REGULATORY IMPACT STATEMENT

DEPARTMENT OF TAXATION AND FINANCE

1. Statutory authority: Tax Law, sections 171, Subdivision First, 697(a), and 605(b)(1). Section 171, Subdivision First authorizes the Commissioner to make reasonable rules and regulations that may be necessary for the exercise of the Commissioner's powers and performance of the Commissioner's duties. Section 697(a) authorizes the Commissioner to adopt regulations relating specifically to the personal income tax. Section 605(b)(1) provides that an individual who is not domiciled in New York is considered a resident if the individual maintains a permanent place of abode in the state and spends more than 183 days of the taxable year in the state.

2. Legislative objectives: This rule is being proposed pursuant to this authority to eliminate problematic provisions of the Personal Income Tax Regulations excepting "temporary stays" from the definition of permanent place of abode for purposes of the personal income tax on resident individuals.

3. Needs and benefits: The purpose of these amendments is to remove provisions of the regulations providing for a "temporary stay" exception from the definition of permanent place of abode for purposes of determining whether an individual is a resident for personal income tax purposes. The elimination of these provisions stems from what the Department believes is a better interpretation of section 605(b)(1) of the Tax Law. Under section 605(b)(1), an individual who is not domiciled in New York is considered a resident if the individual maintains a permanent place of abode in the state and spends more than 183 days of the taxable year in the state. Under section 105.20(e)(1) of the regulations, however, a place of abode will not be considered permanent if it is maintained only during a temporary stay, or "fixed and limited period," for the accomplishment of a "particular purpose." This temporary stay concept does not appear in the statute.

The Department has interpreted the particular purpose requirement to mean that an individual must be present in the state to accomplish a specific assignment with readily ascertainable and specific goals and conclusions, as opposed to a general assignment with general duties having no specified conclusion in order to qualify for the exception. The Department presumes an individual to be present for a fixed and limited period if the period of predetermined duration is reasonably expected to last for three years or less. Taxpayers and practitioners have criticized the temporary stay provisions as confusing and difficult to apply.

In eliminating these provisions, the Department is moving to what it believes is a better interpretation of section 605(b) of the Tax Law, which does not contemplate a temporary stay exception. The proposed rule levels the playing field among non-domiciliary taxpayers, providing equal treatment for all taxpayers who maintain a permanent place of abode within the state for more than eleven months, and spend more than 183 days within the state, irrespective of their purpose for doing so. This interpretation is appropriate because non-domiciliary taxpayers receive the same benefits and services from New York State regardless of their purpose for being in the state.

The temporary stay rule has also proven difficult to administer. Moreover, the effect of eliminating the temporary stay provisions is limited, in that section 105.20(a)(2) of the regulations provides that a place of abode must be maintained for substantially all of the taxable year in order to affect an individual's residency status. The Department has interpreted this requirement to mean that a taxpayer must maintain a permanent place of abode for more than eleven months of the taxable year. Thus, individuals temporarily residing within the state will continue to be considered non-residents unless they maintain a permanent place of abode for more than eleven months of a taxable year.

The elimination of the temporary stay exception from the definition of permanent place of abode will provide taxpayers and the Department with clear, objective, and easily applied rules for assessing residency status for New York State personal income tax purposes.

4. Costs:

(a) Costs to regulated parties: The rule does not impose any new compliance costs on regulated parties. The change in interpretation of section 605(b)(1) may have an impact on the tax liability and reporting responsibilities of particular taxpayers. This is a function of what the Department believes is a better interpretation of the statutory provisions, and the particular circumstances of the affected taxpayers. Only those individuals who would qualify for the temporary stay exception and be considered non-residents but for the amendments will be affected by the change. Such individuals will continue to be considered non-residents if they maintain a permanent place of abode for less than eleven months of the taxable year.

