

1994 Legislation
Taxation of Nonresident Estates and Trusts and
Part-Year Resident Trusts

General

Chapter 170 of the Laws of 1994 amended various provisions of the New York State Tax Law relating to the computation of the New York State personal income tax for nonresident estates and trusts and part-year resident trusts. The general theory of taxing nonresidents and part-year residents remains intact (i.e., the tax is determined as if the estate or trust were a resident and is then allocated to New York using the income percentage).

However, the computation of the numerator and denominator of the fraction¹ used to compute the income percentage has been changed. In addition, for part-year resident trusts only, the computation of items of tax preference subject to the minimum income tax and the amount of a lump-sum distribution subject to the separate tax on lump-sum distributions has also been changed. Furthermore, the special accruals required when a trust changes resident status have been consolidated, without substantive change, into one section of the Tax Law.

As a result of these changes, TSB-M-88-(7)I is valid only for tax years beginning after 1987 but prior to 1994. The following information should be used for tax years beginning after 1993.

Computation of Tax

The New York State personal income tax for nonresident estates and trusts and part-year resident trusts under section 601(e) of the Tax Law is computed in the following manner.

- 1) A tax is first computed under sections 601(c) and (d) of the Tax Law on the estate's or trust's New York taxable income, computed as if the estate or trust were a resident of New York State for the entire tax year. The taxes under sections 601(c) and (d) consist

¹ Section 601(e) of the Tax Law refers to this fraction as the "New York source fraction." The result of this fraction is referred to in the forms and instructions as the "Income Percentage."

of the regular tax and the tax table benefit recapture. The sum of these two taxes is known as the base tax ².

- 2) The base tax is then multiplied by the income percentage. The income percentage is the percentage computed by dividing the estate's or trust's New York source income for the entire tax year by the estate's or trust's New York adjusted gross income for the entire tax year. The income percentage will be more than 100% when New York source income exceeds New York adjusted gross income. The income percentage is more fully explained below.
- 3) The amount computed in Step 2 is then reduced by any New York State credits that the estate or trust is entitled to and increased by any other New York State taxes for which it is liable. The resulting figure is the New York State personal income tax for the year.

Income Percentage

For nonresident estates and trusts and part-year resident trusts, the numerator of the fraction used to compute the income percentage remains New York source income. However, the definition of New York source income has been changed to include the addition and subtraction modifications to federal adjusted gross income under section 618 of the Tax Law, except those modifications described in section 618(3) relating to itemized deductions ³.

² Section 601(e) of the Tax Law refers to this figure as the "tax base." However, this figure is referred to in the forms and instructions as the "base tax", and therefore that term will be used in this memorandum.

³ Except for the modifications described in section 618(3), the modifications described in section 618 reflect only modifications to federal adjusted gross income (the section 612 modifications and the modification for includable gain of a trust). The modification under section 618(3) is the estate's or trust's share of the New York fiduciary adjustment determined under section 619 of the Tax Law. The New York fiduciary adjustment contains modifications to federal adjusted gross income (the section 612 modifications) and modifications that relate to items that would be treated as itemized deductions if incurred by an individual (the section 615 modifications). An example of a section 615 modification is the modification for the federal deduction for state and local income taxes. In computing the numerator and denominator of the income percentage, the portion of the estate's or trust's share of the fiduciary adjustment

The denominator of the fraction has been changed from federal adjusted gross income to New York adjusted gross income (which also includes the section 618 modifications), computed as if the estate or trust were a resident for the entire tax year. The following is a detailed definition of New York source income and New York adjusted gross income for nonresident estates and trusts and part-year resident trusts.

Nonresident Estates and Trusts

New York Adjusted Gross Income

New York adjusted gross income is defined in section 601(e) of the Tax Law as the estate's or trust's federal adjusted gross income under section 67(e) of the Internal Revenue Code (IRC), with the section 618 modifications. Under section 67(e) of the IRC, the federal adjusted gross income of an estate or trust is computed in the same manner as an individual computes his or her federal adjusted gross income, except that **the following deductions are allowed** in arriving at federal adjusted gross income:

- 1) the deductions for costs that are paid or incurred in connection with the administration of the estate or trust and that would not have been incurred if the property were not held in the trust or estate;
- 2) the personal exemption deduction (IRC section 642(b));
- 3) the deduction for trusts distributing current income only (IRC section 651); and
- 4) the deduction for estates and trusts accumulating income or distributing corpus (IRC section 661).

