

2024 Summer Tax Series

State Tax Residency and
Nonresident Allocation
July 18, 2024



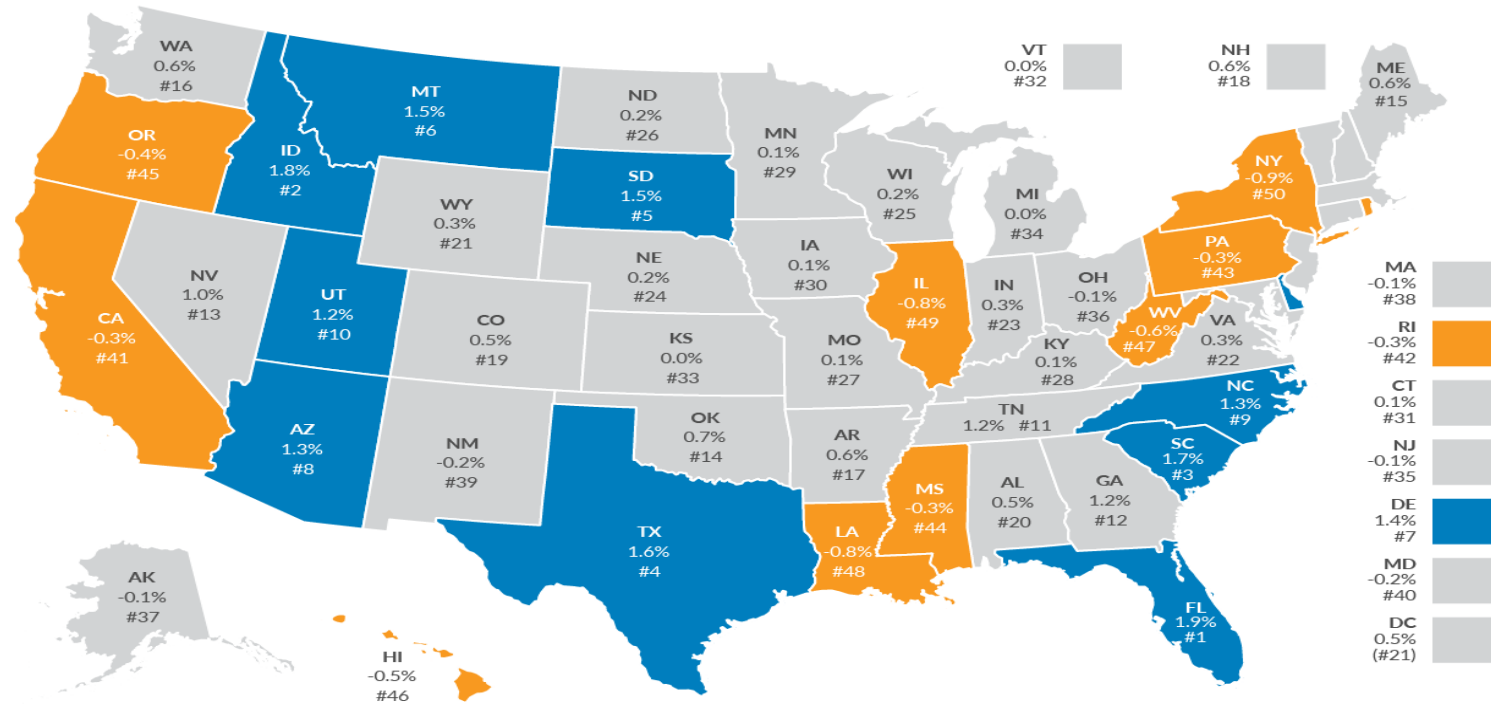
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People are Moving



State Population Change in 2022

State Migration Patterns, from Most Inbound to Most Outbound, 2022



Note: D.C.'s rank does not affect states' ranks, but the figure in parentheses indicates where it would have ranked if included.
Source: U.S. Census Bureau.

