

REPORT #865

TAX SECTION

New York State Bar Association

Duplicative Taxation of Multistate Residents

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January 4, 1996

FEDERAL EXPRESS

The Honorable Michael H. Urbach
Commissioner
Department of Taxation and Finance
W.A. Harriman Campus, Building 9
Albany, New York 12227

Re: Duplicative Taxation of Multistate
Residents

Dear Commissioner Urbach:

The determination of an individual's state of residence or domicile is a very important element in state personal income, estate and gift taxation. New York, like most states in the region, taxes its residents on all income, wherever it may be derived (and imposes estate tax on the intangible assets of its domiciliary). And, like many other states, New York provides credits to residents for taxes paid to other states on income derived from those states.

Under New York law, a "resident" for income tax purposes is either a domiciliary of the state or a statutory resident; a statutory resident includes a non-domiciliary with a permanent place of abode in the state who spends more than 183 part or full days in New York.

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Many other states in the region likewise provide both for residence based on domicile and for statutory residence based on the maintenance of days in the state.

The absence of uniform definitions and determinations of domicile from state to state can result in an individual being considered to be a domiciliary of more than one state. