The Nuts and Bolts of Nonresident Wage Allocation In New York

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In New York

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Timothy P. Noonan is a partner in the Buffalo and New York offices and Ariele R. Doolittle is a senior associate in the Albany and New York offices of Hodgson Russ LLP.

In this installment of Noonan’s Notes, the authors discuss how New York’s personal income tax rules are applied to wage-based compensation for nonresidents and how taxpayers can protect themselves through careful recordkeeping.

State tax departments are getting increasingly aggressive in their efforts to capture tax revenue from nonresident taxpayers, and one of the most common areas where states see noncompliance is in the nonresident personal income tax area. Historically, states have had their eye on highly compensated athletes and entertainers, looking to ensure that these taxpayers are paying their fair share of “jock taxes” and the like on wages paid for playing in the state. And more recently, states are turning their focus to highly compensated executives and salaried employees who are traveling into states for work.

Nowhere is this more prevalent than in New York, where the New York State Department of Taxation and Finance has an entire audit group focused on examining this issue and making sure that nonresidents visiting the state for work purposes — even for just a few days — are paying their fair share of taxes on their compensation. In this article, we’ll outline the nuts and bolts of how New York’s personal income tax rules are applied to wage-based compensation.

I. Introduction: ‘New York Source’ Income

All income received by a resident of New York state is subject to the state’s personal income tax, regardless of where the income is earned or derived. Conversely, income received by a nonresident of New York is taxable only to the extent that income is “derived from or connected with New York sources.”

For a nonresident employee or officer, this “New York source” income includes compensation received for services that were rendered in New York state. By the same token, compensation received by a nonresident for services performed entirely outside the state is not New York source income and should not be subject to New York’s personal income tax.

But this definition means that a nonresident of New York who visits the state for work purposes — even if just for one day — can be liable for New York state income taxes on his or her salary, bonuses, and other compensation. For some highly paid taxpayers, the amount of tax due for just a couple days of work is significant.

1. 20 NYCRR section 132.2; compare N.Y. Tax Law sections 611(a), 612(a) with N.Y. Tax Law section 631(a)(1).
2. 20 NYCRR section 132.4(b).
II. New York Source Income for Nonresident Employees and Officers

In a given year, nonresident employees and officers generally allocate their earnings to New York based on their workdays — that is, days they have worked either in or outside New York. Because the allocation is based on workdays, all nonworking days (typically weekends, holidays, vacation, sick and personal time, or leaves of absence) are eliminated unless the employee performed services for their employer on any of these days.6

A. ‘Workday’ Defined

The term “workday” is not limited to full days spent working in the office. While a single phone call may not be enough, a series of phone calls or a lengthy telephone conference might suffice. If proper records are kept — and often this is a big “if” — a nonresident can allocate days using fractions or even hours of a day for both New York and non-New York workdays.6 There are some other notable nuances.

Travel Days. Days (or even part-days) spent traveling at the direction of one’s employer are considered working days, even if they fall on a weekend or holiday. Also, nonresidents of non-New York employers should allocate travel days as whole non-New York workdays unless they performed services upon arriving in New York.7 For example, if an employee who lives in Nevada takes a Sunday evening flight to New York in advance of a Monday meeting, that Sunday should be treated as a workday outside New York. And if the nonresident employee performed services in New York on a travel day on their arrival, the employee may still allocate by a fraction of a day.

Convenience vs. Necessity. For a nonresident employee of a New York employer, all days worked at home for the employee’s own convenience — and not for the necessity of their employer — are treated as New York workdays. The only exception applies when the employer requires performance of some services out of state, and the duties, by their very nature, cannot be performed in New York. The rationale for this convenience rule is that New York residents cannot decrease their taxable income by working from home, so nonresidents should not get this advantage either.8 But there are also special rules that allow a home office to be treated as a bona fide office, thereby allowing the employee to count days worked at home as workdays outside New York, which is a topic for a whole other article.9

B. Computing the Workday Allocation Fraction

The concept of a workday allocation is simple and is based on a fraction. The numerator is total days worked in New York for the year, and the denominator is total days worked everywhere for the year. The table below contains an example using the schedule found on the Form IT-203-B, which accompanies the New York nonresident and part-year resident tax return. It is used to help taxpayers allocate their New York-sourced compensation income.

