

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-85 (5) I
Income Tax
October 22, 1985

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. I821201A

On December 1, 1982, a Petition for Advisory Opinion was received from David L. Lieb & Co., 200 Park Avenue, New York, New York 10166.

The issue raised is whether the S corporation investment income of a nonresident shareholder of an electing New York S corporation is subject to the Personal Income Tax imposed under Article 22 of the Tax Law.

Petitioner is a New York public accounting firm. A number of Petitioner's clients are considering organizing New York S corporations for investing in securities and commodities. The only income of these corporations would be from interest, dividends and capital gains and losses. Some of the shareholders may be nonresidents.

Section 660 of the Tax Law allows the shareholders of a federal S corporation subject to Article 9-A of the Tax Law to make an election to be treated as a New York S corporation. If all of the shareholders make this election, the New York S corporation will be exempt from the Franchise Tax imposed under Article 9-A.

However, section 632(a)(1)(B) provides that if the shareholders make such an election, they must include in their New York adjusted gross income their pro rata share of the S corporation's income, loss and deduction, increased by deductions for taxes described in sections 1366(f)(2) and (3) of the Internal Revenue Code, as determined under section 637 of the Tax Law.

Section 637 of the Tax Law provides that in determining New York adjusted gross income of a nonresident shareholder of an S corporation, only the portion of the shareholder's pro rata share of items of income, loss and deduction which are connected with New York sources shall be included. The portion connected with New York sources is to be computed pursuant to regulations of the Tax Commission consistent with the applicable methods and rules for allocation under Article 9-A of the Tax Law.

In return for corporate franchise tax exemption, S corporation shareholders assume an obligation to individually pay tax on S corporation income. By freely electing S corporation status, nonresidents choose to subject themselves to New York S corporation rules and procedures. Nonresident shareholders, therefore, must include in their New York adjusted gross income their pro rata share of New York S corporation income, loss and deduction even if such income, loss and deduction would not be included in such nonresidents' New York adjusted gross income if earned or incurred by such nonresidents as individuals.

Accordingly, the S corporation investment income of a nonresident shareholder of an electing New York S corporation is subject to the Personal Income Tax imposed under Article 22 of the Tax Law since the freely made S corporation election creates such an obligation.

DATED: August 21, 1985

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth herein.