- Top 10 States for Inbound Migration
- Top 10 States for Outbound Migration

People are Moving



A Greater Share of New Yorkers Have Left Since Pandemic

The percentage of taxpayers departing has increased

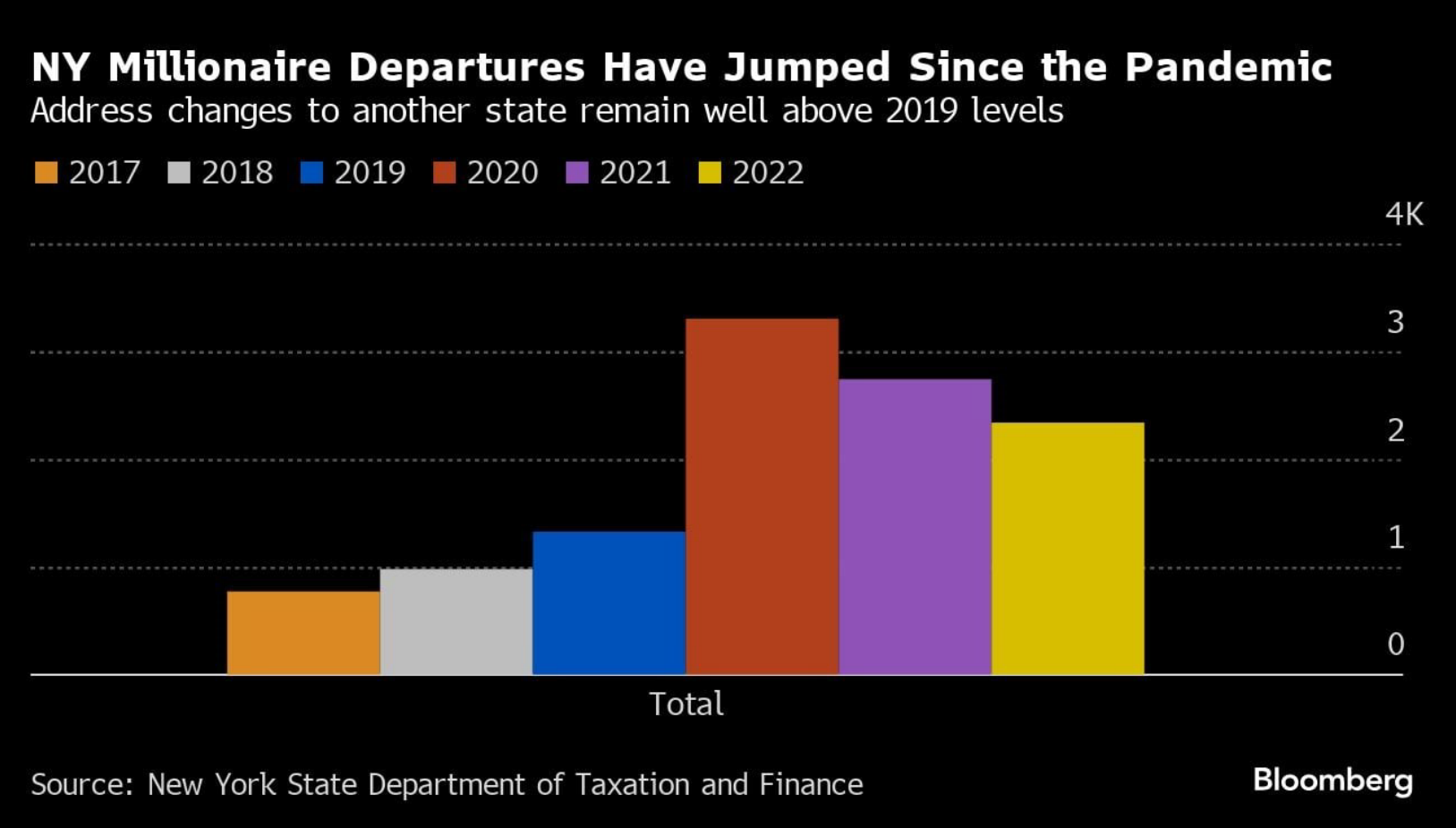
Percentage of Taxpayers Leaving New York

Calendar Year	All Taxpayers
2017	1.86%
2018	1.92%
2019	1.98%
2020	2.89%
2021	3.00%
2022	2.57%

Source: New York State Department of Taxation and Finance

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(Rich) People are Moving!



Billions in Audit Revenue!



