

**New York Personal Income Tax Treatment of Partnership and  
New York S Corporation Income of Part-Year Residents  
For Tax Years Beginning Before 2004**

**General**

As a result of a Division of Tax Appeals Administrative Law Judge's determination in *Matter of Falberg* (DTA No. 818960), the Tax Department is providing clarification regarding the manner in which a partner of a partnership<sup>1</sup> or shareholder of a New York S corporation<sup>2</sup> reports his or her distributive share of items of income, gain, loss, or deduction from a partnership or New York S corporation when the partner or shareholder changes New York residence status during the year. The change discussed in this TSB-M is effective for tax years beginning **before** 2004.

Legislation has been enacted that will change the manner in which a partner of a partnership or shareholder of a New York S corporation will report his or her share of income, gain, and loss (less deductions attributable thereto) from a partnership or S corporation when the partner or shareholder changes New York residence status during the year. This legislative change is effective for tax years beginning after 2003. The Tax Department will issue guidance in the future on how the legislation will affect a part-year resident's allocation of partnership or S corporation income during the year in which a change of residence occurs.

**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<sup>3</sup>. 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 and 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 tax year for federal income tax purposes were limited to the resident period, plus (2) the individual's

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

<sup>2</sup>A 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.

<sup>3</sup>Income 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.

New York adjusted gross income derived from New York sources for the nonresident period, determined as if the individual's tax year for federal income tax purposes were limited to the period of nonresidence.<sup>4</sup> 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.

A 1999 Tax Appeals Tribunal decision in *Matter of Greig* (DTA No. 815529) changed the manner in which a partner (and, by implication, a shareholder of a New York S corporation) 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 resident status during the year. Prior to *Greig*, the Tax Department's regulation section 154.6 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 tax year ended. However, the Tax Appeals Tribunal Decision in *Greig* held the Tax Department's regulation section 154.6 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. In response to *Greig*, the Tax Department issued TSB-M-00(1)I, which required that the amount of a part-year resident 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 was to be computed using the following formula (the proration method):

#### **Partner / Shareholder formula**

- Step 1.** Multiply the individual's distributive or pro rata share of items 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 items 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.

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

The same steps were to be 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.

In *Falberg*, the Administrative Law Judge determined the proration method is not the only acceptable method for determining the amount of S corporation income attributable to the resident and nonresident periods. Instead, the Administrative Law Judge determined that the petitioner should be permitted to determine those amounts using a method that reflects the actual date of receipt or expenditure of the items of income, gain, loss, and deduction of the S corporation. After reviewing the matter, the Tax Department concurs with this method of reporting distributions received from a partnership or S corporation during a year in which a change of residence occurs. Therefore, for tax years beginning **before** 2004, it is the Department's position that in lieu of using the proration method previously discussed, a partner or shareholder may elect to determine the actual amount of his or her distributive share of partnership or S corporation income, gain, loss, or deduction attributable to the period he or she was a resident and nonresident during the partnership or S corporations taxable year ending within his or her taxable year in a manner that reflects the actual or accrued date of receipt and expenditure. This will be referred to as the *direct accounting method*. If a taxpayer elects this method, the partnership's or S corporation's method of accounting (e.g., accrual, cash) for federal income tax purposes must be used to determine the amount attributable to each period. In addition, the direct accounting method must be applied to **all** items of income, gain, loss, deduction or items of tax preference from the partnership or S corporation and must also be applied to any New York addition and subtraction modifications from the partnership or S corporation.

If a taxpayer is a partner or shareholder of more than one entity, the taxpayer may apply either the proration method or direct accounting method separately to each entity. However, the taxpayer is not required to use the same method for all entities.

This new policy applies to all open tax years beginning before 2004. A taxpayer who has previously filed and benefits from the new policy may file an amended personal income tax return within the statutory period and claim a refund.

The following examples illustrate the proration and direct accounting methods described in this memorandum.

**Example 1:**

Judy is a partner in Partnership A during 2003. Partnership A's tax year ends on December 31, 2003. Partnership A carried on business in and out of New York State and has determined that its New York allocation percentage is 75%. For tax year 2003, the distributive share of income from Partnership A included in Judy's federal and New York adjusted gross incomes (the *Federal amount* column on Form IT-203) is \$90,000. Judy changes residence from New York State to New Jersey on April 1, 2003. Using steps 1 through 3 of the *Partner/Shareholder formula*, the

amount of partnership income that Judy must include in the New York source income (the *New York State amount* column) on her 2003 Form IT-203, *Nonresident and Part-Year Resident Income Tax Return*, is computed as follows:

**Step 1 (resident period)**

$$\frac{90(\text{number of days from 1/1/03-3/31/03})}{365} \times \$90,000 = \$22,191.78$$

**Step 2 (nonresident period)**

$$\frac{275(\text{number of days from 4/1/03-12/31/03})}{365} \times \$90,000 = \$67,808.21$$

$$\$67,808.21 \times 75\% (.75) = \$50,856.16$$

**Step 3**

Total amount includable in New York source income	<u>\$73,047.94</u>
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**Example 2:**

