner of distributed property other than money, as determined under section 732.

Section 752(b) of the IRC provides:

Decrease in partner's liabilities. Any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

Section 601(e) of the New York State Tax Law imposes a personal income tax on nonresidents of New York State who have New York source income and provides, in part:

Nonresidents and part-year residents. (1) General. There is hereby imposed for each taxable year on the taxable income which is derived from sources in this state of every nonresident and part-year resident individual . . . a tax which shall be equal to the tax base multiplied by the New York source fraction.

(2) Tax base. The tax base is the tax computed under subsections (a) through (d) of this section, as the case may be, reduced by the credits permitted under subsections (b), (c), (d) and (m) of section six hundred six, as if such nonresident or part-year resident individual . . . were a resident subject to the provisions of part II of this article.

(3) New York source fraction. The New York source fraction is a fraction the numerator of which is such individual's . . . New York source income determined in accordance with part III of this article and the denominator of which is such individual's New York adjusted gross income determined in accordance with part II of this article. . . .

Section 631 of the Tax Law provides, in part:

(a) General. The New York source income of a nonresident individual shall be the sum of the following: (1) The net amount of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources, including: (A) his distributive share of partnership income, gain, loss and deduction, determined under section six hundred thirty-two, and

* * *

(2) The portion of the modifications described in subsections (b) and (c) of section six hundred twelve which relate to income derived from New York sources (including any modifications attributable to him as a partner. . .).

(b) Income and deductions from New York sources.

(1) Items of income, gain, loss and deduction derived from or connected with New York sources shall be those items attributable to:

* * *

(B) a business, trade, profession or occupation carried on in this state; or

* * *

(2) Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property, shall constitute income derived from New York sources only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in this state. . . .

* * *

(d) Purchase and sale for own account. A nonresident, other than a dealer holding property primarily for sale to customers in the ordinary course of his trade or business, shall not be deemed to carry on a business, trade, profession or occupation in this state solely by reason of the purchase and sale of property or the purchase, sale or writing of stock option contracts, or both, for his own account.

Section 632 of the Tax Law pertains, in part, to nonresident partners and provides, in part:

(a) Portion derived from New York sources.

(1) In determining New York source income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with New York sources of such partner's distributive share of items of partnership income, gain, loss and deduction entering into his federal adjusted gross income, as such portion shall be determined under regulations of the [Commissioner of Taxation and Finance] consistent with the applicable rules of section six hundred thirty-one.

* * *

(e) Application of rules for resident partners . . . to nonresident partners. . . .

(1) A nonresident partner's distributive share . . . of items shall be determined under subsection (a) of section six hundred seventeen.

(2) The character of partnership . . . items for a nonresident partner . . . shall be determined under subsection (b) of section six hundred seventeen. . . .

Section 137.1 of the New York State Personal Income Tax Regulations (Regulations) provides:

Partnership income and deductions of nonresident partner derived from New York State sources.

The New York source income of a nonresident partner includes the partner's distributive share of all items of partnership income, gain, loss and deduction entering into such partner's Federal adjusted gross income to the extent such items are derived from or connected with New York State sources, i.e., attributable to the ownership by the partnership of any interest in real or tangible personal property in New York State or to a business, trade, profession or occupation carried on in New York State by the partnership as determined under sections 132.3, 132.4(a), 132.6, 132.9, 132.12-132.16, 132.21 and 132.22 of this article and 137.2 of this Part.

Opinion

As a result of the decrease of the partner's share of liabilities of the partnership, the partner recognized income pursuant to sections 731 and 752 of the IRC. Section 752 of the IRC provides that a decrease in a partner's share of the partnership liabilities is treated as a distribution of money to the partner by the partnership. These deemed distributions of money cause a decrease in the partner's basis of his interest in each of the partnerships. See section 733 of the IRC. When such basis is exhausted, such deemed distributions of money result in the recognition of gain under section 731(a)(1) of the IRC. (See Internal Revenue Service Revenue Ruling 94-4, 1994-1 CB 195.) Any gain recognized under section 731(a)(1) of the IRC is considered a gain from the sale or exchange of the partnership interest of the distributee partner.

A gain (whether treated as capital or ordinary for federal income tax purposes) from the sale of an interest in a New York partnership, except in certain situations not present here, does not constitute gain or loss derived from or connected with New York sources and is not includible as New York source income. (See Technical Services Bureau Memorandum entitled *New York Treatment of Gains and Losses from the Sale by a Nonresident or Part-Year Resident of an Interest in a New York Partnership*, August 21, 1992, TSB-M-92-(2)I.)

In this case, therefore, the recognition of a gain by the nonresident partner for federal income tax purposes as a result of the pay down of the margin debt by the partnerships does not

constitute income, gain, loss or deduction derived from or connected with New York sources for New York State personal income tax purposes.

Accordingly, in determining the numerator of the New York source fraction of the nonresident partner, New York source income does not include any income from the gain recognized from the partnerships' pay down of their margin debt.

DATED: March 3, 2006

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.