The Department does not have data to precisely identify the affected individuals. However, according to information from the Department's Audit Division, nearly all of the identified cases involving temporary residence (focusing on New York City addresses) involve foreign nationals in the United States on working visas (H-1Bs). Therefore, to estimate the impact of these amendments, data for H-1B visa holders in New York obtained from the US Department of Homeland Security's (DHS) 2006 Yearbook of Immigration Statistics were used along with New York State personal income tax data from the Department's Office of Tax Policy Analysis for 2006. The following revenue analysis does not take into account that some of the taxpayers may be improperly reporting as non-residents, so that the impact on the aggregate tax liability of this group based on the rule might be somewhat lower.

The total number of non-immigrants in New York in 2006 with H-1B visas of 69,709 was adjusted to take out taxpayers who have foreign addresses, but file as full year residents since they would not be affected by these amendments. Next, the number of H-1B visa holders was split between those who are within their first three years and those who renewed for an additional three years. The percentage that renewed their visas (45.5%) was obtained from the average of visas renewed between 2000 and 2003.

The DHS also provided the 2003 median salary for all H-1B visa holders of $70,000. This value was grown to 2008 by using the New York State Department of Budget forecast for wages from 2003 to 2008. The resulting estimated prospective annual wage in New York for all H-1B visa workers in 2008 is $93,000. The annual salary was multiplied by the adjusted total number of H-1B visa holders in New York to get estimated total New York wages for these individuals. These total wages were then divided between those in their first three years and those in their second three-year term.

To determine the amount of unearned income that would affect the tax calculation due to these amendments, an estimated ratio of unearned income to earned income of 10% was applied to the total earned income estimates calculated above for each group of H-1B visa holders. The 10% was obtained from 2006 Personal Income Tax data, looking at the unearned and earned income for all New York full-year residents (in New York City) with earned income between $90,000 and $95,000. Earned income includes business income and wages and unearned income includes only interest, dividends, and capital gains. Also using the 2006 Personal Income Tax Study data, an average effective tax rate for New York residents with earned income between $90,000 and $95,000 was calculated to be 4.7%. Lastly, the tax rate is applied to the estimated unearned income and to the years that the amendments apply to come up with the potential revenue gain from eliminating the temporary stay provisions. For those H-1B visa holders who are here for three years or less, it is assumed that the first and last years are less than eleven months, and therefore they would not be considered statutory residents; and for those H-1B visa holders in New York for over three years, it is assumed that they are in New York for one more three-year term, and the last year is less than eleven months. The potential revenue gain to New York State due to elimination of the temporary stay provisions applied to H-1B visa holders in New York is $15 million.

The same procedure was applied to estimate New York City's potential revenue gain from these amendments. However, note that New York City presently does not tax non-residents' income (both earned and

unearned). Therefore, these amendments would generate more revenue at the city level than at the state level. Thus, the total estimated New York Wages was multiplied by 35.1%, which is the ratio of New York wages that are from New York City (obtained from 2006 Personal Income Tax data) to calculate the New York City wages of H-1B visa holders.

The New York City wages are split again between those that are within their first three years and those who renewed for an additional three years and then multiplied by an average effective tax rate for New York City of 2.8%. The 2.8% was estimated using 2006 Personal Income Tax data for New York City taxes paid for New York residents with non-New York addresses, compared to their New York adjusted gross income.

As with the State estimate, the values are applied to the years to which the amendments apply to calculate the potential revenue gain to New York City from eliminating the temporary stay provisions. Therefore, the potential revenue gain to New York City from eliminating the temporary stay provision, applied to H-1B visa holders in New York, is $30 million.

The amendments apply to taxable years ending on or after December 31, 2008. Therefore, for State Fiscal Year 2008 - 2009, the impact would be minimal, and for State Fiscal Year 2009 – 2010 and thereafter, there would be an increase of $15 million annually. Similarly, New York City would experience a minimal impact in State Fiscal Year 2008 – 2009, and an increase of $30 million in State Fiscal Year 2009 – 2010 and thereafter.

