State Tax Observations

New York and New Jersey Tax Update

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New York State updates its statutory residence test while New Jersey revises its Pass-Through Business Alternative Income Tax (BAIT) rules. Both take effect January 1, 2022.

New York State

The New York State (NYS) Department of Taxation & Finance just released revised non-resident audit guidelines which have not been updated since 2014. While there were several minor changes, there is one major change.

This change has to do with the determination of whether an individual is a statutory resident. The NYS law provides that a statutory resident is an individual who is not a NYS domiciliary but maintains a permanent place of abode (PPA) in NYS and spends more than 183 days in the state. The NYS regulation further provides that an individual who maintains a PPA in NYS must do so for "substantially all of the tax year." Under the prior guidelines, the NYS Audit Division's policy defined "substantially all of the tax year" as a period exceeding 11 months. Now, under the revised guidelines and effective for tax years beginning in 2022, the Audit Division's new policy is to define this to mean a period exceeding 10 months.

To put this rule in perspective, below are a few examples:

A taxpayer is domiciled in New Jersey and works in New York City during the year. If that taxpayer acquires a PPA in NYS on February 15 of the taxable year and spends 190 days in NYS, the individual will be considered a statutory resident and be taxed as a NYS resident under the new 10-month rule. However, under the prior 11-month rule, this taxpayer would not be considered a statutory resident and thus not be taxed as a NYS resident.

A taxpayer maintains a PPA in NYS, spends 190 days in NYS, but sells the residence on November 10. Under the prior rule, the taxpayer would not be considered a statutory residency since the PPA was not maintained for more than 11 months. However, under the new rule, the taxpayer would be treated as a statutory residency.

A taxpayer purchases or leases a PPA on February 12 and spends 200 days in NYS. Under the prior rule, the taxpayer would not be considered a statutory residency since the PPA was not maintained for more than 11 months. However, under the new rule, the taxpayer would be treated as a statutory residency.

Since this revision was just published and is effective for tax years beginning January 1, 2022, it seems that this change will have to be made on future tax instructions as well as the NYS Department of Taxation & Finance's website guidance.

New Jersey

In previous Thought Leadership articles, we discussed in detail New Jersey's BAIT. Subsequent to the NJ Division of Taxation's (Division) issuance of frequently asked questions on its website and as taxpayers and practitioners began to understand the rules, several issues arose. These issues were then brought to the Division's attention, who in turn, maintained that they had to be addressed legislatively.

The good news is that on January 18th, Governor Murphy signed legislation effective January 1, 2022 which addresses these issues. Below is a list of the legislative changes:

- The highest tax bracket was expanded to include distributable income in excess of $1 million. This allows the BAIT to more closely align to the tax brackets of the Gross Income Tax.

- New Jersey source income will be the basis for calculating the BAIT, as opposed to federal taxable income.

- Three-factor formula for allocation of income to New Jersey is required for both partnerships and S-Corporations (S-Corp) notwithstanding the fact the legislation includes a reference to the S-Corp statute that provides for a single sales factor allocation.

- Tax payments made in tiered partnership structures can be applied to upper-tier non-individual entities. This alleviates two important "traps" under the prior law. First, the double payment of tax from a cash flow point of view until the refund is paid by the state. Second, any BAIT payment credits that flow through to an S-Corp will not be trapped within the S-Corp and, instead, will be refundable.

- The requirement for non-resident withholding on partner income is eliminated if the taxpayer has a reasonable basis that the BAIT would substantially cover the withholding amount required under separate provisions of New Jersey tax law.

- An overpayment of BAIT taxes by pass-through entities (PTEs) can be applied to future estimated taxes or refunded. Previously, the overpayment had to be refunded.

While the above changes are effective January 1, 2022, there is one change effective for the 2021 tax year. The Division has announced on its website that S-Corps will have an option to use the three-factor formula in determining the BAIT.

Contact Us

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