

Income Received by a Nonresident Related to a Business, Trade, Profession, or Occupation Previously Carried on Within New York State

Chapter 57 of the Laws of 2010 amended the definition of New York source income of a nonresident individual by adding section 631(b)(1)(F) to the Tax Law. The new section provides that income, gain, loss, and deduction (hereinafter, income) from New York sources includes income received by a nonresident that is includable in federal adjusted gross income (hereinafter, federal income) that is related to a business, trade, profession, or occupation previously carried on within the state, whether or not as an employee. This income includes, but is not limited to, income related to covenants not to compete and income related to termination agreements.

The new law does not apply to income received from pension and other retirement plans described in section 114 of Title 4 of the US Code (See Publication 36, *General Information for Senior Citizens and Retired Persons* for a list of these plans). States are prohibited from taxing nonresidents on payments received from the plans described in section 114. Accordingly, income received by nonresidents under those plans is not includable in New York source income and remains exempt from New York tax.

The new law applies to income received in tax years beginning on or after January 1, 2010, even if the income is attributable to a contract or other agreement entered into before 2010.

Computing the amount of income related to a business, trade, profession, or occupation previously carried on within the state to be included in New York source income

The amount of the income includable in federal adjusted gross income that must be included in New York source income is computed as follows:

- If the nonresident's business, trade, profession, or occupation was previously carried on wholly in New York State, the entire amount of income must be included in New York source income.
- If the nonresident's business, trade, profession, or occupation was previously carried on wholly outside New York State, none of the income is includable in New York source income.
- If the nonresident's business, trade, profession, or occupation was carried on partly within and partly outside New York State, the amount of income to be included in New York source income is determined using the rules described below for employees if the nonresident was an employee, or under the rules described below for businesses if the nonresident was carrying on a business in New York.

Employees

Employees must use the following method to determine the amount of federal income related to past employment in New York State that must be included in New York source income.

- (1) The employee must compute a fraction. The numerator of the fraction is the total amount of compensation included in his or her New York source income, related to the employment previously carried on within New York State, for the portion of the tax year prior to the termination of that employment and the three tax years immediately preceding the termination. The denominator of the fraction is the total amount of compensation from that employment includable in federal income during the same period. If the employee's period of employment is shorter than the period described above, the shorter period is used.
- (2) Multiply the fraction determined in step (1) by the amount of income related to past employment received in the tax year. The result is the portion of the payments or income that must be included in the employee's New York source income for the tax year.

Example: Taxpayer X, a nonresident of New York State, worked both in and out of New York State for a corporate employer under a five-year employment contract that was signed in 2008. Taxpayer X was not employed by this employer before 2008. Under this contract, for each year of employment, Taxpayer X receives a salary of \$200,000.

By mutual agreement, Taxpayer X's employment is terminated effective December 31, 2009. As a result of the termination agreement, Taxpayer X will receive a termination payment of \$300,000 payable on March 1, 2010.

For tax years 2008 and 2009, the employee's total federal compensation and New York amounts are as follows:

<i>Tax year</i>	<i>Total federal compensation</i>	<i>New York amount</i>
<i>2008</i>	<i>\$200,000</i>	<i>\$30,000</i>
<i>2009</i>	<i>\$200,000</i>	<i>\$45,000</i>
<i>Totals</i>	<i>\$400,000</i>	<i>\$75,000</i>

Taxpayer X computes the amount of the termination payment that must be included in Taxpayer X's New York source income for tax year 2010 (using step (1) and step (2) above) as follows:

$$\frac{\text{New York compensation}}{\text{Total federal compensation}} \times \text{Income amount} = \text{Amount included in New York source income}$$

$$\frac{\$75,000}{\$400,000} \times \$300,000 = \$56,250$$

Accordingly, for tax year 2010, \$56,250 of the termination payment must be included in New York sources income.

Businesses

For purposes of this memorandum, the term *business* includes sole proprietorships and partnerships (including limited liability companies (LLCs) and limited liability partnerships (LLPs) that are treated as partnerships for federal income tax purposes). It also includes shareholders of New York S corporations where the income is included in the shareholders' pro rata share of S corporation income.

If an individual who is a shareholder of a New York S corporation receives income that is related to the individual's past employment by the S corporation, then the individual must use the method for employees to determine the amount of federal income related to that past employment that must be included in New York source income (see *Employees* on page 2).

An individual who receives income related to a business previously carried on in New York State determines the amount of New York source income as follows:

- (1) Determine the business allocation percentage (BAP) for the year the contract or other agreement was entered into that results in the federal income.
- (2) Multiply the amount of the federal income (or the distributive share or pro rata share) for the year by the BAP.
- (3) The result is the portion of the income that must be included in the taxpayer's New York source income for the tax year.

Part-year residents

If an individual changes resident status during the tax year, the rules described in this memorandum also apply where the federal income is properly reportable in the nonresident period of the tax year.

Nonresident and part-year resident estates and trusts

The rules described in this memorandum apply to nonresident estates and trusts and part-year resident trusts where the income is includable in the federal income of the estate or trust.

Yonkers nonresident earnings tax

The Yonkers nonresident earnings tax is imposed on wages and net earnings from self-employment attributable to a business, trade, profession, or occupation carried on in the city of Yonkers. Under the rules described in this memorandum, if an individual performed services in the city of Yonkers, the income is allocated to Yonkers using the same rules that apply to nonresidents or part-year residents of New York State.

2010 estimated income tax

As a result of the amendment, a taxpayer's 2010 estimated personal income tax may be underpaid, or some taxpayers may be required to begin making estimated tax payments. To avoid the penalty for underpayment of estimated tax for tax year 2010, the total amount of estimated tax and withholding tax paid must be:

- at least 90% (66 2/3% for farmers and fishermen) of the amount of income tax due as shown on the taxpayer's return for 2010; **or**
- 100% of the tax shown on the taxpayer's return for 2009 (110% of that amount if he or she is not a farmer or a fisherman and his or her New York adjusted gross income shown on that return is more than \$150,000 or, if married filing separately for 2010, more than \$75,000). To qualify for this provision, the taxpayer must have filed a return for 2009, and it must have been for a full 12-month year.

No penalty will apply to any shortage in a taxpayer's April 15, 2010, or June 15, 2010, estimated tax payment that is attributable to this amendment, provided the taxpayer includes any shortfall in his or her September 15, 2010, payment or, if applicable, the taxpayer begins making estimated tax payments by September 15, 2010.

Withholding tax

Amounts an employer pays to an employee for cancellation of an employment contract and relinquishment of contract rights are wages subject to income tax withholding. Employers who maintain an office or transact business in New York State who make these types of payments subject to New York State, New York City, or Yonkers income tax withholding must withhold the tax and comply with New York State withholding requirements for employers.

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