<table>
<thead>
<tr>
<th>Total days</th>
<th>365</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nonworking days:</td>
<td></td>
</tr>
<tr>
<td>Saturdays and Sundays</td>
<td>104</td>
</tr>
<tr>
<td>Holidays</td>
<td>10</td>
</tr>
<tr>
<td>Vacation days</td>
<td>14</td>
</tr>
<tr>
<td>Sick days</td>
<td>5</td>
</tr>
<tr>
<td>Other nonworking days</td>
<td>2</td>
</tr>
<tr>
<td>Total nonworking days</td>
<td>135</td>
</tr>
<tr>
<td>Total days worked in year</td>
<td>230</td>
</tr>
<tr>
<td>Total days worked outside NY</td>
<td>55</td>
</tr>
<tr>
<td>Days worked in NY</td>
<td>175</td>
</tr>
</tbody>
</table>

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6 20 NYCRR section 132.18(a); and Allocation Guidelines, supra note 3, at para. III.A.
7 Allocation Guidelines, supra note 3, at para. III.B, C.
9 See TSB-M-06(3)(I).
A few notes on this breakdown. First, total nonworking days include Saturdays, Sundays, and sick, personal, and vacation days on which the individual did not work. If an individual works either in or out of New York on any typical nonworking day, such as a Saturday, it should be reclassified as a working day. But the devil can be in the details. It seems everyone these days thinks that they work seven days a week, 365 days a year, especially with the constant flow of emails that all of us face. But proof is paramount here. As noted above, while a single phone call or email may not be enough, a series of phone calls or a lengthy telephone conference might suffice. More on what it takes to prove these facts is outlined below.

Next, when determining New York workdays, non-New York workdays are subtracted from total days worked in the year (in the example: 230 minus 55). The remaining days (175 in the example) should be those spent working in New York or days that constitute New York workdays such as telecommuting days. To determine the appropriate New York allocation percentage, New York workdays are divided by total days worked in the year (in the example: 175 ÷ 230). The resulting allocation percentage (75.09 percent) is applied to total compensation earned from that employer for that tax year.

But be careful when applying this fraction to bonus income, stock options, or any other compensation attributable to services performed in a previous year. Those forms of income are detailed in the next paragraphs, which break out specific categories of compensation allocable to New York state for nonresident individuals.

C. Types of Wage-Based Compensation Subject to Allocation

Here’s how the nonresident allocation rules apply to specific categories of wage-based compensation commonly received by employees and officers.

Wage Income. When a nonresident spends one or more days working in New York during the year, the wages attributed to those New York workdays are generally considered to be New York source income. The amount of the wages sourced to New York is calculated by dividing New York workdays by total workdays.\(^\text{10}\) This is known as the “wage allocation fraction.” To illustrate, if a nonresident employee worked 250 days during the year and 25 of those days were worked in New York, then 10 percent of their wages would be sourced to (and thus, taxable by) New York.

Bonuses. Bonuses received for services performed in a particular year are allocated on the same basis as salary for that year (that is, using the wage allocation fraction), even if the bonus is received in a later year.\(^\text{11}\) The employee or officer’s resident status at the time of payment is irrelevant, and the income is allocated to the extent it is derived from or connected to New York sources.\(^\text{12}\)

Director’s Fees. The method used to allocate director’s fees is like the wage allocation fraction, except that the number of board meetings attended in New York is divided by the total number of board meetings attended at all locations during the year.\(^\text{13}\)

Pensions and Retirement Income. Many types of pensions and retirement income are exempt from New York tax by operation of federal or state law (or both).\(^\text{14}\) However, when pensions and retirement income are taxable, the allocation typically turns on a formula in which the numerator is the total New York source compensation related to the employment previously carried on in New York during the allocation period, and the denominator is the total compensation from that employment includable in federal income for that same period. The allocation period is the tax year before retirement.

