

New York State's Tax Reform and Reduction Act of 1987
Tax Reform Technical Corrections and
New York City Tax Reduction Act of 1987

Taxation of Nonresident Estates and Trusts and
Part-Year Resident Trusts

Background

The New York State Tax Reform and Reduction Act of 1987 (Chapter 28) and the Tax Reform Technical Corrections and New York City Tax Reduction Act of 1987 (Chapter 333) amended various sections of the New York State Tax Law relating to the computation of the New York State personal income tax for nonresident estates and trusts and part-year resident trusts. A nonresident estate or trust is defined as an estate or trust which is not a resident estate or trust for any part of the year. A part-year resident trust is a trust which changes resident status during the year and therefore is not a resident or nonresident for the entire year. The changes, explained below, apply to taxable years beginning after 1987.

Computation of Tax

The New York State personal income tax for nonresident estates and trusts and part-year resident trusts is now imposed by Section 601(e) of the Tax Law. This section requires these entities to compute their tax in the following manner:

- 1) A tax is first computed as if the estate or trust were a resident of New York State for the entire taxable year. This figure is known as the base tax.
- 2) The base tax is then multiplied by a percentage which is determined by dividing the estate's or trust's New York source income for the entire year by the estate's or trust's federal adjusted gross income for the entire year. This percentage will be more than 100% when New York source income exceeds federal adjusted gross income.
- 3) The amount determined in "2" is then reduced by any New York State credits that the estate or trust may be entitled to and/or increased by any other New York State taxes for which it may be liable. This resulting figure is the New York State personal income tax for the year.

Base Tax

For tax years beginning in 1988 only, the base tax will also include the additional tax on unearned income, imposed by Section 601(d), determined as if the estate or trust were a resident for the entire year.

In determining the base tax, New York taxable income is to be computed with the following exceptions:

- For nonresident estates and trusts, their share of the modifications provided for in Section 612(b)(1), (2) and (20) will not be included, except to the extent that they are connected with property employed in a business, trade, profession or occupation carried on in New York.
- Part-year resident trusts will include their share of the modifications provided for in Section 612(b)(1), (2) and (20) determined for the period of their residence. For the period of their non-residence, these modifications are to be included only to the extent that they are connected with property employed in a business, trade, profession or occupation carried on in New York.

New York taxable income for part-year resident trusts will also include any special accruals required under Section 638(c), with any applicable modifications required under Section 612, as if the accrued items were includable or allowable for federal income tax purposes.

New York Source Income and Federal Adjusted Gross Income

Nonresident Estates and Trusts

New York source income is defined under new Section 633 as the estate's or trust's share of New York source items included in distributable net income. In addition, New York source income includes the entire amount of New York source items not included in distributable net income. The determination of New York source is in accordance with the applicable rules of Section 631, as in the case of a nonresident individual.

Items in distributable net income from New York sources are determined under Section 634. These items are defined as the estate's or trust's share of income, gain, loss and deduction derived from or connected with New York sources which would be included in the determination of federal adjusted gross income if the estate or trust were an individual and which enter into the definition of federal distributable net income.

The share is defined as the amount of income, gain, loss and deduction allocated to the estate or trust in proportion to its respective share of federal distributable net income. If no federal distributable net income exists, the share is the amount allocated to the estate or trust in proportion to its share of income determined under local laws or its governing instrument.

Items not in distributable net income are those items of income, gain, loss and deduction which would be included in the determination of federal adjusted gross income if the estate or trust were an individual but are excluded from the definition of federal distributable net income. The items in distributable net income and the items not in distributable net income do not include the addition or subtraction modifications under Section 612.

The federal adjusted gross income of a nonresident estate or trust is the estate's or trust's federal adjusted gross income for the entire year, determined as if the estate or trust were an individual.

Part-Year Resident Trusts

New York source income of a part-year resident trust is defined under new section 638(b) as the sum of the following:

- 1) The share of the federal adjusted gross income for the period of residence, determined as if the trust were an individual whose taxable year for federal purposes were limited to the period of residence, allocated to the trust using the rules in Section 634.
- 2) New York source income for the period of non-residence, determined in accordance with Section 633 as if the taxable year for federal purposes were limited to the period of non-residence.

3) The special accruals required under Section 638(c) as follows:

When a trust changes its resident status during the year, it must accrue to the portion of the taxable year prior to the change its share of items of income, gain, loss and deduction determined under Section 634 accruing prior to the change, if these items were not properly included in the trust's federal taxable income for the taxable period or for a prior taxable year. However, a trust which changes status from nonresident to resident is not required to accrue any item derived from or connected with New York sources. Any items that are accrued do not have to be taken into account in determining New York taxable income or New York source income for any subsequent taxable period.