New York's Aggressive Auditing Yields Billions in Revenue

State tax audits of all types have increased in past two years

Year	Number of Audits Conducted	Assessments (\$)	Collections (\$)
2019-2020	600,345	5.48B	3.26B
2020-2021	542,685	4.25B	28.24B
2021-2022	826,577	4.24B	2.21B
2022-2023	756,344	5.98B	3.22B

Source: New York State Department of Taxation and Finance

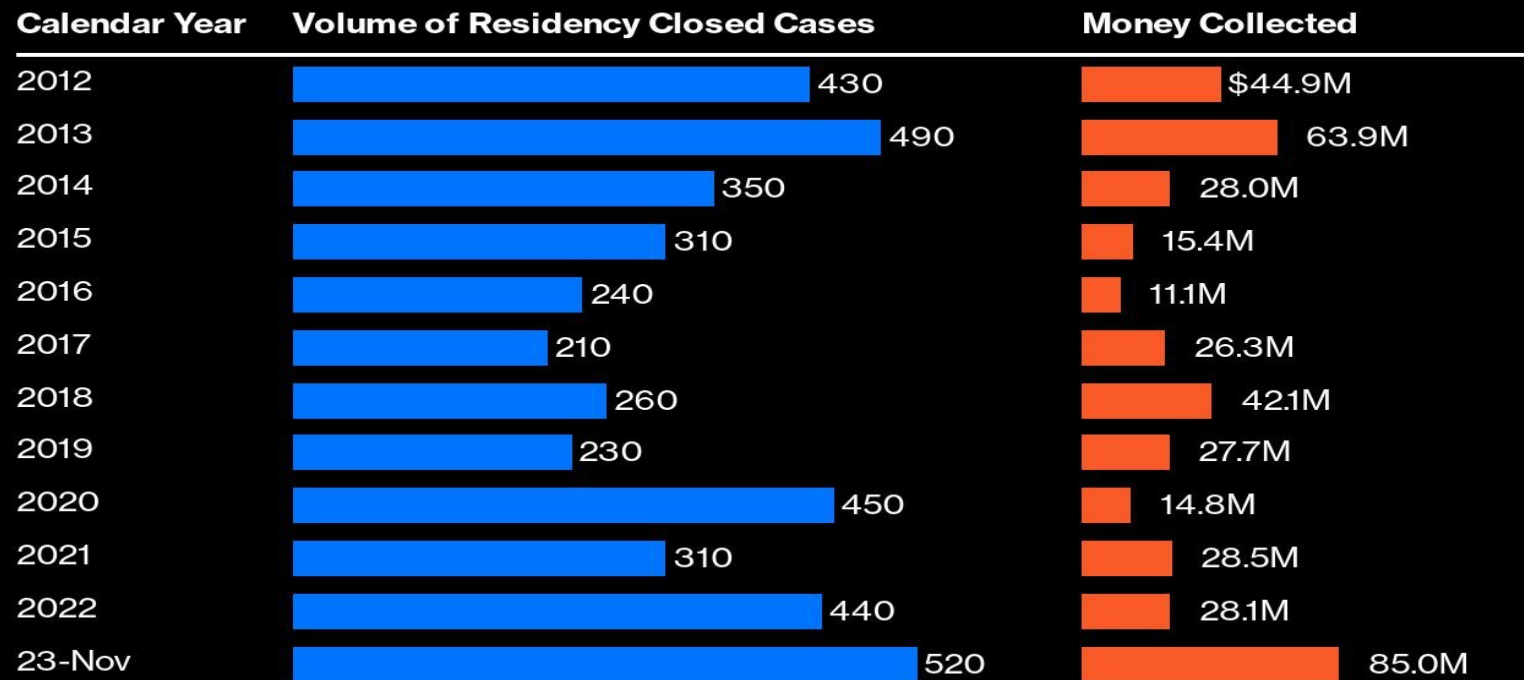
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California: Not as Much of an Audit Hotbed?



California Ramps Up Residency Audits

Cash collections have surged as state faces budget crunch



Source: California Franchise Tax Board

Note: Volume of cases is rounded to the nearest ten. Cash collected in each year comes from audits closed in any prior year.