Federal adjusted gross income, with the section 618 modifications, yields New York adjusted gross income. Since New York adjusted gross income is to be as if the estate or trust were a resident for the entire tax year, 100% of any section 618 modifications related to the estate's or trust's federal adjusted gross income must be included in New York adjusted gross income.

that relates to the section 615 modifications is not included. In this memorandum, the term "section 618 modifications" will refer, unless otherwise specified, to the modifications to federal adjusted gross income.

New York Source Income

New York source income is defined under section 633 of the Tax Law as the sum of the following:

- the net amount of items of income, gain, loss and deduction entering into federal adjusted gross income that are derived from New York sources; and
- the portion of the section 618 modifications that relates to income derived from New York sources.

In computing New York source income, the source of federal adjusted gross income items is determined under the applicable rules of section 631 of the Tax Law, as in the case of a nonresident individual. In addition, the IRC section 67(e) deduction items allowed in computing federal adjusted gross income (described in 1-4 above) are derived from New York sources to the same extent as the income items to which they relate. For example, if one-third of the income includable in the federal distributable net income of an estate or trust is derived from New York sources, one-third of the federal distribution deduction is derived from New York sources.

However, if the IRC section 67(e) deduction item is not directly applicable to a specific item of income (e.g., the federal exemption), that deduction item is derived from New York sources to the same extent as the estate's or trust's federal adjusted gross income, computed as if the estate or trust were an individual, is derived from New York sources. For example, if 80% of the estate's or trust's federal adjusted gross income, computed as if an individual, is derived from New York sources, 80% of the federal exemption amount is derived from New York sources and would be deductible in computing New York source income.

Furthermore, the portion of the section 618 modifications that are derived from New York sources and therefore includable in New York source income is computed in the same manner as the federal items to which they relate. For example, if 35% of an estate's or trust's business income is derived from New York sources, 35% of any modification applicable to that business income is derived from New York sources.

Part-Year Resident Trusts

The New York source income of a part-year resident trust is defined in section 638(b) of the Tax Law as the sum of the following:

- 1) New York adjusted gross income for the period of residence, computed as if the tax year for federal income tax purposes were limited to the period of residence;
- 2) New York source income for the period of nonresidence, computed in accordance with section 633 of the Tax Law, as if the tax year for federal income tax purposes were limited to the period of nonresidence; and
- 3) those special accruals, required under section 639 of the Tax Law when trusts change their resident status, that relate to adjusted gross income.

The special accruals under section 639 that relate to adjusted gross income are required to be made not only in computing New York source income (the numerator of the income percentage) but also in computing New York adjusted gross income (the denominator of the income percentage). In addition, when a part-year resident trust computes its tax as if a resident, its New York taxable income must include all of the special accruals required under section 639 of the Tax Law.

Note: As a result of these changes, the exceptions in computing the New York taxable income and the base tax (tax as if a resident) of nonresident estates and trusts and part-year resident trusts, described in the Base Tax section of TSB-M-88-(7)I no longer apply.

Minimum Income Tax and Separate Tax on Lump-Sum Distributions

Nonresident Estates and Trusts

The method of computing the minimum income tax and the separate tax on lump-sum distributions for nonresident estates and trusts is unchanged. These entities are only subject to tax on those items of tax preference or the amount of lump-sum distributions that are derived from New York sources.