To see the effect on a representative taxpayer, consider a typical H-1B visa holder working in New York City. Assume his or her annual salary is $93,000, and he or she is in the second year of a three-year stay (in which case, the individual is considered a resident, and his or her income is taxed accordingly). Using the 10% estimated ratio of unearned to earned income would produce unearned income of $9,300 for the individual. Applying a 4.7% average effective state tax rate, the individual would see his or her state tax liability increase by $437. In addition, since this individual lives in New York City, and is considered a New York City resident

for tax purposes, he or she would also owe New York City income tax (currently, New York City does not tax non-residents). Therefore, the taxpayer would pay an average effective New York City tax rate of 2.8% on $102,300 ($93,000 in earned income plus the $9,300 in unearned income) for a New York City tax liability of $2,864. As a result of the amendments eliminating the temporary stay exception, a typical H-1B visa holder working in New York City could see his or her State and City tax liability increase by approximately $3,300 per year.

Additionally, certain individuals with no New York State earned income, previously not required to file a New York State income tax return, may now be required to file a return. It is estimated that the costs associated with complying with this filing requirement for the first time would be approximately $145, and $58 annually thereafter. This estimate is based on the estimated number of hours necessary to prepare and file a New York State Resident Income Tax Return. The estimate is higher in the first year due to the time needed to learn about the form and requirements.

(b) Costs to the agency and to the State and local governments including this agency: It is estimated that the implementation and continued administration of this rule will not impose any costs upon this agency, New York State, or its local governments. As discussed above, the rule will result in increased revenue for the State and New York City.

(c) Information and methodology: The methodology employed to estimate the impact of the proposed rule is set forth in detail in the discussion of costs in section four herein. This analysis is based on a review of the rule, on discussions among personnel from the Department's Taxpayer Guidance Division, Office of Counsel, Office of Tax Policy Analysis, and Office of Budget and Management Analysis, and on data obtained both from the Department's records and from the United States Department of Homeland Security.

5. Local government mandates: This rule imposes no mandates upon any county, city, town, village, school district, fire district, or other special district.

6. Paperwork: The rule imposes no new reporting requirements, forms, or other paperwork upon regulated parties. There may be a limited number of individuals with no New York State sourced income who may be required to file a return, where they were not previously required to do so.

7. Duplication: There are no relevant rules or other legal requirements of the Federal or State governments that duplicate, overlap, or conflict with this rule.

8. Alternatives: The Department considered retaining the temporary stay rule but determined that the proposed rule represents a better interpretation of section 605(b)(1) of the Tax Law, and treats non-domiciliaries more even-handedly. The Department also considered modifying the rule in keeping with a suggestion made by the New York State Society of Certified Public Accountants. The Society acknowledged the problematic nature of the rule, but suggested a "safe harbor" analysis which would entail consideration of the duration of the individual's stay in New York State, and the individual's ties to his or her domicile. The Department concluded that this alternative would not resolve the fundamental problems caused by the temporary stay concept.

The following organizations were notified that the Department was in the process of developing this rule and were given the opportunity to participate in its development: the National Federation of Independent Businesses; the Division for Small Business of Empire State Development; the New York State Association of Counties; the Association of Towns of New York State; the New York Association of Convenience Stores; the Small Business Council of the New York State Business Council; the Retail Council of New York State; the New York State Conference of Mayors and Municipal Officials; the Office of Local Government and Community Services of the New York State Department of State; the Tax Section of the New York State Bar Association; the National Tax Committee for the National Conference of CPA Practitioners; and the New York State Society of CPAs. The Department also discussed the rule with the New York City Department of Finance. Only the Society of CPAs submitted comments. The temporary stay provision has been the subject of frequent criticism from taxpayers and tax practitioners.

9. Federal standards: The rule does not exceed any minimum standards of the Federal government for the same or similar subject area.

10. Compliance schedule: The amendment will take effect when the Notice of Adoption is published in the State Register, and apply to taxable years ending on or after December 31, 2008.