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\(^\text{10}\) 20 NYCRR section 132.18.

\(^\text{11}\) Allocation Guidelines, supra note 3, at para. V.A; and 20 NYCRR section 132.4(c).


\(^\text{13}\) Allocation Guidelines, supra note 3, at para. V.D.

\(^\text{14}\) Pub. L. No. 104-95 prohibits states from taxing most forms of retirement income received by nonresidents (e.g., all qualified plans such as pensions, IRAs, and deferred compensation such as 401(k) plans, and most nonqualified plans with certain exceptions). New York also excludes certain retirement benefits, including but not limited to those qualifying as an “annuity,” and pension benefits received from state, municipal, or federal retirement systems. 20 NYCRR section 132.4(d); Allocation Guidelines, supra note 3, at para. V.I and L; and N.Y. Tax Law section 612(c)(3).
plus the three tax years immediately preceding the retirement date. Note an important difference, though, in the computation: The focus is on compensation, not on workdays. An employee would not count all workdays in and out of New York over the prior four years to determine the New York allocation. Instead, each year would stand on its own, and the percentage of New York compensation received each year would be the numerator; the total compensation received over the course of the four years would be the denominator. This comp-to-comp method can yield much different results than a straight workday computation, especially when an employee’s percentage of workdays and compensation levels vary significantly from year to year.

**Restricted Stock and Stock Options.** Restricted stock compensation received by a New York nonresident employee or director is allocable to New York to the extent that the compensation is taxable for federal income tax purposes and is sourced to New York. The income is sourced to New York using a grant-to-vest method, based on the taxpayer’s workday allocation factors for the years between the date on which the options were granted and the date on which the options vested. This can prove difficult for taxpayers whose compensation is based heavily on options and restricted stock, particularly when grants date back many years. For example, we’ve had many cases in which an audit of current years (say 2016-2018) requires us to prove the taxpayer’s day-to-day work location dating back 15 years to cover options that were granted in the early 2000s!

**Termination and Severance Pay.** Post-termination payments are taxable to nonresidents, even if not designated by the nonresident’s employer as compensation for prior services in New York. This compensation is sourced to New York based on the same allocation formula for pensions and retirement benefits (total New York source compensation related to the employment previously carried on in New York during the allocation period divided by total compensation from that employment includable in federal income for that same period). As with pensions and retirement benefits, the allocation period is the tax year before the termination of that employment, plus the three tax years immediately preceding the employee or officer’s termination.

### III. Typical Q&A

Here’s a rundown of the kinds of questions we often face when dealing with these allocation issues.

**Q:** My employer never withheld taxes based on my workdays. How is this my problem?

A: Because New York says so! It is true that employers are supposed to follow these same nonresident allocation guidelines for payroll tax purposes. In fact, we wrote a whole article about that years ago. But the employer’s failure to withhold doesn’t relieve the employee from liability for the state’s personal income tax.

**Q:** How do I get my employer to withhold the right amount of tax?

A: Provide your employer with a completed Form IT-2104.1, “New York State, City of New York, and City of Yonkers Certificate of Nonresidence and Allocation of Withholding Tax.” In part 1, state the percentage of expected New York workdays for the year. This form can be updated as needed. Starting in 2020, withholding allowances are no longer reported on federal Form W-4. In response to this change, New York has begun instructing employers that they may use zero as the employee’s number of

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17 See TSB-M-10(9); and N.Y. Tax Law section 631(b)(1)(F).
allowances if the employer does not receive a Form IT-2104.1.\(^\text{19}\)

Q: What if I earned my stock options in years when I was a resident but received it after moving to Florida?
A: Consider yourself lucky! You can allocate the option income based on your workdays in and out of New York during the grant-to-vest period even if you were a resident during these periods.\(^\text{20}\)

Q: If a minute counts as a day, don’t I have to treat any day in New York as a workday?
A: No, that’s mixing the residency day counting rules with the income allocation rules. For a day to constitute a workday, actual work must be performed in New York. So it’s something more than just physical presence.