Part-Year Resident Trusts

Minimum Income Tax

For a part-year resident trust, the amount of the items of tax preference subject to the minimum income tax is the sum of the following:

- 1) the federal items of tax preference for the period of residence, computed as if the tax year for federal income tax purposes were limited to the period of residence;
- 2) the federal items of tax preference for the period of nonresidence that are derived from New York sources, computed as if the tax year for federal income tax purposes were limited to the period of nonresidence;
- 3) any New York modifications related to the tax preference items computed in steps 1 and 2; and
- 4) the special accruals required under section 639 of the Tax Law, to the extent they relate to items of tax preference and associated modifications

Separate Tax on Lump-Sum Distributions

For a part-year resident trust, the amount of a lump-sum distribution that is subject to the separate tax on lump-sum distributions is the sum of the following:

- 1) the ordinary income portion of a lump-sum distribution for the period of residence, computed as if the tax year for federal income tax purposes were limited to the period of residence;
- 2) the ordinary income portion of a lump-sum distribution for the period of nonresidence that is derived from New York sources, computed as if the tax year for federal income tax purposes were limited to the period of nonresidence;
- 3) any New York modifications related to the amounts computed in steps 1 and 2; and
- 4) the special accruals required under section 639 of the Tax Law, to the extent they relate to a lump-sum distribution and associated modifications.

Special Accruals for Part-Year Resident Trusts

A new section 639 has been added to the Tax Law to consolidate all of the special accrual rules relating to a change of resident status. As a result, the separate accrual rules previously contained in section 601(e) (base tax), section 636 (minimum income tax), section 637 (separate tax on lump-sum distributions) and 638 (New York source income of a part-year resident) have been deleted.

The consolidated accrual rules are substantially the same as the prior rules, with one exception. The required accruals now include any modifications required under section 618, **including those in section 618(3) which relate to itemized deductions**, that relate to the items being accrued. The specific accrual rules for each change of residence status are as follow.

Change of Status from Resident to Nonresident

If a trust changes status from resident to nonresident, the trust must, regardless of the method of accounting employed, accrue to the period of residence:

- any items of income, gain, loss or deduction;
- any items of tax preference; and
- the ordinary income portion of a lump-sum distribution

accruing prior to the change of status. The accrual is required only if the item is not otherwise properly includable or allowable for New York income tax purposes for the resident period or for a prior period under the trust's method of accounting. In addition, the trust must include in the resident period any New York modifications or adjustments to federal adjusted gross income, itemized deductions, items of tax preference or a lump-sum distribution that relate to items being accrued.

Change of Status from Nonresident to Resident

If a trust changes resident status from nonresident to resident, the trust must, regardless of the method of accounting employed, accrue to the **period of nonresidence**:

- any items of income, gain, loss or deduction;
- any items of tax preference; and
- the ordinary income portion of a lump-sum distribution

accruing prior to the change of status, **except for those items derived from New York sources**. The accrual is required only if the item is not otherwise properly includable or allowable for New York income tax purposes for the nonresident period or a prior tax year.

In addition, the trust must include in the nonresident period any New York modifications or adjustments to federal adjusted gross income, itemized deductions, items of tax preference or a lump-sum distribution that relate to the items being accrued.

General Rules

No item of income, gain, loss, or deduction; no item of tax preference; no ordinary income portion of a lump sum distribution; and no related modification or adjustment that is accrued under section 639 will be taken into account in determining the trust's New York State personal income tax for any subsequent tax year.

The accruals required under section 639 will not be required if the trust files with the Tax Department a bond or other security acceptable to the Department. If a bond or other security is filed, the amounts accruable under section 639 must be taken into account in determining the trust's New York State tax in one or more subsequent years as if the trust had not changed resident status. For more information on accruals and filing a bond or other security, see TSB-M-86-(3)-I.

Examples

The following examples illustrate the revised method of computing the New York State personal income tax for nonresident estates and trusts and part-year resident trusts in various situations.

Example 1: For tax year 1994, a nonresident estate receives income in respect of a decedent of \$55,000, of which \$42,000 is from New York State sources. The estate also receives interest income of \$50,000, of which \$8,000 is from U.S. government bonds. Expenses of \$5,000 were incurred for federal income tax purposes in connection with the administration of the estate which would not have been incurred if the property were not held in the estate. A deduction of \$700 was taken on the federal fiduciary return for New York State income taxes paid. The net fiduciary adjustment is a subtraction modification of \$7,300, composed of a subtraction modification for U.S. government interest of \$8,000 and an addition modification for the state income taxes of \$700.