The accruals are not required if the trust files a bond or other acceptable security with the Department. If it does file a bond or other acceptable security, it must also elect to include the amounts accruable in New York taxable income or New York source income for subsequent years as if no change of residence had occurred. For more information on accruals and filing a bond, see TSB-M-86-(3)-I.

Federal adjusted gross income of a part-year resident trust is determined in the same manner as for a nonresident trust, except it must also be increased or decreased by any of the special accruals required under Section 638(c).

Minimum Income Tax and Separate Tax on Lump-Sum Distributions

The new method of computing the personal income tax for nonresident estates and trusts and part-year resident trusts does not apply to the minimum income tax (Section 636) or the separate tax on lump-sum distributions (Section 637). The computation of the minimum income tax and the separate tax on lump-sum distributions for nonresident estates and trusts remains the same as under prior law. However, the following changes affect the computation of the minimum income tax and the separate tax on lump-sum distributions for a part-year resident trust. For minimum income tax purposes, the term "items of tax preference" shall now mean only those items derived from or connected with New York sources for the entire year, together with any special accruals, and the specific deduction shall be \$5,000 for the entire year. The ordinary income portion of lump-sum distributions shall now mean only those items derived from or connected with New York sources for the entire year, together with any special accruals.

Examples

The following examples illustrate the application of this change in computing the New York State personal income tax.

Example 1. A revocable trust changes its resident status out of New York on September 30, 1988. The trust received rental income from property located in New York State of \$24,000 for the entire year (\$18,000 in the resident period and \$6,000 in the nonresident period). The trust also earned interest income of \$20,000 (\$15,000 in the resident period and \$5,000 in the nonresident period) of which \$12,000 was from United States Government Bonds. In addition, the trust received interest income from Connecticut bonds of \$2,000 (\$1,500 in the resident period and \$500 in the nonresident period). The federal adjusted gross income determined as if the trust were an individual is \$44,000 and the federal distributable net income is \$46,000, of which 75% is retained by the trust.

	<u>Federal</u>	<u>New York</u>
Interest income	\$20,000	\$15,000
Rental income	<u>24,000</u>	<u>24,000</u>
Adjusted total income	\$44,000	\$39,000
<u>\$29,250</u> (\$39,000 x 75%)		
<u>\$44,000</u>	= .6648 (66.48%)	
Adjusted total income		\$44,000
Less: Income distribution		
deduction		11,000
Federal exemption		<u>100</u>
Federal taxable income		\$32,900
Add: Exemption claimed on		
federal return		<u>100</u>
Total		\$33,000
Less: New York exemption	\$ 600	
Fiduciary's share of N.Y. fiduciary		
adjustment (\$12,000 - \$1,500 x 75%)	<u>7,875</u>	<u>8,475</u>
New York taxable income		\$24,525
Tax on above (base tax)		\$1,618.22
State tax (\$1,618.22 x .6648)		\$1,075.79

Example 2. A revocable trust changes its resident status out of New York on June 30, 1988. The trust receives business income from sources outside New York State of \$10,000 (\$5,000 in each period) and dividend income of \$5,000 (\$2,500 in each period). On March 1, 1988 the trust sold a painting which is held as part of the trust corpus. At this time the trust recognized a gain from the sale of \$30,000 and agreed to receive payment on installments of two equal payments due October 1, 1988 and February 1, 1989, respectively. The trust instrument stated that all capital gains are to be retained by the trust. Since the amount of the sale of the painting is fixed and determinable as of the date of the trusts' change of residence, it must be accrued to the portion of the taxable year prior to the change of status. The federal adjusted gross income determined as if the trust were an individual (computed with the special accrual) is \$45,000 and the federal distributable net income is \$15,000 of which 40% is retained by the trust.

	<u>Federal</u>	<u>New York</u>
Dividends	\$ 5,000	\$ 2,500
Business income	10,000	5,000
Capital gain	15,000	<u>-0-</u>
Total income	\$30,000	\$ 7,500
Special accrual-capital gain	<u>15,000</u>	<u>30,000</u>
Adjusted total income	\$45,000	<u>\$37,500</u>

$$\frac{\$33,000}{\$45,000} \quad [\$30,000 + (\$7,500 \times 40\%,)] = .7333 \text{ (73.33\%)}$$

Adjusted total income		\$ 45,000
Less: Income distribution		
deduction	\$9,000	
Federal exemption	<u>100</u>	<u>9,100</u>
Federal taxable income		\$ 35,900
Add: Exemption claimed on		
federal return		<u>100</u>
Total		\$ 36,000
Less: New York exemption		<u>600</u>
New York taxable income		\$ 35,400
Tax on above (base tax)		\$2,529.00
State tax (\$2,529.00 x .7333)		\$1,854.52

Example 3. For tax year 1988, a nonresident estate receives income in respect of a decedent of \$55,000, of which \$42,000 is from New York State sources. The estate also receives interest income of \$50,000. Expenses of \$5,000 were incurred in connection with the administration of the estate which would not have been incurred if the property was not held in the estate. In addition, the estate has a charitable deduction of \$10,000 for contributions permanently set aside for New York charitable purposes. The federal adjusted gross income determined as if the estate were an individual is \$105,000 and the federal distributable net income is \$90,000, of which 75% is retained by the estate. As its New York adjusted gross income, determined as if the estate were a resident, is in excess of \$50,000, it must compute and include in its base tax the additional tax on unearned income.

