STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PATRICK MCLOUGHLIN	:	DETERMINATION DTA NO. 818468
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1997.	:	

Petitioner, Patrick T. McLoughlin, 234 Knollview Drive, Phillipsburg, New Jersey 08865-3553, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1997.

A small claims hearing was held before Timothy J. Alston, Presiding Officer, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on April 1, 2002, at 1:15 P.M., which date began the three-month period for the issuance of this determination. Petitioner, Patrick McLoughlin, appeared *pro se.* The Division of Taxation appeared by Barbara G. Billet, Esq. (Louis N. Guertin).

ISSUE

Whether the Division of Taxation properly included non-New York source income earned by petitioner's nonresident spouse in calculating the tax rate to be applied to the New York source income of petitioner, a part-year resident.

FINDINGS OF FACT

1. On July 20, 2000, the Division of Taxation ("Division") issued to petitioner, Patrick McLoughlin, a Notice of Deficiency asserting additional personal income tax due in the amount of $399.23, plus interest, for the year 1997.

2. Petitioner and his wife filed a joint 1997 Federal income tax return and properly reported their joint income thereon.

3. Petitioner filed a 1997 New York Nonresident and Part-Year Resident Personal Income Tax Return, Form IT-203, with a filing status of "married filing separate return." On the return petitioner indicated that he had lived in New York for six months during the year, and had left the State as of July 1, 1997.

4. Petitioner's wife, a nonresident of New York, had no New York source income in 1997.

5. Petitioner reported income that he earned in 1997 in the "Federal Amount" columns on the IT-203. Petitioner did not include any of the income earned by his wife in 1997 in the Federal Amount columns on the IT-203.

6. Through its exchange of information agreement with the Internal Revenue Service, the Division became aware of the difference between the income reported on petitioner's joint Federal return and the income reported in the Federal Amount column of his New York return. Upon review the Division determined that petitioner had improperly filed a separate New York return. The Division further determined that petitioner had improperly failed to include income earned by his wife in 1997 in the Federal Amount columns on the IT-203 and had improperly calculated his New York tax liability. Accordingly, the Division recomputed petitioner's New York income tax liability for the year at issue. In so doing, the Division included income earned

by petitioner's spouse to determine petitioner's "base tax." That is, the Division calculated petitioner's and his wife's New York tax liability as if they were New York residents. Next the Division determined petitioner's "New York source fraction" by dividing his reported New York source adjusted gross income by Federal adjusted gross income as reported on his joint Federal return. The Division then multiplied the base tax amount by the New York source fraction to reach petitioner's New York tax liability for the year in question. After allowing for tax previously paid, this computation resulted in the tax deficiency of $399.23, plus interest, as asserted in the July 20, 2000 Notice of Deficiency.

CONCLUSIONS OF LAW

A. Tax Law § 601(e)(1) imposes New York personal income tax on the New York source income of nonresidents and part-year residents in an amount "equal to the *tax base* multiplied by the *New York source fraction*"(emphasis added). The *tax base* is the computation of the nonresident or part-year resident's New York income tax computed as if such nonresident or part-year resident were a resident (***see***, Tax Law § 601[e][2]). The *New York source fraction* equals the nonresident or part-year resident's "New York source income" (determined in accordance with Tax Law § 631) divided by such nonresident or part-year resident's "New York adjusted gross income," which is defined in Tax Law § 612(a) as Federal adjusted gross income with certain modifications (***see***, Tax Law § 601[e][3]).

Tax Law § 651(b)(2) provides that, where the Federal income tax liabilities of a husband and wife are determined on a joint Federal return, such individuals shall file a joint New York return.

The New York income tax is a graduated or progressive tax; the rate increases as the taxpayer's income increases (***see***, Tax Law § 601).

B. Pursuant to the foregoing, since petitioner and his wife filed a joint 1997 Federal return, they were required to file a joint New York return for that year. Accordingly, petitioner's tax base, which computes tax as if petitioner and his wife were New York residents, properly included non-New York source income earned by petitioner's nonresident wife. Petitioner's New York source fraction had petitioner's New York source income in the numerator and petitioner and his wife's joint Federal adjusted gross income in the denominator. The net result of this statutory scheme is the use of non-New York source income to determine the rate at which petitioner's New York source income is taxed. Given the graduated nature of New York income tax rates, such rate is higher than if petitioner separately filed and reported his income for the year at issue.

C. Petitioner challenges the Division's use of his nonresident wife's non-New York income to calculate the tax rate to be applied to his New York source income. Petitioner does not dispute that the Division's calculations in this matter are consistent with the statutes outlined above and consistent with the decision of the New York State Court of Appeals in ***Matter of Brady v. State of New York*** (80 NY2d 596, 592 NYS2d 955, ***cert denied*** 509 US 905, 125 L Ed 2d 692). Petitioner asserts that use of his wife's non-New York income to determine the tax rate to be applied to his New York source income indirectly taxes such income. Accordingly, petitioner asserts that such provisions are flawed and inconsistent with the spirit and intent of the Tax Law, which is to tax only the New York source income of nonresidents. Accordingly, petitioner asks that such rules be waived in this instance.