The federal adjusted total income of the estate is \$99,300, 75% of which is retained by the estate. Federal adjusted total income of the estate of \$99,300 equals the total income of the estate (\$105,000) less the total expenses (\$5,700). Therefore, the estate is entitled to a distribution deduction for federal income tax purposes of \$24,825 ($\$99,300 \times .25$).

The estate's 1994 New York State personal income tax is computed as follows:

| | |
|--|--------------------------|
| | Federal <u>Amount</u> |
| Federal adjusted total income | \$99,300 |
| Less: federal income distribution deduction | <u>24,825</u> |
| Balance | \$74,475 |
| Less: federal exemption | <u>600</u> |
| Federal taxable income | \$73,875 |
| Less: estate's share of net NY fiduciary adjustment (\$7,300 X .75) | <u>5,475</u> |
| New York taxable income | \$68,400 |
| | |
| Base tax (from New York State tax rate schedule) | \$5,027.75 |
| | |
| *Income percentage: \$29,830 | .4350 |
| <u>\$68,575</u> | |

New York State personal income tax (\$5,027.75 X .4350) \$2,187.07

*The numerator and denominator of the income percentage are computed as follows:

| | Federal <u>Amount</u> | NY State <u>Amount</u> |
|---|--------------------------|---------------------------|
| Interest income | \$ 50,000 | \$ -0- |
| Income in respect of a decedent | <u>55,000</u> | <u>42,000</u> |
| Federal adjusted gross income as if an individual | \$105,000 | \$42,000 |
| Less: federal income distribution deduction | (24,825) | |
| NY amount (\$42,000/5105,000 X \$24,825) | | (9,930) |
| Less: federal exemption | (600) | |
| NY amount (\$42,000/5105,000 X \$600) | | (240) |
| Less: federal amount of administration costs | (5,000) | |
| NY amount (\$42,000/5105,000 X \$5,000) | | <u>(2,000)</u> |
| Federal adjusted gross income | \$ 74,575 | \$29,830 |
| **Less: estate's share of fiduciary adjustment (\$8,000 X .75) | <u>(6,000)</u> | |
| New York adjusted gross income/NY source income..... | <u>\$ 68,575</u> | <u>\$29,830</u> |

**In determining New York adjusted gross income and New York source income, an estate or trust includes only the portion of the fiduciary adjustment that relates to items includable in federal adjusted gross income. Since the deduction for income taxes does not constitute an item includable in federal adjusted gross income, that portion of the fiduciary adjustment (the addition modification of \$700) is not included in the computation of New York adjusted gross income or New York source income. In addition, since, in this example, the U.S. government bond interest is not derived from New York sources, no portion of the fiduciary adjustment for that item is entered in the NY State Amount column

Example 2: A revocable trust changed its residence from New York to another state on September 30, 1994. The trust had net rental income from property located in New York State of \$24,000 for the entire year (\$18,000 in the resident period and \$6,000 in the nonresident period). The trust also received interest income taxable for federal income tax purposes of \$20,000 for the year (\$15,000 in the resident period and \$5,000 in the nonresident period). \$12,000 of the interest income was from U.S. government bonds (\$9,000 in the resident period and \$3,000 in the nonresident period). None of the interest income was derived from New York sources.

The trust also had fiduciary fees for the year of \$3000 (\$2,250 paid in the resident period and \$750 in the nonresident period), resulting in federal adjusted total income of \$41,000. The federal adjusted total income of the trust of \$41,000 is equal to the total income of the trust (\$44,000) less its fiduciary fees (\$3,000). The trust agreement provides that the trust is to retain 65% of its federal adjusted total income. Therefore, the trust is entitled to a distribution deduction of \$14,350 ($\$41,000 \times .65$). Since, for purposes of this example, the income of the trust was earned ratably during the year, \$10,762 ($\frac{9}{12}$) of the distribution deduction is attributable to the resident period and \$3,588 ($\frac{3}{12}$) to the nonresident period.

