

New York Tax Treatment of Partnership and New York S Corporation Income of Part-Year Residents

General

A Tax Appeals Tribunal Decision (Matter of Greig, DTA No. 815529) has changed the manner in which a partner of a partnership¹ or shareholder of a New York S corporation² reports his or her share of the income, gain, loss, and deduction of the partnership or New York S corporation where the partner or shareholder changes residence status during the year. A discussion of the new rules follows.

Part-year New York State resident individuals

Section 601(e) of the New York State Tax Law imposes a personal income tax for a part-year resident individual on the individual's taxable income that is derived from New York sources. The tax is equal to the tax computed as if the individual were a New York State resident for the entire year, reduced by certain credits, multiplied by the income percentage. The numerator of the fraction used to compute the income percentage is the part-year resident's New York source income. The New York source income of a part-year resident is the sum of (1) the individual's New York adjusted gross income from all sources for the period of residence, determined as if the individual's taxable year for federal income tax purposes were limited to the resident period, plus (2) the individual's New York adjusted gross income derived from New York sources³ for the nonresident period, determined as if the individual's tax year for federal income tax purposes were limited to the period of nonresidence.⁴ The denominator of the fraction used to compute the income percentage is the individual's New York adjusted gross income from all sources for the entire year.⁵

¹A partner includes a member of an LLC that is treated as a partnership for federal income tax purposes.

²A New York S corporation is a federal S corporation that has made the election under section 660 of the Tax Law to be treated as a New York S corporation.

³Income derived from New York sources includes income attributable to a business, trade, profession, or occupation carried on in New York State, the ownership of any interest in real or tangible personal property in New York State, or the ownership of shares in a federal S corporation that has made the election to be treated as an S corporation for New York tax purposes.

⁴Certain special accrual rules also apply when an individual changes residence status. The special accrual rules are not at issue here.

⁵The Greig case did not affect the computation of the denominator of the income percentage.

Prior to Greig, the Department's regulations (section 154.6), in conformity with comparable federal law, provided that the part-year resident tax treatment of the distributive or pro rata share of income, gain, loss, and deduction from a partnership or New York S corporation depended upon the individual's resident status at the time the partnership's or New York S corporation's taxable year ended. Accordingly, if the individual was a resident at the time the partnership's or New York S corporation's taxable year ended, the individual's total federal distributive or pro rata share of income, gain, loss, and deduction was included in New York source income. If the individual was a nonresident at the time the partnership's or corporation's taxable year ended, the individual's federal distributive or pro rata share of income, gain, loss, and deduction was included in New York source income only to the extent such items were derived from New York sources.

However, in Greig, the Tribunal, relying on the Court of Appeals decision in the matter of Matter of McNulty v New York State Tax Commission (70 NY2d 788, 522 NY2d 103 (1987)), held these regulations invalid, and provided that the amount of partnership or New York S corporation income, gain, loss, and deduction for the year in which the change of residence occurs must be prorated between the resident and nonresident periods. As a result of this decision, the former regulations cannot be used to determine the amount of partnership or New York S corporation income, gain, loss, and deduction to be included in New York source income.

Accordingly, based upon Greig, the amount of an individual's distributive or pro rata share of items of partnership or New York S corporation income, gain, loss, and deduction to be included in New York source income is computed using the following formula.

Partner / Shareholder formula

- Step 1.** Multiply the individual's distributive or pro rata share of income, gain, loss, and deduction for federal income tax purposes for the tax year by a fraction, the numerator of which is the number of days in the individual's tax year that the individual was a resident of New York State and the denominator of which is the total number of days in the individual's tax year.
- Step 2.** Multiply the individual's federal distributive or pro rata share of income, gain, loss, and deduction for federal income tax purposes for the tax year by a fraction, the numerator of which is the number of days in the individual's tax year that the individual was a nonresident of New York State and the denominator of which is the total number of days in the individual's tax year. This result is then multiplied by the partnership's or New York S corporation's New York allocation percentage for the year.
- Step 3.** Add the amounts computed in Step 1 and Step 2. This is the amount includable in New York source income.