D. The states have the power to tax the income of nonresidents which is derived from sources within their borders (***Travis v. Yale & Towne Mfg. Co.***, 252 US 60, 64 L Ed 460; ***Shaffer v. Carter***, 252 US 37, 64 L Ed 445). In addition, progressive tax systems, which

apportion the tax burden based upon the taxpayer's ability to pay, have been held to be constitutional (***Brushaber v. Union Pac. R.R.***, 240 US 1, 60 L Ed 493), and indeed are "widespread among the United States and firmly imbedded in the federal tax structure" (***Wheeler v. State,*** 127 Vt 361, 365, 249 A2d 887, 890, ***appeal dismissed for want of a substantial Federal question*** 396 US 4, 24 L Ed 2d 4).[1]

States may refer to nontaxable out-of-state assets in setting their rates for taxable assets (***see, Atlantic & Pacific Tea Co. v. Grosjean,*** 301 US 412, 81 L Ed 1193; ***Maxwell v. Bugbee***, 250 US 525, 63 L Ed 1124). The ***Maxwell*** case involved a New Jersey inheritance tax that required the inclusion of the entire estate of the decedent, wherever located, to determine the rate by which the New Jersey property would be taxed. The actual tax was calculated by applying the rate applicable to the entire estate, but then reducing the tax to reflect only the percentage of the estate located in New Jersey, similar to the Division's adjustments in the present situation. In ***Grosjean,*** the Supreme Court upheld a Louisiana license tax on in-state chain stores that was calculated on the basis of the taxpayer's nationwide operation, stating that the tax was appropriate as it did not impose a tax upon property situated without its borders.

Since the above-mentioned decisions, high courts in several other states have upheld tax schemes similar to the one at issue (***see, Stevens v. State Tax Assessor***, 571 A2d 1195 [Maine], ***cert denied*** 498 US 819, 112 L Ed 2d 40; ***Wheeler v. State***, ***supra***; ***cf., United States v. State of Kansas***, 810 F2d 935 [upholding validity of including nonresident military income — which was not taxable by state — in determining state tax rate]; ***Aronov v. Secretary of Revenue***, 323 NC 132, 371 SE2d 468 ***cert denied*** 489 US 1096, 103 L Ed 2d 935 [upholding requirement that

[1] Dismissal for want of a substantial constitutional question operates as a decision on the merits (***see, Washington v. Yakima Indian Nation***, 439 US 463, 58 L Ed 2d 740).

nonresident taxpayer reduce net operating loss from North Carolina partnership by amount of out-of-state income]).

As in ***Stevens*** and ***Wheeler***, the subject matter of this case is a tax on in-state income, which is within the jurisdiction of the state. When the state imposes taxes within its authority, "property not itself taxable can be used as a measure of the tax imposed on property within the state and . . . to do so is 'in no just sense a tax on the foreign property'." (***United States v. State of Kansas***, ***supra,*** quoting ***Maxwell v. Bugbee***, ***supra***; ***Brady v. State of New York***, ***supra***.)

E. In ***Brady***, the Court of Appeals held that the statutory procedure for determining a nonresident's tax on income earned in New York by taking into account New York and non-New York source income in order to calculate the tax rate to be applied to the New York income does not violate the privileges and immunities or equal protection clauses of the U.S. Constitution since similarly situated residents and nonresidents receive equal treatment. The taxing scheme in the present matter is the same as that upheld by the Court in ***Brady***; it employs all of the income of petitioner and his wife in determining the tax rate to be applied, but applies the tax rate only to petitioner's New York source income.

F. The Court of Appeals, in concluding its decision in ***Brady***, stated as follows:

> Plaintiff's real quarrel, in the end, is with the graduated tax. A system of progressive taxation apportions the tax burden based on ability to pay — higher income taxpayers can pay more and are therefore taxed at a higher rate than lower income taxpayers. This system does not implicate the State or Federal Constitution so long as the rates are applied, as here, in a nondiscriminatory manner and only to taxable New York income. ***(Id.*** at 605, 592 NYS2d at 960.**)**

Petitioner in the present matter stands in the same position as that occupied by the taxpayers in ***Brady***; he objects to the use of non-New York source income to increase the tax rate which is applied to his New York income. However, as the statutory procedure applies the tax

rates in a nondiscriminatory manner and only to taxable New York income, the Division's adjustment to petitioner's nonresident income tax return by taking into account petitioner's and his wife's non-New York income to compute the tax rate was proper. Furthermore, I believe that the foregoing discussion makes clear that New York's system of taxing the New York source income of nonresidents is well-founded in law and is not, as petitioner asserts, unfair. Accordingly, I find no equitable basis to consider the relief requested by petitioner.

G. The petition of Patrick McLoughlin is denied and the Notice of Deficiency dated July 20, 2000 is sustained.

DATED: Troy, New York
April 25, 2002

/s/ Timothy J. Alston
PRESIDING OFFICER