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New York Residency Rules Overview



State Income Tax Generally

High Tax Rates....and Rising

- NYS: 10.9%
- NYS/NYC: 14.7%
- CA: 13%
- MA: 9% (new)
- FL/TX/NV/TN: 0%
- Wealth taxes???

Residency-based Taxation

- Residents pay tax on one thing: EVERYTHING

Nonresident Taxation

- Nonresidents still pay tax on sourced income



Understanding State Residency Rules: The Domicile Test

- State of “Domicile” = State of Residency
 - Definition: permanent, primary home
 - Not 6 months and one day!
 - Subjective test: where is “home”
 - Important: time patterns, housing, business ties, kids’ school
 - Not so much: driver’s license, voter registration, cemetery plots...
 - Burden of Proof: must be “clear and convincing” evidence
 - Must “leave” the old place and “land” in the new



Understanding State Residency Rules: “Statutory” Residency

Statutory Residency: a more mechanical test

- Definition: >183 days + a “permanent place of abode” (PPA)
 - Days test: any part of a day
 - Burden of proof: must prove the negative
 - Recordkeeping (cell phone, MONAEO app, etc.)
 - PPA: any living quarters in the state
 - Can be owned, rented, shared, etc.
 - Name on title/lease is irrelevant

Careful of other “statutory” tests: non-temporary/transitory purpose states

- Similar concept: you can be a resident even if domicile is somewhere else
- CA, IL, AZ, HI



Case Studies: “Leave and Land”

➤ Facts

- NYC-domiciled taxpayer with place in Hamptons
- Escaped to Hamptons home during Covid; kept NYC rental
- But....moved back to NYC in the Fall of 2022

➤ Analysis

- All good on 183-day rule for NYC
- But Leave and land? Domicile issue?
- Similar issue arises with moves from other states to low-tax jurisdictions (CA to NV or TX; NJ to FL, etc.)
But perhaps other states less aggressive?



Case Studies: Big Sale Coming Up

➤ Facts

- Business owner ready to sell company
- Long-time NYC residents with no place in FL
- Deal set to close November 2024

➤ Issues

- Changing domicile? Main to do items:
 - Sell or list apartment?
 - Get FL place.
 - Do the time!!!
 - Some transfer of business responsibilities?
- Accrual/Allocation considerations?
- 183-day rule....the "Sobotka" issue
- 30-Day Rule or 548-Day rule possibilities?



Special Safe Harbor Tests (NY and Northeastern States)

548-Day Rule

- 450 out of 548 days in foreign country for taxpayer
- Less than 90 days in NY for taxpayer AND spouse-kids
- “Short-period” limitation for taxpayer:
 - $\frac{\text{Total \# of days in short period}}{548} \times 90 \text{ days} = \# \text{ of NY allowed}$
- Perfect option when a foreign-country “landing” is a problem
- Watch out for residency status in foreign country!

30-Day Rule – calendar- year test

- No PPA in NY; PPA somewhere else; 30 days or less in NY = nonresident for that tax year



Case Studies: Double Tax Problem?

➤ Facts

- Taxpayer lives in CT, kids are in school in CT, but works in NYC.
- But taxpayer also maintains a vacation home in the Hamptons. Used mostly in summer.
- Commutes to NYC for work most days, so is over 183 days in New York State for the year.
- Significant intangible income in 2023.

➤ Issues

- Statutory residency problem in NY State: over 183 state days and a “PPA”
- Double tax potential on intangible income?
- *Obus* case: vacation home relief?



Telecommuting and The Convenience Rule



The Basics

- If taxpayer is a NYS resident, then 100% of their compensation earned from employment in NY (or earned but not taxed in another state) is subject to NYS tax.
 - An employer must withhold 100% NYS tax.
- If taxpayer is a nonresident, then NYS tax is still due on the NY source amount of the wage income.
 - Sourcing of wages generally determined based on physical working location.
 - Employer must withhold NYS tax based on amount of time worked in NYS, so long as employee has more than 14 workdays in NY during the year.
 - NY Form IT-2104.1 used for this purpose.
- But what is a NY workday?
 - Days spent in NY by the nonresident employee on company business.
 - Remote work?