Q: Are there general rules to help distinguish between workdays and non-workdays?
A: Yes, in general, the auditors will treat weekdays as workdays absent some proof of vacation, holiday, or otherwise. And the same goes for weekends; they’ll generally be treated as nonworking days unless we can prove actual work through calendar entries, expense reports, proof of significant emailing, etc.

Q: I had to go to Asia for a trip that spanned 10 days, including a weekend. Can I treat the weekend as a working day even though I didn’t really work (don’t tell my boss)?
A: Generally, yes. In a situation like this, you were not hanging out in Asia for fun; your company sent you there and you were stuck there away from your family for work. So we’ve always argued that these days should count as workdays, and we usually can win the argument.

Q: I came to New York for a couple meetings in the morning on a Friday and then went home to Connecticut and played golf. Can I count this as a half-day worked in New York?
A: Unfortunately, New York would say no. To split up days into part-days, you must be able to show work in two different places. So, in the example, if you went back to the office in Connecticut like a good employee should instead of skipping out for golf, you could count a half-day worked in New York and a half-day worked in Connecticut.

Q: I need to determine how much I worked in New York in 2011 to figure out a stock option allocation and I have no records anymore. My company is out of business and there’s nothing. What do I do?
A: Look, records are critical here, more on that below. But in a situation like this what we try to do is at least recreate the taxpayer’s 2011 day count from sources such as cell phone data, credit cards, etc. From there, we can usually get a sense of where they spent their time. Then, applying the general rule that weekdays are workdays and weekends are not, we can usually back into a workday count that is close enough that an auditor will accept.

IV. Recordkeeping

Finally, recordkeeping is critical. A nonresident taxpayer will need to prove both the number of days worked over the course of the year and the number of those days that were worked in New York. As a starting point, taxpayers should keep a diary or calendar as evidence of days spent in and out of New York. And electronic calendars like an Outlook calendar are key pieces of data in these audits. We would advise an employee to print out their electronic calendars on a monthly or at least an annual basis to ensure access to this important data source later. Often with limited data-retention policies, we find that employees lose access to their calendar after a year or so.

\(^{19}\) See New York State Department of Taxation and Finance, “Withholding Tax Amount to Deduct and Withhold” (Dec. 6, 2019).
\(^{20}\) See TSB-M-07(7).
However, a diary alone may not be deemed conclusive, or an auditor may argue a calendar is not contemporaneous (another reason why regular printing of the calendar is important). Thus, taxpayers should retain third-party documentation, which can include the following sources of information to establish their whereabouts on particular workdays:

- attendance reports;
- hotel folios;
- flight records (frequent flyer summaries are usually most reliable);
- location-based apps like Monaeo (www.monaeo.com);
- expense reports;
- cell phone records; and
- business credit card statements.

Due to the three-year statute of limitations on tax returns and the length of the audit process, individuals are advised to maintain copies of these records themselves for at least three years, and for deferred compensation income like stock options, sometimes the lookback period can be even longer.

The allocation guidelines indicate that even those individuals working primarily outside New York for their New York employer have the burden of proving that they did not work in New York during any portion of each day during the years under audit. Absent clear and convincing documentation, auditors can reclassify any nonworking day or day worked outside New York State as a New York workday. The guidelines urge auditors to use good judgment in this area and not to excessively burden taxpayers on microscopic examinations of day-by-day and minute-by-minute activity. However, definitions of burden of proof and excessive can vary in practice from auditor to auditor. Keeping excellent records is imperative.