The same steps are used to determine the amount of the distributive or pro rata share of New York addition and subtraction modifications from the partnership or New York S corporation to be included in New York source income. In addition, where an individual is a partner or a shareholder of more than one partnership or New York S corporation, these steps must be repeated for each partnership or New York S corporation.

Example 1:

Sam Smith was a partner in partnership Q during 1999. Partnership Q's taxable year ends on December 31, 1999. Partnership Q carried on business both within and without New York State and has determined that the partnership's New York allocation percentage is 65 percent. For tax year 1999, the distributive share of income from partnership Q included in Sam's federal and New York adjusted gross income (the *Federal Amount* column on Form IT-203) was \$40,000. Sam changed residence from New York State to New Jersey on September 30, 1999. Using steps 1 through 3, the amount of partnership income that Sam Smith must include in New York source income (the *New York State Amount* column) on his 1999 Form IT-203, *New York State Part-Year Resident Return*, is computed as follows:

Step 1 (Resident period)

$$\frac{273(\text{number of days from 1/1/99-9/30/99})}{365} \times \$40,000 = \$29,917.81$$

Step 2 (Nonresident period)

$$\frac{92(\text{number of days from 10/1/99-12/31/99})}{365} \times \$40,000 = \$10,082.19 \times 65\% (.65) = + 6,553.42$$

Step 3

Total amount includable in New York source income \$36,471.23

Example 2:

John Jones is a shareholder of a New York S corporation. The S corporation has a taxable year ending March 31, 1999. The New York S corporation's business allocation percentage computed under Article 9-A of the Tax Law is 40%. For John Jones' 1999 tax year, the pro rata share of New York S corporation income included in John's federal and New York adjusted gross income (the *Federal Amount* column on Form IT-203) was \$62,000. John's pro rata share of New York addition modifications from the corporation includable in his New York adjusted gross income (*Federal Amount* column on Form IT-203) was \$4,000. John changed residence from New Jersey to New York State on July 31, 1999. The amount of John's pro rata share of federal S corporation

income and New York addition modifications that must be included in New York source income (the *New York State Amount* column) on his 1999 Form IT-203, *New York State Part-Year Resident Return* is computed as follows:

Step 1 (Resident period)

$$\frac{153(\text{number of days from 8/1/99-12/31/99})}{365} \times \$62,000 = \$25,989.04$$

Step 2 (Nonresident period)

$$\frac{212(\text{number of days from 1/1/99-7/31/99})}{365} \times \$62,000 = \$36,010.96 \times 40\% (.40) = +14,404.38$$

Step 3

Amount includable in New York source income \$40,393.42

The amount of the \$4,000 of New York addition modifications that must be included in New York source income (the *New York State Amount* column) is computed using the same steps as above, except that \$4,000 would be substituted for \$62,000. Using steps 1 through 3, the amount of the New York addition modifications includable in New York source income is \$2,606.03 (\$1,676.71 + \$929.32).

Part-year New York State resident trusts

A part-year resident trust computes its New York State tax in the same manner as a part-year resident individual. Accordingly, if a trust that is a partner in a partnership or shareholder of a New York S corporation changes resident status, the amount of partnership or New York S corporation income, gain, loss, and deduction includable in the trust's New York source income is computed using the same *Partner/Shareholder formula* that applies to individuals.

Part-year New York City residents

A New York City part-year resident individual or trust is subject to the New York City personal income tax for the period of residence and, if applicable, the New York City nonresident earnings tax for the period of nonresidence. For a part-year resident, the New York City personal income tax is computed based upon all income, gain, loss, and deduction for the period of residence, and the nonresident earnings tax, if applicable, is based upon wages or net earnings from self-employment derived from New York City sources for the period of nonresidence. (Income from a New York S corporation is not taxable under the nonresident earnings tax.)

