

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

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Income Tax
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New York State's Tax Reform and Reduction Act of 1987
Additional Tax on Unearned Income

The New York State Tax Reform and Reduction Act of 1987 (Chapter 28), as amended by the Tax Reform Technical Corrections and New York City Tax Reduction Act of 1987 (Chapter 333), adds new provisions to the Tax Law under Section 601(d) to provide an additional tax on unearned income for taxable years beginning in 1987 and 1988 only. This additional tax does not apply to taxable years beginning after 1988.

The additional tax on unearned income is imposed on resident and nonresident individuals who have unearned income and also have New York adjusted gross income over \$100,000 (\$50,000 for married taxpayers filing separately). Estates and trusts are subject to the additional tax on unearned income if they have unearned income and also have New York adjusted gross income over \$50,000. For purposes of computing the additional tax, the New York adjusted gross income of an estate or trust is determined as if the estate or trust were an individual. The additional tax is computed using the following formulas:

1987

$$\text{Unearned income} \times 32 \times \frac{\text{lesser of } \$100,000 \text{ or } (\text{NYAGI} - \$100,000)}{\$100,000}^*$$

1988

$$\text{Unearned income} \times 22 \times \frac{\text{lesser of } \$100,000 \text{ or } (\text{NYAGI} - \$100,000)}{\$100,000}^*$$

* \$50,000 for married taxpayers filing separately and estates and trusts

Example 1

Tax year - 1987
Filing status - married filing jointly
New York adjusted gross income - 150,000
New York unearned income - 40,000

$$\$40,000 \times 32 \times \frac{\text{lesser of } \$100,000 \text{ or } (\$150,000 - \$100,000)}{\$100,000}$$

$$\$40,000 \times 32 \times \frac{\text{lesser of } \$100,000 \text{ or } \$50,000}{\$100,000}$$

$$\$40,000 \times 32 \times \frac{\$50,000}{\$100,000}$$

$$\$40,000 \times 32 \times 502$$

$$\$40,000 \times 1.52 (.015) = \$600 \text{ tax on unearned income}$$

Since the additional tax on unearned income is based upon New York adjusted gross income rather than taxable income, it is possible for individuals to incur a tax on unearned income even though they are not subject to the personal income tax, as the following example illustrates:

Example 2

Tax year - 1987	
Interest income	\$ 200,000
Total New York adjusted gross income	\$ 200,000
Less: itemized deductions	200,000
New York taxable income	<u>0</u>
New York State income tax	<u>0</u>
Additional tax on unearned income (\$200,000 x 3%)	\$ 6,000

Definition of Unearned Income

New Sections 601(d)(4), (5) and (6) of the Tax Law define New York unearned income as New York adjusted gross income with the following adjustments.

Adjustments increasing New York adjusted gross income:

- Any federally allowed deduction for capital losses under Section 161 of the Internal Revenue Code
- Any deductions allowed under Section 62 of the Internal Revenue Code, such as deductions attributable to a trade or business, rents, royalties, and pensions, profit-sharing and annuity plans, including self-employment plans to the extent that the deductions are related to any item of increase or decrease
- Any modifications required by Section 612(c) of the New York State Tax Law to the extent the modifications are related to any item of increase or decrease

Adjustments decreasing New York adjusted gross income:

- Earned income as defined in Section 911(d)(2) of the Internal Revenue Code such as wages, salaries, professional fees and other amounts received as compensation for personal services actually rendered. In the case of a trade or business where both personal services and capital are material income producing factors, earned income is a reasonable allowance as compensation for personal services actually rendered. The reasonable allowance is not subject to the federal 302 net profit limit. However, it can not be more than the net profits of the business.

- Gains and net earnings from the sale or transfer of an interest in, or license for, the use of property (other than goodwill) that is created by the taxpayer's personal efforts (IRC Section 401(c)(2)(C))
- Pensions and annuities connected with income earned from past personal services that arise from an employer-employee relationship
- Payments or distributions from an individual retirement plan
- Distributions from a deferred compensation plan
- Capital gain net income
- Alimony and separate maintenance payments
- Any modifications required by Section 612(b) of the New York State Tax Law to the extent the modifications are related to any item of increase or decrease
- Expenses directly related to unearned income which is includible in New York adjusted gross income, to the extent they are paid or incurred during the taxable year and are not deducted in arriving at New York adjusted gross income:
 - Interest on indebtedness incurred or continued to purchase or carry obligations or securities
 - Ordinary and necessary expenses for the production or collection of income or the management, conservation or maintenance of property held for the production of income
 - Amortization of bond premium

The following examples illustrate the computation of unearned income:

Example 3

Tax year - 1987

Federal gross income:

Wages	\$ 30,000
Professional fees	250,000
Interest	20,000
Capital gain net income	20,000
Total gross income	\$ 320,000
Less: trade and business deductions (IRC Section 62)	<u>100,000</u>
Federal adjusted gross income	\$ 220,000
Add: Federal deduction for New York City Unincorporated Business Tax Tax Law Section 612(b)(3)	<u>10,000</u> \$ 230,000
Less: two-earner deduction Tax Law Section 612(c)(29)	<u>3,000</u>
New York adjusted gross income	\$ 227,000

Adjustments in determining unearned income

Add: trade and business deductions (IRC Section 62)	100,000
two-earner deduction	<u>3,000</u>
Total	\$ 330,000
Less: earned income	(280,000)*
capital gain net income	(20,000)
New York City Unincorporated Business Tax	<u>(10,000)</u>
Unearned income	<u>\$ 20,000</u>

* \$30,000 wages plus \$250,000 professional fees

Example 4

Federal gross income:

Wages	\$250,000
Interest	20,000
Capital loss	(3,000)
Business income (capital is material)	<u>100,000 *</u>
Total federal gross income	<u>\$367,000</u>
Less: trade and business deductions (IRC Section 62)	<u>120,000</u>
Federal and New York adjusted gross income	<u>\$247,000</u>

Adjustments in determining unearned income

Add: capital loss	3,000
trade and business deductions allocable to earned income	
<u>\$ 50,000</u>	
\$100,000 X \$120,000	
Total	<u>60,000</u>
Less: earned income	<u>300,000 **</u>
Unearned income	<u><u>10,000</u></u>

*Taxpayer considers \$50,000 as reasonable compensation (earned income)

**\$250,000 wages plus \$50,000 reasonable compensation from business

Nonresidents and Part-Year Residents

For tax year 1987, the unearned income of nonresidents and part-year residents is computed using only those unearned income items derived from or connected with New York sources.

If an individual changes resident status during the 1987 tax year, the combined New York adjusted gross income for the resident and nonresident periods is used when computing the additional tax on unearned income.

For tax year 1988, nonresidents and part-year residents will compute the additional tax on unearned income as if they were residents for the entire year and then prorate the tax based upon the ratio of New York source income (both earned and unearned) to all sources.

Estate or Trust

The New York adjusted gross income of an estate or trust is determined as if the estate or trust were an individual. The tax is imposed on the New York unearned income of every estate and trust that has New York adjusted gross income in excess of \$50, 000.