



# 2015 NEW YORK TAX UPDATE

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# Topics

- New Cases and Hot Topics
- Review of the 2014 Gaied Case, and Recent Aftermath
- The Wynne Case – what does it mean for everybody else?

# New Cases and Hot Topics - Residency

- Residency -- Continued focus on audit
  - 5,000 audits/year!
- *Matter of Zanetti* (2015)
  - A minute really does count as a day
- *Matter of May* (2015, ALJ)
  - Taxpayers win these cases, even if domicile changes to foreign country

# Sales and Use Tax Carve-Out for Yachts

- “Vessel” purchase price not subject to sales tax after 1<sup>st</sup> \$230K
- Credit for sales tax paid on vessel to other state
  - Only available for sales tax paid to other state for portion of purchase price  $\leq$  \$230K
- No use tax until vessel is used 90 consecutive days in NYS or is registered in NYS



# Sales Tax EXEMPTION for Aircraft

- New sales tax exemption “general aviation aircraft”
- Defined as “all aircraft “used in civil aviation,” except for commercial aircraft used to transport persons or property for hire.”





# Gaied – What it means?

# NY's Statutory Residency Test

- Alternative test for residency, not connected to “domicile”
- Two Requirements:
  - The taxpayer spends more than 183 days in NY
  - The taxpayer “maintains a permanent place of abode” in New York
- *Gaied* involved the “PPA” test, which over the years has been broadly applied by the Tax Department
  - Usage not determinative
  - Vacation property enough
  - Ownership really is enough

# Gaied Facts

- New Jersey domiciled; More than 183 days in NY due to work
  
- Owned three-bedroom apartment complex
  - Two units rented out, most of the time
  - One unit maintained for parents, who relied on him for support
  
- Parent's Place
  - Gaied paid all expenses; everything in his name
  - But didn't use for himself; only stayed overnight at parents' request; and even then, slept on couch
  - Overnight stays about once a month

# Decisions, Decisions!

- *Gaied I Tribunal*: we must look at his “relationship to the place;” he didn’t use this as a residence for himself; taxpayer wins!
- *Gaied II Tribunal*: Tribunal grants reargument and changes course
  - “One need not dwell in an abode, only maintain it”
- *Gaied II*: Appellate Division, Third Dept: Taxpayer loses in split decision
  - Three-judge majority says there’s enough in record to support what Tribunal did
  - Two-judge dissent says the Tribunal got the test wrong; taxpayer must have “living arrangements” or a “residential interest” in the place in order to get taxed
  - Dissenters also rely on intent of the law: to tax those people who “really are residents”

# Onward to NY's Highest Court

- Two judge dissent gives Mr. Gaied a free pass to the Court of Appeals
- Sets the stage for oral argument before the seven-judge panel
- First time ever that the high court has taken a residency issue like this
- Very active Court, and they were very interested in the issue

# Oral Argument Begins!



# Statutory Residency: What is the purpose of this test?

- Our Strategy: get the Court to focus on the intent of the statute
- Should the test be objective, where ownership of a place is all that counts?
- Or do we have to look at whether the taxpayer really is “residing” there, in order to tax him as a “resident?”

# Look to Intent of Law: Why do we have this Test?



# Does the Department Agree?



# Statutory Residency: What is the purpose of this test?

- Here's what the Court said: the purpose was to tax people who “really are residents:”
  - “In *Matter of Tamagni*... this court examined the legislative history of the tax statute, and noted that there had been “several cases of multimillionaires who actually maintain homes in New York and spend ten months of every year in those homes...but...claim to be nonresidents.” ...We explained that the statutory residence provision fulfills the significant function of taxing individuals who are “really and for all intents and purposes...residents of the state” but “have maintained a voting residence elsewhere and insist on paying taxes to us as nonresidents. ...In short, the statute is designed to discourage tax evasion by New York residents.”
  
- So, with that, what are the two possible tests here?

# Our Test vs. Dept's Test



# Attacking the Department's Position

- The Court doesn't buy into the Department's position, that ownership/maintenance is all that is required.
- To the Judges, "it just doesn't make sense."

# Judge Smith: One of the problems I'm having...



# Judge Pigott: “It Just Doesn’t Make Sense”



# What Does Make Sense?

- Look to legislative history: why do we have this test?
- It is to tax people who really are residents; it is to tax people who really live here
- That's what “makes sense”

# What Does Make Sense?



# Here is What Makes Sense?

- “There’s got to be some rhyme or reason to it.”
- “What makes sense is, if you don’t really reside there, that’s the ultimate test.”

So, then, what is the test?



## The Court's Holding

“We agree with petitioner and hold that in order for an individual to qualify as a statutory resident, *there must be some basis to conclude that the dwelling was utilized by the taxpayer as a residence.*”

# The Aftermath

- Tax Dept says “we use the same test!”
  - Really? Then why did it lose the case!
  - “Relationship to dwelling” = PPA
  
- But that’s just not the rule. This is the rule:
  - “What makes sense is, if you don’t really reside there, that’s the ultimate test”
  - “There must be some basis to conclude that the dwelling was utilized by the taxpayer as a residence.”
  - And isn’t this consistent with the purpose of the law—to tax people who really live in NY?