Convenience of the Employer Rule

- 7 states (CT, DE, NE, NJ, NY, PA, AL) have a “convenience rule”
 - In general, if the employee works from home for their own convenience, the workdays at home will be treated as days worked at the assigned work location.
 - “Convenience” has been broadly defined in NY cases— Government shutdowns? No, for now – Matter of Zelinsky, DTA Nos. 830517, 830681, ALJ (Nov. 30, 2023).
 - Required out-of-state work OK.
 - But if the work could be done in NY, likely means trouble
 - CT’s rule applies as of 2019, more generous than NY’s. Only applies if taxpayer’s home state also applies a convenience rule; NJ has a new, similar reciprocity rule.
 - NJ v. NJ rule: funding NY litigation?



Matter of Zelinsky, DTA Nos. 830681 and 830517

- Zelinsky challenged NY's convenience rule more than 20 years ago and lost at the NY Court of Appeals.
- Because of the pandemic, he challenged the convenience rule again, arguing in part that remote work was a necessity, not a convenience, during the pandemic since his employer required him to work from home for a period of time.
- He lost at the ALJ level, and the ALJ held that remote work, even during a pandemic, was not employer necessity.
- The ALJ strangely concluded that remote teaching, using Zoom and other virtual tools to connect with students, essentially gave Prof. Zelinsky a "virtual" presence in NY, citing to the Wayfair decision.
- The case is on appeal at the Tribunal. Will the result be different?



Remote Employee Options?

- Option #1: Assign to Non-NY Office
 - But be careful that this assignment is real!
 - Should be used regularly, paid for by employer, etc.
- Option #2: No NY Workdays
 - Year-by-year test – the *Hayes* Rule.
 - Even a few NY workdays, probably too many (See Matter of Huckaby)
 - Should be in writing (employee told that they are not required to come to the NY office and employee indicates that they are not planning to come to NY during the calendar year)
 - Should be documented (for withholding purposes, T&E should reflect that no travel to NY)
- Option #3: Bona-Fide Home Office
 - TSB-M Factors



The TSB-M Factors

Step 1: Primary Factor: Employee's duties require the use of special facilities that cannot be made available at the employer's place of business, but those facilities are available at or near the employee's home

If the home office does NOT satisfy the primary factor, proceed to Step 2

Step 2: The Secondary and "Other" Factors: The home office may still qualify as a "bona fide employer office" if it meets four out of the six Secondary Factors PLUS three out of the ten "Other" Factors

Secondary Factors (4 out of 6)

1. Home office is a requirement or condition of employment
2. Employer has a bona fide business purpose for the employee's home office location.
3. Employee performs some core duties at the home office.
4. Employee meets with clients, patients, or customers at the home office.
5. Employer does not provide the employee with office space or regular work accommodations.
6. Employer reimburses expenses for the home office.

"Other" Factors (3 out of 10)

1. Employer maintains a separate telephone line and listing for the home office.
2. Employee's home office address and phone number are on the employer's business letterhead and/or cards.
3. Employee uses a specific area of the home exclusively for the employer's business.
4. Employee keeps inventory of products or samples in the home office.
5. Employer's business records are stored at the home office.
6. Employer signage at the home office.
7. Home office is advertised as employer's place of business.
8. Home office covered by a business-related insurance policy.
9. Employee properly claims a deduction for home office expenses for federal income tax purposes.
10. Employee is not an officer of the company.



Case Studies: Hybrid to Fully Remote

➤ Facts

- Taxpayer lives in Vermont but his employer is in NYC.
- Initially, the taxpayer is expected to be in the office 2 days a week, but he is allowed to work from home the other 3 days.
- The taxpayer gets tired of commuting, so he switches to being fully remote, but is still expected to attend all hands meetings in NYC twice a year.

➤ Issues

- Allocation
 - Allocation while hybrid?
 - Does this change when fully remote?
 - No *Hayes argument*
 - What if he lived in a different state?
- Options:
 - Telecommuting agreement?



