

An Easier Fix to the New York's Statutory Residency Problem?

by Timothy P. Noonan



Unless you've been hiding under a rock for the past few months (or feverishly working toward a recent deadline that affects some in our profession), you surely have noticed all the press coverage about one of my favorite topics: New York's statutory residency rules. *The Wall Street Journal* devoted a few articles to the subject.¹ Rush Limbaugh

talked about the rules on his radio show.² And even *The New York Times* ran a cover-page story that contained a photograph (some would say an unflattering one) of yours truly.³ The issue has also received coverage in tax circles as well, with one commentator penning an article in this publication with the not-so-subtle suggestion that the statutory residency rules should simply be repealed.⁴

What's all this commotion about? Most of it arises out of a Tax Appeals Tribunal decision in *Matter of John and Laura Barker*, a case in which a Connecticut commuter was treated as a statutory resident of New York state because he owned a rarely used

vacation home in the Hamptons.⁵ I'll reserve comment on that case for another day, because I represent the taxpayers in that case and it is still in litigation. Nonetheless, the case ended up shining a light on New York's statutory residency rules and, specifically, the Department of Taxation and Finance's aggressive enforcement and interpretation of the rule in personal income tax audits. The rule, of course, provides that a taxpayer who spends more than 183 days in New York and maintains a "permanent place of abode" in New York is taxed as a resident regardless of the taxpayer's state of domicile.⁶ Again, some commentators suggest that the rule is being applied in a way that was never intended by the State Legislature; others argue it should be repealed.⁷ Both arguments have a lot of merit.

The real problem is that often a statutory residency finding in New York state results in two layers of tax on the same income, without offsetting credits.

But it's also important to understand why, in fact, this is such a problem. Is it just because these kinds of audits are difficult and time consuming? I don't think that's the real problem. At its core, the real problem is that often a statutory residency finding in New York state results in *two* layers of tax on the same income, without offsetting credits. If we can fix that problem, maybe some of the commotion about statutory residency will subside.

The Double Tax Problem

Indeed, if it was just a matter of changing a taxpayer's residence from one state to another, who

¹Craig Karmin, "State Tax Probe Expands," *The Wall Street Journal*, Mar. 8, 2011; Karmin, "Second Homes May Be Costly at Tax Time," *The Wall Street Journal*, Feb. 17, 2011; Karmin, "Out of State Owners Could Face Tax Bill," *The Wall Street Journal*, Feb. 11, 2011.

²See Transcript of Judge: Out-of-State NY Property Owners Must Pay NY Income Tax, *The Rush Limbaugh Show* (Feb. 11, 2011) at http://www.rushlimbaugh.com/home/daily/site_021111/content/01125115.guest.html.

³Cara Buckley, "In City Often? Tax Man Asks Some for Tally," *The New York Times*, Feb. 24, 2011.

⁴See Peter L. Faber, "New York's Statutory Residence Rule Should Be Repealed," *State Tax Notes*, Apr. 4, 2011, p. 29, *Doc 2011-4763*, or *2011 64-1*; see also Joseph Lipari and Debra Silverman Herman, "Recent New York Residency Cases Reveal Difficulties," *New York Law Journal*, Mar. 11, 2011.

⁵*Matter of John and Laura Barker* (Tax Appeals Tribunal, Jan. 13, 2011).

⁶Tax Law section 605(b)(1)(B).

⁷Faber and Lipari, *supra* note 4.

would really care? We'd just be shifting money from one state's pocket to another. The problem arises in large part because the taxpayer ends up getting taxed as a resident of two states. And because of the limitation of state-based resident credits, taxpayers subject to statutory residency often end up paying personal income tax in two states on the exact same income.

For example, under New York Tax Law section 620, residents of New York are permitted to take a credit for "any income tax imposed for the taxable year by another state . . . upon income both derived therefrom and subject to tax under this article." The regulations then define income derived from another state for purposes of Tax Law section 620 as compensation for services performed in that jurisdiction, income from a trade or business carried on in that state, or from tangible personal property situated in the other jurisdiction. The regulation specifically excludes the available credit for taxes paid to the other jurisdiction on income from intangibles.⁸ Connecticut has a similar rule.⁹ Thus, if a Connecticut domiciliary is subject to tax as a statutory resident of New York, Connecticut will provide a credit for New York taxes paid on New York-source income, and vice versa. But the intangible income? It gets taxed twice.

A Credit Fix?

Of course, the double tax problem goes away if we repeal statutory residency. But the problem also goes away if we simply fix the credit provisions. For instance, in the situation above, what if New York offered to give its statutory resident a credit for all Connecticut tax paid on the intangible income? Connecticut would get tax on the intangibles, which would be appropriate because the taxpayer's home is in Connecticut. But the income would get taxed only once. Plus, the rule would be reciprocal, so that if the situation were reversed and a New York domiciliary was subject to tax as a Connecticut statutory resident, Connecticut would offer a credit for the New York taxes paid on the intangible income. You still have the problem of taxpayers being treated as dual residents. And you'd still have to go through difficult residency audits, for which auditors spend hours, days, and sometimes years combing through E-Z Pass records, phone bills, and so on. But that fix would nearly eliminate the worst aspect of most statutory residency cases: double taxation.

