

Amendment to the Definition of New York Source Income of a Nonresident Individual

Chapter 57 of the Laws of 2009 amends the definition of New York source income of a nonresident individual by adding section 631(b)(1)(A)(1) to the Tax Law. The new section expands the definition of income, gain, loss, and deduction from New York sources to include certain gains or losses from a nonresident taxpayer's sale or exchange of an interest in an entity that owns real property in New York State. The sale or exchange of an interest in the following entities is covered by the new law: partnerships, limited liability companies (LLCs), S corporations, or non-publicly traded C corporations with 100 or fewer shareholders. This provision applies to a sale or exchange of an interest in an entity that occurs on or after May 7, 2009.

All or a portion of the gain or loss from a nonresident taxpayer's sale or exchange of an interest in an entity is considered to be derived from New York sources if the entity owns real property in New York State that has a fair market value that equals or exceeds 50% of the fair market value of the assets the entity has owned for at least two years as of the date of the sale or exchange. If the entity owns real property in New York State, and all of its assets have been owned for less than two years as of the date of the sale or exchange, then the 50% test is met.

If the test described above is met, the portion of the gain or loss to be included in the taxpayer's New York source income is the total gain or loss for federal income tax purposes¹ from that sale or exchange multiplied by a fraction. The numerator of the fraction is the fair market value of the entity's real property located in New York State on the date of the sale or exchange and the denominator is the fair market value of all the assets that the entity owns on the date of the sale or exchange, regardless of how long the entity has owned the assets.

Section 631(b)(1)(A)(1) of the Tax Law also applies to the determination of the New York source income for a part-year resident individual when there is a sale or exchange of an interest in an entity and the gain or loss on the sale or exchange is properly reportable in the nonresident portion of the tax year.

Note: The new law does not affect the existing tax treatment of gain and loss passed through to a partner or New York S corporation shareholder where the entity itself sells real property located in New York State. In addition, the new law does not affect the existing tax treatment of the gain or loss from the sale of an interest in an entity where the interest in the entity is employed in another business carried on in New York State.

The following examples illustrate the new law:

¹ Federal gain or loss includes any capital gain or loss and any gain or loss attributable to unrealized receivables and inventory items.

Example 1: *On June 1, 2009, Taxpayer X, a nonresident individual of New York State, sold his entire interest in Partnership ABC. For federal income tax purposes, Taxpayer X will recognize a gain of \$12,000 from the sale.*

Partnership ABC owns real property in New York State. On June 1, 2009, the fair market value of Partnership ABC's real property located in New York State is determined to be \$950,000. On that same date, the fair market value of all the assets that Partnership ABC owns is \$ 2,375,000; and the fair market value of all the assets that the partnership has owned for at least two years, including any real property located in New York State, is determined to be \$1,532,258.

Accordingly, on June 1, 2009, the fair market value of Partnership ABC's real property located in New York State exceeds 50% of the fair market value of all the assets Partnership ABC owned for at least two years ($\$950,000/\$1,532,258 = .62$ or 62%). Therefore, all or a portion of Taxpayer X's gain from the sale of his partnership interest is considered to be derived from New York sources.

To determine the portion of the gain from the sale of his partnership interest in Partnership ABC that must be included in New York source income, the gain reported for federal income tax purposes (\$12,000) is multiplied by a fraction whose numerator is the fair market value of Partnership ABC's real property located in New York State (\$950,000), and whose denominator is the fair market value of all the assets that the entity owned on the date of the sale (\$2,375,000). Therefore, Taxpayer X determines that \$4,800 is the portion of the gain from the sale of his partnership interest in Partnership ABC that must be included in New York source income, as shown below:

- $\$950,000/\$2,375,000 = .40$
- $\$12,000 \times .40 = \$4,800$

Example 2: *On October 1, 2009, Taxpayer Y, a nonresident individual of New York State, sells all her shares in a non-publicly traded C corporation. The corporation has fewer than 100 shareholders. For federal income tax purposes, Taxpayer Y will recognize a gain of \$30,500 from the sale.*

The corporation owns two apartment buildings located in New York City. Building 1 was purchased by the corporation on December 1, 1998, and Building 2 was purchased by the corporation on January 28, 2008. On October 1, 2009, the fair market value of Building 1 is determined to be \$8,000,000, and the fair market value of Building 2 is determined to be \$2,700,000. Therefore, the fair market value of all real property located in New York State is \$10,700,000. On that same date, the fair market value of all the assets that the corporation owns is determined to be \$15,285,714; and the fair market value of all the assets that the corporation has owned for at least two years, which includes Building 1 but not Building 2, is determined to be \$12,159,090.

Accordingly, on October 1, 2009, the fair market value of the corporation's real property located in New York State exceeds 50% of the fair market value of all the assets the corporation owned for at least two years ($\$10,700,000/\$12,159,090 = .88$ or 88%). Therefore, all or a portion of Taxpayer Y's gain from the sale of her shares in the corporation is considered to be derived from New York sources.

To determine the portion of the gain from the sale of her shares of stock in the corporation that must be included in New York source income, the gain reported for federal income tax purposes (\$30,500) is multiplied by a fraction whose numerator is the fair market value of the corporation's real property located in New York State (\$10,700,000), and whose denominator is the fair market value of all the assets that the entity owned on the date of the sale (\$15,285,714). Therefore, Taxpayer Y determines that \$21,350 is the portion of the gain from the sale of her shares of stock in the corporation that must be included in New York source income, as shown below:

- $\$10,700,000/\$15,285,714 = .70$
- $\$30,500 \times .70 = \$21,350$

Tiered entities

If an individual sells or exchanges an interest in an entity that is part of a tiered structure of entities, the law applies to the sale or exchange if any entity in the tiered structure owns real property located in New York State.

Additionally, if a partnership in a tiered structure of entities sells or exchanges its interest in an entity in the tiered structure, the law also applies to the sale or exchange. In that case, the partnership will determine whether it has any New York source income relating to the sale or exchange for personal income tax purposes under section 631(b)(1)(A)(1) of the Tax Law as if it were a nonresident individual.

Resident trusts that are partners or shareholders in an entity that owns real property in New York State

A resident trust that is not currently subject to New York State personal income tax because the trust meets the conditions under section 605(b)(3)(D) of the Tax Law may become subject to tax based on the sale or exchange of its interest in an entity that owns real property in New York State if the gain or loss from the sale or exchange is considered to be New York source income under section 631(b)(1)(A)(1) of the Tax Law.

Section 605(b)(3)(D) of the Tax Law provides that a resident trust is not subject to New York State personal income tax if all three of the following conditions are met:

1. All the trustees are domiciled in a state other than New York;

2. The entire corpus of the trust, including real and tangible personal property, is located outside of New York State (it is the Tax Department's position that intangibles located in the state but not employed in a business carried on in the state are not deemed to be located in the state for purposes of this rule); and
3. All income and gains of the trust are derived from or connected with sources outside of New York State.

Accordingly, if a resident trust is considered to have New York source income based on section 631(b)(1)(A)(1) of the Tax Law, the resident trust would no longer meet condition 3 above and would be subject to New York State personal income tax.

NOTE: A TSB-M is an informational statement of existing department policies or of changes to the law, regulations, or department policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in department policies could affect the validity of the information presented in a TSB-M.