The fiduciary adjustment is a subtraction for U.S. government bond interest of \$12,000. \$9,000 of the fiduciary adjustment is attributable to the resident period and \$3,000 to the nonresident period. The trust's share of the total fiduciary adjustment is \$7,800 ($\$12,000 \times .65$). The trust's 1994 New York State part-year resident personal income tax is computed as follows.

| | <u>Federal Amount</u> |
|---|---------------------------|
| Adjusted total income | \$41,000 |
| Less: income distribution deduction | <u>14,350</u> |
| Balance | \$26,650 |
| Less: federal exemption | <u>100</u> |
| Federal taxable income | \$26,550 |
| Less: trust's share of New York fiduciary adjustment for for U.S. government interest (\$12,000 X .65).. | <u>7,800</u> |
| New York taxable income | \$18,750 |
| | |
| Base tax (from New York State tax rate schedule) | \$ 1,117.81 |
| | |
| *Income percentage: $\frac{\$17,617}{\$18,750}$ | .9396 |

New York State personal income tax (\$1,117.81 X .9396) **\$ 1,050.29**

*The numerator and denominator of the income percentage are computed as follows:

| | <u>Federal Amount</u> | <u>NY State Amount</u> |
|---|---------------------------|----------------------------|
| Interest income | \$20,000 | \$15,000 |
| Rental income | <u>24,000</u> | <u>24,000</u> |
| Federal adjusted gross income as if an individual | \$44,000 | \$39,000 |
| Less: federal income distribution deduction | (14,350) | |
| **NY amount | | |
| [\$10,762 + (\$6,000/511,000 X \$3,588)] | | (12,719)** |
| Less: federal exemption | (100) | |
| ***NY amount | | |
| [\$100 + (\$6,000/511,000 X \$100)] | | (155)** |
| Less: fiduciary expenses | (3,000) | |
| **NY amount | | |
| [\$2,250 + (\$6,000/511,000 X \$750)] | | <u>(2,659)**</u> |
| Federal adjusted gross income | \$26,550 | \$23,467 |
| ****Less: trust's share of fiduciary adjustment | | |
| (\$12,000 X .65) | (7,800) | |
| NY amount (\$9,000 X .65) | | <u>(5,850)****</u> |
| New York adjusted gross income/NY source income.. | <u>\$18,750</u> | <u>\$17,617</u> |

**The total amount of these items to be entered in the New York amount column is the sum of (1) the federal amount for the resident period, and (2) the federal amount for the nonresident period, allocated to New York in the same manner as the income to which the item relates. The federal amounts for the resident and nonresident periods of the distribution deduction are, as provided in the facts, \$10,762 and \$3,588. The federal amounts for the resident and nonresident periods of the fiduciary expenses are, as provided in the facts, \$2,250 and \$750. In allocating the nonresident period amounts in this example, the income distribution deduction, the exemption and the fiduciary expenses do not relate to any particular item of income.

Therefore, the federal amount of these deductions for the nonresident period is allocated to New York based on a fraction consisting of (A) the federal adjusted gross income, computed as if the trust were an individual, derived from New York sources for the nonresident period over (B) the federal adjusted gross income, computed as if the trust were an individual, for the nonresident period. In this example, the trust's federal adjusted gross income, computed as if it were an individual, derived from New York sources for the nonresident period is the \$6,000 of rental income. The federal adjusted gross income for the nonresident period, computed as if the trust were an individual, is \$11,000, comprised of rental income of \$6,000 and interest income of \$5,000.

***In addition, a trust that has a change of resident status is allowed the full federal exemption amount in each period. However, the federal exemption for the nonresident period is subject to allocation as described above.

****In this example, the fiduciary adjustment relates only to U.S. government bond interest. Since the U.S. government bond interest received in the nonresident period is not derived from New York sources, only the trust's share of the fiduciary adjustment attributable to the resident period ($\$9,000 \times .65 = \$5,850$) is included in the NY State Amount column.