You may be thinking to yourself, "No wonder Noonan has his own column in *State Tax Notes* . . . this is a great idea!" Unfortunately, I can't take all the credit. In fact, I can't take *any* of the

credit. This is an idea that has been around for more than a decade. It was born out of a 1996 cooperative agreement by the North Eastern States Tax Officials Association (NESTOA). As you can guess from the title, NESTOA is composed of members of the tax departments of each of the 12 northeastern states. In October 1996 the tax officials of the NESTOA member states ratified the Cooperative Agreement on Determination of Domicile, which addressed many of the problems arising from multiple state residency rules. The agreement called for the adoption of uniform criteria for determining a taxpayer's domicile, a mechanism to resolve disputes when two or more states each claim domicile for the same year, and the adoption of uniform credits for taxes paid to other states.¹⁰

This last provision is the one of interest here. Specifically, the NESTOA agreement contains the following provision:

The member states agree that the preferred method for the elimination of double taxation of the select classes of income is the utilization of a credit for taxes paid to the other jurisdiction. The state to which income is sourced shall be entitled to the tax on earned income and the states of domicile and statutory residence shall be required to give the individual a credit for taxes paid to another jurisdiction on such income. The state in which an individual is domiciled shall be entitled to the tax on income sourced to, but not taxed by, a state other than the state of statutory residence and "non-source" income such as from intangible assets with the state claiming statutory residence being required to give the individual a credit for taxes paid to the state of domicile on such income.

This is the same method I outlined above. If a taxpayer is deemed to be domiciled in one state and a statutory resident of another, the state of domicile gets the tax on the intangible income. The statutory resident state is required to give the resident a tax credit on non-sourcable income.

Of course, the agreement also recognized that implementing those changes would require legislation in some states. And here's where it gets tricky. Following the NESTOA agreement, Connecticut and Vermont enacted legislation to establish the tax credit mechanism envisioned by the cooperative agreement. Connecticut's rule, notably, said that the application of the credit provisions is contingent on the existence of similar legislation in the reciprocal

⁸20 NYCRR 120.4(d).

⁹Conn. Agencies Regs. 12-704(a)-4(3).

¹⁰A copy of the entire agreement is contained in Paul R. Comeau and Mark S. Klein, *New York Residency and Allocation Audit Handbook*, 407-412 (Andrew B. Sabol, ed., 4th ed. 2002).

state.¹¹ Other states (Delaware, Maine, Rhode Island, and Maryland) already provided for such a credit, and New Jersey's credit provision was broad enough already to permit a credit for taxes paid regardless of the source of income.

What about New York? Unfortunately, no credit provision was ever enacted. Legislation was proposed in 1997 to amend the resident credit provisions to include language consistent with the NESTOA agreement.¹² But it didn't go anywhere. Now, here we are, almost 15 years later, engaged in the same conversation. We have difficult residency audits. We have different states applying different tests. And taxpayers still face double taxation. To fix at least part of that problem, all New York has to do is follow through on the 1996 NESTOA agreement and enact a revised credit provision.

Conclusion

This change wouldn't end the statutory residency debate. The difficult and time-consuming day-count audits that so many practitioners lament would continue. And the debate about what constitutes a permanent place of abode that has been played out in recent cases like *Barker* and *Matter of Gaied*

would also still rage on.¹³ Plus, we'd still have a double tax problem to the extent that New York City residency issues arise. But repealing the statutory residency rule altogether may not be the answer. Indeed, most other states already have the same type of residency rule on the books.

This change, however, provides a good start toward fixing what ultimately is the most obvious problem created by the statutory residency rules — the existence of double taxation. And given that officials from the tax departments of the various states have already agreed that the enactment of these provisions is a sensible and significant solution to the problem, this seems like a change that should be easy enough to make.

Other problems, of course, still persist, including the apparent treatment of vacation homes as permanent places of abode, which seems to contradict both legislative intent and common sense. Changes there are needed and recommended as well. But this provides a good and sensible start. ☆

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¹¹Conn. Gen. Stat. section 12-704(d) says: this subsection shall apply only where the jurisdiction in which such individual is domiciled allows an income tax credit for the tax imposed by this state to an individual who is domiciled in this state for a taxable year but maintains a permanent place of abode in such jurisdiction and is in such jurisdiction for an aggregate of more than one hundred eighty-three days of the taxable year that is analogous to that provided in this subsection.

¹²The New York bills were titled S 5208 and A 8062.

¹³*Matter of John Gaied* (Tax Appeals Tribunal, July 8, 2010) (holding that a taxpayer's Staten Island home was not his permanent place of abode because it was occupied by his parents, he did not maintain living quarters there, and he did not keep any personal effects there). However, note that the tribunal has recently granted reargument in *Gaied* on whether an apartment occupied by a taxpayer's parents qualifies as the taxpayer's permanent place of abode.