STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
IRWIN AND PHYLLIS NATHAN	:	DETERMINATION DTA NO. 820410
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2000.	:	

Petitioners, Irwin and Phyllis Nathan, 121B North Country Road, Mount Sinai, New York 11766-1503 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 2000.

On December 12, 2005 and December 19, 2005, respectively, petitioner, Irwin Nathan on behalf of himself and his wife, and the Division of Taxation by Mark F. Volk, Esq. (Margaret T. Neri, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by April 17, 2006, which commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Arthur S. Bray, Administrative Law Judge, renders the following determination.

ISSUE

Whether it was error for the Division of Taxation to consider non-New York source individual retirement account distributions to determine the tax rate that is imposed on New York source income.

FINDINGS OF FACT

1. Petitioners, Irwin and Phyllis Nathan, filed a Nonresident and Part-Year Resident Income Tax Return for the year 2000. On this return, petitioners reported Federal adjusted gross income in the Federal amount column and New York State amount column of $147,962.00 and $110,971.00, respectively. Petitioners also reported New York adjusted gross income in the Federal amount column and New York State amount column of $109,506.00 and $74,116.00, respectively.

2. The Division of Taxation ("Division") issued a Statement of Proposed Audit Changes, dated October 2, 2003, which explained that New York State exchanges information with the Internal Revenue Service ("IRS") and that adjustments were made to petitioners' New York tax liability based upon a comparison of the Federal information with petitioners' New York return. The Division explained that information provided by the IRS showed that petitioners' IRA distribution for the year 2000 was $392,911.00 and that this amount should have been entered on the New York return in the Federal amount column. Information from the same source also showed that petitioners' Federal adjusted gross income for the year 2000 was $467,961.00 and that this amount should have been reported in the Federal amount column of petitioners' New York income tax return. The Division then recomputed petitioners' New York State personal income tax liability on the basis of the information provided by the IRS. No adjustment was made to petitioners' New York source income. The statement explained that the amount of allocated New York State tax was calculated by multiplying petitioners' base tax by the income percentage. All of petitioners' income was included in computing the base tax. However, petitioners were only taxed on the income from New York State sources. According to the

statement, the amount of tax due was $3,159.57 plus interest in the amount of $569.65 for a balance due of $4,089.22.

3. Petitioners paid $4,932.00 and filed a Claim for Credit or Refund of Personal Income Tax in the amount of $4,115.00 plus interest. The claim stated that Public Law 104-95 prohibited state taxing authorities from using nonresident IRA distributions to compute the amount of state taxes due.

4. On or about June 25, 2004, the Division issued a Notice of Disallowance which advised petitioners that their claim for refund was denied. The notice explained that petitioners were required to figure a base tax as if they were full-year New York residents. They were then directed to multiply the base tax by a fraction whose numerator is income from New York sources and whose denominator is Federal adjusted gross income. Accordingly, the Division directed that the items of income in the Federal amount column had to be entered on the New York income tax return exactly as they appeared on the Federal return.

5. Petitioners filed a request for a conciliation conference. In a Conciliation Order dated February 4, 2005, the request was denied and the statutory notice was sustained.

SUMMARY OF THE PARTIES' POSITIONS

6. In their letter briefs, petitioners explained that in 1999 they decided to move from out of state to the Port Jefferson, New York area. Petitioners found a home in Mt. Sinai before they were able to sell their previous home. Petitioners took title to their new home in March 2000 and moved in on or about April 15, 2000.

In order to pay for the new residence petitioners found it necessary to obtain a portion of the payment for the home from Mr. Nathan's individual retirement account. On the basis of when they became New York State residents, a distribution of $54,684.00 was used by

petitioners to calculate the amount due to New York State. New York State disputed this calculation and used the entire distribution of $392,911.00 to calculate the tax due. The inclusion of the distribution raised the amount of tax due from $810.00 to $4,330.00.

Petitioners contend that the method used by the Division is erroneous because it relied upon the pension income received during a period of nonresidency to calculate the tax burden. According to petitioners, the United States Congress prohibited the use of pension income to calculate taxes due when it enacted 4 USC § 114 (added by Public Law 104-95). Petitioners further submit that in response to the Federal law, the State of California eliminated the use of pension income in determining the amount of tax due from nonresidents. Petitioners also argue that the inclusion of the pension income in order to produce a fraction which reduces the tax improperly circumvents the restrictions placed on the collection of taxes for part-year residents by using their pension income. According to petitioners, the previous taxing authority taxed Mr. Nathan's pension distributions while a resident there, and it is not possible to go back to that State and get a credit for the taxes paid to New York State. Therefore, petitioners contend that their pension distributions were being taxed twice.