Other Nonresident Income Allocation Issues



Nonresident Allocation: Paying Tax on “Sourced” Income

- Nonresidents still pay tax on “sourced” income
 - Wages for services performed in-state
 - More day-counting rules
 - Careful of remote-work rules
 - Gains from the sale of in-state properties
 - Flow-through Business Income
 - Apportionment rules vary by state
 - S Corps: Market-sourcing
 - Partnerships/LLCs: three-factor formula in NY
 - If office and employees in NY, will be close to 100% sourcing



More on Flow Through Income Apportionment

- Nonresident partner will pay personal income tax on its distributive share of the business's income.
 - For example a New York nonresident partner of an S corporation includes in its New York taxable income its portion of the business's New York-source income as determined by the BAP
- NYS and NYC use different apportionment rules for each entity type
 - *Watch out for mismatch between State and City apportionment for the same type of entity*
 - S- Corporations
 - NYS: Single Sales Factor and Market-Based Sourcing
 - NYC: Single Sales Factor and Place of Performance

Apportionment Rules by Entity



	C Corporations	S Corporations	Partnerships, LLCs, Etc.
NEW YORK STATE			
Apportionment Formula	Single sales factor	Single sales factor	Three factor formula (gross income, property, payroll)
Sourcing of Service Receipts	Market-based sourcing	Market-based sourcing	Office where sale was negotiated or consummated / agent is based
Sourcing of Tangible Personal Property Receipts	Destination	Destination	Origination
MTA SURCHARGE			
Apportionment Formula	Three factor formula (gross income, property, payroll)	N/A	N/A
Sourcing of Service Receipts	Market-based sourcing	N/A	N/A
Sourcing of Tangible Personal Property Receipts	Destination	N/A	N/A
NEW YORK CITY			
Apportionment Formula	Single sales factor	Single sales factor	Single sales factor
Sourcing of Service Receipts	Market-based sourcing	Place of performance	Place of performance
Sourcing of Tangible Personal Property Receipts	Destination	Destination	Destination



Case Studies: Tax Difference by Entity

➤ Facts

- Entity is a small widget retailer in NYC. It has an office in NYC worth \$5 million and \$50,000 in annual payroll.
- Last year it had \$900,000 of receipts from sales of widgets, and \$100,000 of which were from sales to NYC customers. The annual cost of goods sold is \$50,000. The company also acted as a consultant to a college in Vermont and received \$100,000 for those services.
- The entity has two nonresident owners who each own 50%

➤ Issue

- If the entity is an LLC, what is the NYS and NYC tax implications to the nonresident owner?
- S Corporation?
- C Corporation?



Case Study BAP Summary

	C Corporations			S Corporations		Partnerships, LLCs, Etc.	
	New York State	<i>MTA Surcharge</i>	New York City	New York State	New York City	New York State	New York City
<i>Property percent</i>	N/A	100%	N/A	N/A	N/A	100%	N/A
<i>Payroll percent</i>	N/A	100%	N/A	N/A	N/A	100%	N/A
<i>Sales percent</i>	10%	100%	10%	10%	20%	100%	20%
BAP	10%	100%	10%	10%	20%	100%	20%



Nonresident Allocation: No Tax on “Un-Sourced” Income

Nonresidents do not pay tax on “un-sourced” income

- Investment Income
 - Interest, dividends, capital gains, etc.
- Carried Interest
 - Treated as intangible
 - Not taxable to nonresident
- Gain on Sale of Businesses
 - Asset Sale
 - Taxed based on entity apportionment percentage
 - Stock Sale = generally not taxable to nonresident
 - Careful of 338(h)(10) deals (See TSB-M-10(10)I).
 - Sale of interests in an entity owning NY real property if NY real property is more than 50% of assets (See Tax Law § 632(b)(1)(A)(1).
 - Special NY rule on sale of partnership interest under IRC § 1060 (TSB-M-18(2)I)



Resident Tax Credit Issues



Resident Tax Credits - Generally

- States generally allow their residents a credit for taxes paid to other states
- Credit cannot exceed the tax due in home state
- Two general approaches:
 - Most common – Credit allowed for tax paid to other state on income sourced to that state, typically based on the home state’s allocation rules (i.e. if we would tax a nonresident on the income, we will give the resident credit on taxes paid to the other state on that income)
 - E.g., New York
 - Less common – Credit allowed for tax paid to other state on income not sourced to the home state (intangible income)
 - E.g., New Jersey



Resident Tax Credit Statutes

- New York's statute:
 - "A resident shall be allowed a credit against the tax otherwise due... for any income tax imposed on such individual for the taxable year by another state of the United States, a political subdivision of such state, the District of Columbia or a province of Canada, **upon income both derived therefrom** and subject to tax under this article." [N.Y. Tax Law § 620(a) (emphasis added)].
 - Similar to Connecticut and California's resident credit statutes
- New Jersey's statute:
 - "A resident taxpayer shall be allowed a credit against the tax otherwise due under this act for the amount of any income tax or wage tax imposed for the taxable year by another state of the United States or political subdivision of such state, or by the District of Columbia, with respect to income which is also subject to tax under this act, except as provided by subsections (c) and (d) of this section." [N.J. Tax Law § 54A:4-1(a)].
 - Similar to Michigan, Montana, and Oregon's resident credit statutes



Resident Tax Credit Examples

➤ Work and Live in Different States

- Employee lives in NJ and receives wages from NY employer. Employee also received \$1M in dividends.
 - NY – Taxes all wage income.
 - NJ – Taxes all income (wages & dividends) but gives a credit for the tax paid to NY on wage income.
- Employee is domiciled in NY and telecommuting from CA during COVID.
 - CA – Taxes all wage income.
 - NY – Taxes all wage income and doesn't allow a credit for the tax paid to CA since days commuting from CA are deemed NY workdays under NY's convenience rule.



Resident Tax Credit Examples

➤ Dual-Resident (Resident of Two States)

- Employee is domiciled in NJ and is a statutory resident of NYC where she works and has an apartment. Employee received \$1M in dividends.
 - NY - Taxes all income (wages & dividends). NYS and NYC PIT imposed.
 - NJ – Taxes all income (wages & dividends) but gives a credit for the tax paid to NY on all non-NJ income (which covers wages & dividends). But NJ’s tax rate lower than the combined NYS/NYC PIT rate.
- Employee is domiciled in CT and is a statutory resident of NYC where she works and has an apartment. Employee received \$1M in dividends.
 - NY - Taxes all income (wages & dividends). NYS and NYC PIT imposed.
 - CT – Taxes all income (wages & dividends) but gives a credit for the tax paid to NY on NY-sourced income (which covers wages only). No credit allowed for tax paid to NY on dividend income.



Resident Tax Credit: Carried Interest Issue

- Taxation of hedge fund owners and investors is a hot topic!
- Carried interest can be part of a compensation package, but not generally considered to be “sourced” income.
- New York does not allow a credit on the tax imposed by another state on intangible income “except where such income is from property employed in a business, trade or profession carried on in the other jurisdiction.” [20 NYCRR section 120.4(d)]
- For carried interest, is the taxpayer engaged in a trade or business, or is the taxpayer receiving income from intangibles that themselves were used in a trade or business?
 - *Matter of Greenberg*, DTA No. [829737](#) (N.Y. Tax. App. Trib. Nov. 22, 2023) vs *Matter of Sobel*, 2017 WL 1240119 (Conn. Super. Ct. 2017)



Audit Updates



Residency/Income Tax Audits

- Huge Enforcement Area
 - About 3,000 audits per year
 - 250-300 auditors
 - \$343 million in revenue in 2018!
- Two Main Audit Areas
 - Residency
 - Income Allocation
- Other Issues
 - Resident credits
 - Federal tax issues
 - Flow-through audit issues



Residency Audits

- NYS: Industry Leader!
 - 300 auditors.....and dropping?
 - 5,000+ field audits per year
 - More than 100,000 “desk audits” in 2020-21 to catch Covid moves and telecommuters
- Likelihood of Audit?
 - Close to 100% chance of audit at higher incomes No close calls
 - 3-year SOL: so audit could come years after the move



Residency Audits

- Best Practices
 - Burden of Proof
 - No close calls
 - You have to prove where you were and where you weren't
 - Cell phones data and smartphone apps
 - Prepare for the audit when preparing for the move
 - "Field Audits" post-Covid
 - Not always a zero-sum game
 - Be wary of double taxation

Questions?



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