# Wynne – What it means?

# Comptroller of the Treasury of Maryland v. Wynne

- 5-4 decision by U.S. Supreme Court decided on May 18, 2015
- MD imposed state and county-level taxes on all income of residents; allowed resident credit only against state tax
- Held: MD's personal income tax scheme violates the dormant Commerce Clause



# Maryland's Personal Income Tax on Residents

- MD residents (like NY residents) pay tax on their worldwide income
- MD personal income tax has two components: (1) state and (2) county
- Nonresidents only pay tax on sourced income, but they pay BOTH the state and county tax (called “special nonresident tax”)
- Residents only allowed credit against state portion of tax

# Facts in *Wynne*

- MD residents who held stock in an S corp that operated and filed returns in 39 other states
- Reported flow-through income from the S corp on MD income tax returns
- Claimed resident tax credit (against both the state and county components) for taxes paid to other states
- The MD State Comptroller disallowed credit against county component



# On to the Supreme Court

During Oral argument, Chief Justice John Roberts observed that:

*“if each State did what we’re talking about, people who work in one State and live in another would pay higher taxes overall than people who live within one State and work in the same State.”*



# The Internal Consistency Test

- Justice Roberts was talking about the “Internal Consistency Test”: the Commerce Clause requires that taxes on interstate commerce be nondiscriminatory and fairly apportioned.
- This test is designed to allow us to distinguish between: (i) a tax structure that is inherently discriminatory (bad); and (ii) one that might result in double taxes only as a result of two nondiscriminatory state schemes (OK)
- Past cases may have suggested that the Commerce Clause was n/a to individual income taxes; the Court laid that to waste.

# The Internal Consistency Test

*The test: whether interstate and intrastate commerce would be taxed equally if every state were to adopt the precise tax scheme at issue*

- State A imposes a 1.25% tax on all residents, regardless of where earned.
- State A also imposes a tax on nonresidents' source income at 1.25%
- No resident credits
- April and Bob live next door to each other in State A; Bob's business located in State B; April's is all in State A.
- To apply the I/C test, we have to assume all states have the State A scheme. State A fails the test!!

	April	Bob
State A Tax	1.25%	1.25%
Hypo State B Tax	0	1.25%
Total Bill	1.25%	2.5%

# The Internal Consistency Test: Passing Grade?

Could this be *cured* in order to pass the Internal Consistency Test?

- State A imposes a 1.25% tax on all residents, regardless of where earned.
- State A also imposes a tax on nonresidents' source income at 1.25%
- *State A provides resident credit for taxes paid to other states on sourced income*
- April and Bob live next door to each other in State A; Bob's business located in State B; April's is all in State A.

	April	Bob
State A Tax	1.25%	0
Hypo State B Tax	0	1.25%
Total Bill	1.25%	1.25%

# The Internal Consistency Test: Passing Grade?

*Could this be cured in order to pass the Internal Consistency Test?*

- State A imposes a 1.25% tax on all residents, regardless of where earned.
- *State A does not tax on nonresidents*
- No resident credits
- April and Bob live next door to each other in State A; Bob's business located in State B; April's is all in State A.

	April	Bob
State A Tax	1.25%	1.25%
Hypo State B Tax	0	0
Total Bill	1.25%	1.25%

- But is this fairly apportioned – externally consistent?

# The Aftermath of *Wynne*

- Commerce Clause protections extend equally to:
  - Taxes based on gross and net income (prior cases generally focused on gross receipts taxes); and
  - Both corporations and individuals (prior cases generally dealt with corporations)
- Maryland counties to pay more than \$200 million in refunds
- Consider filing refund claims—in MD, and maybe even elsewhere?

# Questions Remain

- *Must NYS allow resident credit against NYC personal income taxes for source income in other states?*
- CA is typical example, since NYC resident with source income pays 13% to CA and only gets credit against 8% NYS tax.
  - No longer can say Commerce Clause n/a to individuals
  - Unlike MD, NYC doesn't tax nonresidents
  - But see slide 34: fair apportionment?



# Questions Remain

- *Is NY's Statutory Residency Test unconstitutional?*
- Court of Appeals in *Tamagni* upheld rule; declined to apply Commerce Clause analysis, but said that rule was fine anyway even if it did
  - How does the *Wynne* rule, that the Commerce Clause applies to individuals, affect the analysis?
  - Must a credit be provided for taxes paid to other states in all circumstances?
  - Different rule for “non-sourced” income?
  - 1995 NESTOA agreement attempted to remedy



# Questions Remain

- *Is NY's convenience rule unconstitutional?*
- Court of Appeals in *Zelinsky* upheld rule; applied Commerce Clause analysis and said that rule was fine
  - No question about IC test; taxpayer conceded the rule passed.
  - External consistency was issue
  - But what about reverse-convenience days?



Questions?



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