7. Relying upon ***Brady v. New York*** (80 NY2d 596, ***cert denied*** 509 US 905), the Division states that the fundamental fairness of the New York method of taxing the income of nonresidents and part-year residents has been upheld by the Court of Appeals. The Division further maintains that the California State Board of Equalization has also held that the inclusion of a nonresident's retirement income to compute the tax rate on California income is not prohibited by 4 USC § 114.

8. In response to the forgoing, petitioners state that reliance upon ***Brady*** is specious because this case preceded the enactment of 4 USC § 114. Petitioners further submit that the

enactment of 4 USC § 114 shows that Congress thought that the existing tax computation methodology was unfair to nonresident retirees.

Petitioners state that for the past five years they filed nonresident tax forms with California that excluded IRA distributions from the Federal column although the distributions were included on their Federal return. These returns have been accepted. Petitioners also argue that if they were to compute their taxes using the IRA distributions, then California has a correction mechanism to eliminate the double taxation of nonresidents. Lastly, petitioners point out that they contacted the Franchise Tax Board of California and it responded that California does not tax nonresident pension income.

CONCLUSIONS OF LAW

A. Section 601(e)(1) of the Tax Law imposes tax on the income from New York sources of a nonresident individual. The tax imposed upon the nonresident is equal to the tax imposed upon a New York resident for the full year, reduced by certain credits, and then multiplied by the New York source fraction (Tax Law § 601[e][2], [3]). The New York source fraction, in turn, is equal to the individual's New York source income divided by the individual's New York adjusted gross income from all sources for the entire year (Tax Law § 601[e][3]). A nonresident individual's New York source income is defined by Tax Law § 631(a)(1) and (2) and consists of the sum of the items of income, gain, loss and deduction entering into Federal adjusted gross income derived from or connected with New York sources and the modifications set forth in Tax Law § 612(b) and (c) which relate to income derived from New York sources.

B. Section 114(a) of Title 4 of the US Code, as added by Public Law 104-95, provides that "[n]o State may impose an income tax on any retirement income of an individual who is not

a resident or domiciliary of such State (as determined under the laws of such State)." The term "retirement income" includes a distribution from an individual retirement account (4 USC § 114[b][1][E]).

C. As set forth above, petitioners submit that the Division's method of calculating their income tax liability is erroneous because the Division utilized the amount of pension income they received during the period of nonresidency to calculate their tax burden. It is petitioners' position that only New York source income may be used to determine the tax rate.

D. The argument raised by petitioners has been rejected on repeated occasions. The leading case in New York is ***Brady v. New York*** (80 NY2d 596, 592 NYS2d 955, ***cert denied*** 509 US 905). In ***Brady***, as in this case, plaintiffs challenged New York's method of taking into account both New York and non-New York source income in determining the tax rate to be applied to the New York income. Plaintiffs urged the Court that only New York income could be taken into account in determining the tax rate.

After outlining New York's scheme for taxing New York source income of nonresident taxpayers, the Court rejected the plaintiffs' arguments under the Due Process, Privileges and Immunities and Equal Protection clauses of the U.S. Constitution. The Court then specified what it regarded as petitioners' real argument as follows:

> Plaintiffs' 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. (***Brady v. New York***, ***supra***, 80 NY2d at 605, 592 NYS2d at 960**.**)

E. Here, petitioners are in the same position as that held by the taxpayers in ***Brady***. They take issue with the use of non-New York income to increase the tax rate which is applied to New

York income. Since New York's tax scheme is applied in a nondiscriminatory manner and only to New York source taxable income, it was proper for the Division to take into account petitioners' non-New York taxable income to determine the tax rate (***see, Matter of Dean***, Tax Appeals Tribunal, October 28, 1999; ***Matter of Scudieri***, Tax Appeals Tribunal, August 12, 1999).

F. Petitioners are correct that the ***Brady*** decision predates the effective date of 4 USC § 114. However, the reasoning employed in ***Brady*** was unaffected by this provision and continues to control the outcome of this matter. In view of the fact that there is controlling authority in New York which governs the outcome, the references to the law of California are irrelevant and will not be addressed.

G. The petition of Irwin and Phyllis Nathan is denied and the Notice of Disallowance, dated June 25, 2004, is sustained.

DATED: Troy, New York
October 5, 2006

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE