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State Tax Observations

New York State Expands Taxation of Nonresidents

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New York State is on a hunt for increasing personal income taxes on nonresidents. Its method: expanding the definition of a nonresident individual's source income. Nonresidents, of course, are the easiest of targets. They don't vote in the state.

In April 2018, the New York State Department of Taxation and Finance released Technical Memorandum TSB-M-18(1)I which states that a nonresident's New York sourced income now includes the gain or loss from the sale of ownership interests in certain entities (i.e., partnerships, LLCs and S corporations) that own shares in cooperative housing corporations located in New York.

The TSB-M addressed a tax law change in 2017. Even if you sold your New York co-op shares in 2017, you are out of luck. The law is effective for tax years beginning on or after January 1, 2017.

History of Nonresident-Sourced Income

In general, nonresidents of New York are subject to income tax on income or gain derived from or connected to New York. Also, income from the sale of intangible property (i.e., sale of a stock or even a partnership interest) is New York sourced income if the property is used in a business carried on in New York. Historically, however, by placing property in an entity and selling the interest in that entity, a nonresident could potentially avoid personal income tax on the sale of that asset.

To eliminate this 2009 "loophole" [via TSB-M-09(5)I] and the tax law it addressed, New York expanded its definition of nonresident New York source income to include gain attributable to the ownership of any interest in New York real property. The term "real property" in New York was changed to include an interest in a partnership, LLC, S corporation, or non-publicly traded C corporation with 100 or fewer shareholders, that owned New York real property with a fair market value that was 50% or more of all the assets in the entity on the sale date of the taxpayer's interest in the entity. But, somehow, ownership of cooperatives was not included in this change.

The Latest Change

Under the latest TSB, New York further expands its definition of New York real property for a nonresident to include an interest in a partnership, LLC, S corporation, or non-publicly traded C corporation with 100 hundred or fewer shareholders that owns shares of stock in a New York cooperative, provided that the fair market value of the entity's real property and shares of New York cooperative stock equals or exceeds 50% of all the assets the entity has owned for at least two years as of the sale date. If all of the entity's assets have been owned less than two years, the 50% rule has been met. The TSB states that the rules apply to nonresident and part year resident trusts and entities in tiered structures.

Two Other New Nonresident New York Sourcing Situations Addressed

At the same time as the issuance of the above TSB, two other TSBs were issued that address the sourcing of a nonresident's income to New York. The first, TSB-M-18(2)I, sets forth that where a nonresident partner has a gain on the sale of a partnership interest and the sale is subject to IRC § 1060 and occurs on or after April 10, 2017, then the gain from New York sources is determined by multiplying the gain by the partnership's business allocation percentage for the taxable year when sold.

The second, TSB-M-18(2)C, (3)I, provides guidance on how nonresidents will determine the New York-source portion of nonqualified deferred compensation attributable to services provided prior to 2009 to an entity exempt from U.S. taxation. Such compensation was granted a deferral from taxation for 10 years. However, the previously untaxed amount is now included in taxable income federally. For New York, different rules apply depending on who is including pre-2009 nonqualified deferred compensation in their federal taxable income.

Know Your Situation

As always, it's important to discuss any proposed transactions with your tax advisor and to recognize how tax authority changes are applicable to your ownership structure. While owning a cooperative in New York through an entity may have certain legal and tax benefits, it is important to understand how the New York tax rule change impacts you.

Contact Us

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