Using the same set of facts above, Judy elects to determine her distributive share of income, gain, loss, and deduction from Partnership A attributable to her resident and nonresident periods using the direct accounting method. Applying its federal income tax method of accounting to all items of income, gain, loss, and deduction, Partnership A determines that Judy's distributive share of partnership items of income, gain, loss, and deduction for the resident period (1/1/03 - 3/31/03) would have been \$18,000, and for the nonresident period (4/1/03 - 12/31/03), her share of those items would have been \$72,000. Therefore, the amount of partnership income that Judy must include in the New York source income (the *New York State amount* column) on her 2003 Form IT-203, *Nonresident and Part-Year Resident Income Tax Return*, is computed as follows:

Income during the resident period	\$18,000.00
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Income attributable to New York sources during the nonresident period

\$72,000 X 75% =	<u>\$54,000.00</u>
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Total amount includable in New York source income	<u>\$72,000.00</u>
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**Fiscal-year partnerships and New York S corporations**

In applying the direct accounting method, in the case where a partner or shareholder of a New York S corporation changes resident status during his or her tax year and the partnership or corporation reports its income on a fiscal-year basis, any item of income, gain, loss, or deduction

occurring during the partnership's or S corporation's fiscal year that is includable in the partner's or shareholder's federal adjusted gross income in the tax year of the change of residence must be taken into account in computing the part-year resident partner's or shareholder's New York tax for the year of the change of residence. This is true even if the item was actually received or accrued by the partnership or corporation during the part of the fiscal year that falls within the partner's or shareholder's previous tax year. However, for the year of the change of residence, the determination as to whether the item should be taken into account in computing New York source income for the resident or nonresident period is based upon the partner's or shareholder's resident status on the date the item would have been taken into account by the partnership or corporation during its fiscal year using its federal income tax method of accounting. The following example illustrates this rule:

**Example 3:**

John is a shareholder in corporation D during the corporation's fiscal year ending June 30, 2003. Corporation D is a New York S corporation. Corporation D carries on business in and out of New York State and has a New York allocation percentage of 30% for the fiscal year ending June 30, 2003. For John's calendar tax year 2003, the pro rata share of corporation D's income (for corporation D's fiscal year ending in 2003) includable in John's 2003 federal and New York adjusted gross incomes (the *Federal amount* column of Form IT-203) is \$87,500. John changed residence from Michigan to New York on March 1, 2003. Applying its federal income tax method of accounting to all items of income, gain, loss, and deduction, corporation D determines that John's pro rata share of corporation D's items of income, gain, loss and deduction for the nonresident period (7/1/02 - 2/28/03) would have been \$62,000, and for the resident period (3/1/03 - 6/30/03), his share of those items would have been \$25,500. The amount of S corporation income that John must include in the New York source income (the *New York State amount* column) on his 2003 Form IT-203, *Nonresident and Part-Year Resident Income Tax Return*, is computed as follows:

Income during the resident period	\$25,500.00
Income attributable to New York sources during the nonresident period	
\$62,000 X 30% =	<u>\$18,600.00</u>
Total amount includable in New York source income	<u>\$44,100.00</u>

**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 includable in the trust's New York source income is computed using the same methods that apply 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. For a part-year resident, the New York City personal income tax is computed based upon all income for the period of residence. New York City part-year resident individuals and trusts may use the proration method (only Step 1 of the *Partner/Shareholder formula*, using New York City days) or the direct accounting method 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. However, if the individual or trust is a part-year resident of both New York State and New York City during the tax year, the individual or trust is not required to use the same method for computing the part-year New York City resident tax that was used to compute the New York State part-year resident tax.

## **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. 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 using the proration method, Step 1 of the *Partner/Shareholder formula* is used to determine the amount of partnership or New York S corporation income 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.

For part-year Yonkers resident individuals and trusts using the direct accounting method, the amount of income, gain, loss, or deduction of the partnership or S corporation calculated for the period of residence will be included in the numerator of the fraction used to compute the allocated net New York State taxes. If applicable, the direct accounting method and the Yonkers allocation percentage are 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.

If an individual or trust is a part-year resident of both New York State and Yonkers during the tax year, the individual or trust is not required to use the same method to compute the Yonkers income tax surcharge and the Yonkers nonresident earnings tax that was used to determine the New York State part-year resident tax.

### **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 proration method or the direct accounting method may be 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, a part-year resident taxpayer may use the proration method (only Step 1 of the *Partner/Shareholder formula*, using New York City days) or the direct accounting method to determine the amount of federal items of tax preference and modifications subject to the city minimum income tax.

### **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 proration method or the direct accounting method to attribute the amount of S corporation income to the resident and nonresident periods. The amount attributable to the resident period is includable in New York source income. The corporation's income that is attributable 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 includes a federal S corporation that is eligible to make the New York S election but does not make the election for the tax year. A part-year resident shareholder of a New York C corporation does not have to make the calculations required of other S corporation shareholders. This is because any New York C corporation income 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 applicable to any tax year beginning before 2004, provided the statute of limitations for filing an amended return is still open.