For New York City part-year resident individuals and trusts, Step 1 of the *Partner/Shareholder formula*, using New York City days, is used to determine the amount of partnership or New York S corporation income, gain, loss, and deduction subject to the personal income tax for the resident period. Due to the partial repeal of the nonresident earnings tax on June 30, 1999, if a partnership has income from New York City sources, partnership income included in the nonresident earnings tax computation is determined using the formula set forth under the caption *Part-year New York City residents*, in TSB-M-99(6.1)I.

Part-year Yonkers residents

A part-year Yonkers resident individual or trust is subject to the Yonkers income tax surcharge for the period of residence and, if applicable, the Yonkers nonresident earnings tax for the period of nonresidence. The Yonkers income tax surcharge is equal to the allocated net New York State tax multiplied by the Yonkers income tax surcharge rate (10% for 1999, 5% for 2000). The allocated net New York State tax for the resident period is equal to the net New York State tax for the entire year (the sum of all state taxes imposed by Article 22 of Tax Law on the individual or trust, reduced by any allowable state credits) multiplied by a fraction. The numerator of the fraction is the individual's or trust's New York adjusted gross income for the period of residence. The denominator of the fraction is the individual's or trust's New York adjusted gross income for the entire year. The nonresident earnings tax, if applicable, is based upon wages or net earnings from self-employment derived from Yonkers sources for the period of nonresidence. (Income from a New York S corporation is not taxable under the nonresident earnings tax.)

For part-year Yonkers resident individuals and trusts, Step 1 of the *Partner/Shareholder formula* is used to determine the amount of partnership or New York S corporation income, gain, loss, and deduction to be included in the numerator of the fraction used to compute the allocated net New York State taxes. If applicable, Step 2 of the *Partner/Shareholder formula* is used to determine the amount of net earnings from self-employment from a partnership subject to the Yonkers nonresident earnings tax during the nonresident period, except that net earnings from self-employment and the Yonkers allocation percentage are used in the computation. In addition, in using Steps 1 and 2, Yonkers days are used instead of New York State days.

Minimum income tax

The New York State minimum income tax for a part-year resident is imposed on federal items of tax preference, with any New York modifications, for the period of residence and federal items of tax preference, with any New York modifications, that are derived from New York sources for the period of nonresidence. If a part-year resident individual or trust has federal items of tax preference from a partnership or New York S corporation, the *Partner/Shareholder formula* is used to determine the amount of tax preference items, and any New York modifications, reportable in the resident and nonresident periods.

The New York City minimum income tax for a part-year resident is imposed on federal items of tax preference, and any New York City modifications, for the resident period only. Accordingly, only Step 1 of the *Partner/Shareholder formula* is used to determine the amount of federal items of tax preference and modifications subject to the city minimum income tax. In using Step 1, New York City days must be substituted for New York State days.

Shareholders of S corporations that are not New York S corporations

Shareholders of ineligible corporations

An ineligible corporation is a federal S corporation that cannot make the New York S election because it is not subject to tax under Article 9-A of the Tax Law. The shareholders of an ineligible corporation are treated for New York purposes as shareholders of a New York S corporation. Accordingly, a part-year resident individual or trust shareholder of an ineligible corporation also uses the *Partner/Shareholder formula* to prorate the amount of S corporation income, gain, loss, and deduction between the resident and nonresident periods. The amount prorated to the resident period is includable in New York source income. The amount prorated to the nonresident period should not be included in New York source income unless the stock of the S corporation is employed in another business carried on by the shareholder in New York State.

Shareholders of New York C corporations

A New York C corporation is a federal S corporation that is eligible to make the New York S election but does not make the election for the taxable year. A part-year resident shareholder of a New York C corporation does not have to make the prorations required of other S corporation shareholders. This is because any New York C corporation income, gain, loss, and deduction is eliminated from the computation of New York source income by reason of the New York C corporation modifications provided for under sections 612(b) and 612(c) of the Tax Law.

Note: For more information on the tax treatment of ineligible and New York C corporations, see Publication 35, *New York Tax Treatment of S Corporations and Their Shareholders*.

Effective date

The rules discussed in this memorandum are effective for tax years beginning in 1999 and thereafter. They also apply to any prior tax year for which the statute of limitations is still open.