	<u>Federal</u>	<u>New York</u>
Interest income	\$ 50,000	\$ -0-
Income in respect of a decedent	<u>55,000</u>	<u>42,000</u>
Total income	\$105,000	<u>\$ 42,000</u>
$\frac{\$ 31,500}{\$105,000} (\$42,000 \times 75\%) = .30 \quad (30\%)$		
Total income (from above)		\$ 105,000
Less: Charitable deduction		10,000
Administration costs		<u>5,000</u>
Adjusted total income		\$ 90,000
Less: Income distribution deduction	22,500	
Federal exemption	<u>600</u>	<u>23,100</u>
Federal taxable income		\$ 66,900
Exemption claimed on federal return		<u>600</u>
Total		\$ 67,500
Less: New York exemption		<u>600</u>
New York taxable income		\$ 66,900
Tax on above		\$5,167.13
Plus: Additional tax on unearned income *		<u>375.00</u>
Base tax		\$5,542.13
State tax (\$5,542.13 x .30)		\$1,662.64

*The additional tax on unearned income was computed as follows:

Interest income	\$ 50,000
Income in respect of a decedent	<u>55,000</u>
New York adjusted gross income	\$105,000

Less: Earned income	<u>55,000</u>
Unearned income	\$50,000
Beneficiaries share of unearned income (\$50,000 x 25%)	<u>12,500</u>
Taxable unearned income to fiduciary	\$37,500

$$\$37,500 \times .02 \times \frac{\$50,000}{\$100,000} (\$100,000 - \$50,000)$$

$$\$37,500 \times .02 \times .50 = \$375.00$$

Example 4. For tax year 1988, a nonresident trust received business income of \$20,000 all of which was from New York State sources. The business generated New York source items of tax preference which resulted in a New York minimum income tax of \$50. The trust also received interest income of \$20,000 (which includes \$6,000 from Connecticut bonds and \$4,000 from United States government bonds). The federal adjusted gross income determined as if the trust were an individual is \$34,000 and the federal distributable net income is \$40,000 of which 25% is retained by the trust.

	<u>Federal</u>	<u>New York</u>
Interest income	\$14,000	\$ -0-
Business income	<u>20,000</u>	<u>20,000</u>
Adjusted total income	\$34,000	\$20,000

$$\frac{\$5,000}{\$34,000} (\$20,000 \times 25\%) = .1471 \quad (14.71\%)$$

Adjusted total income		\$34,000
Less: Income distribution deduction	25,500	
Federal exemption	<u>100</u>	<u>25,600</u>
Federal taxable income		\$ 8,400
Add: Exemption claimed on federal return		<u>100</u>
Total		\$ 8,500
Less: New York exemption		600
Fiduciary's share of N.Y. fiduciary adjustment (\$4,000 x 25%)		<u>1,000</u>
New York taxable income		\$ 6,900

Base tax	\$264.00
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State tax (\$264.00 x .1471)	38.83
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Minimum income tax	<u>50.00</u>
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Total State tax	\$88.83
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Example 5. For tax year 1988, a nonresident trust sells real property located in New York State and recognizes a gain from the sale of the property of \$25,000. The trust instrument states that 50% of the capital gains are to be distributed to the beneficiaries. The trust earned partnership income of \$10,000, of which \$6,000 was derived from New York sources. In addition, the trust received \$5,000 of interest income. The federal adjusted gross income determined as if the trust were an individual is \$40,000 and federal distributable net income is \$27,500. Fifty percent (50%) of the income and gain is retained by the trust.

	<u>Federal</u>	<u>New York</u>
Interest income	\$ 5,000	\$ -0-
Partnership income	10,000	6,000
Capital gain	<u>25,000</u>	<u>25,000</u>
Adjusted total income	\$40,000	<u>\$31,000</u>
<u>\$21,750</u>	[\$12,500 + (\$18,500 X 50%)] = .5438 (54.38%)	
\$40,000		
Adjusted total income		\$40,000
Less: Income distribution		
deduction	\$20,000	
Federal exemption	<u>100</u>	<u>20,100</u>
Federal taxable income		\$19,900
Add: Exemption claimed on		
federal return		<u>100</u>
Total		\$20,000
Less: New York exemption		<u>600</u>
New York taxable income		\$19,400
Tax on above (base tax)		\$1,189.00
State tax (\$1,189.00 x .5438)		\$646.58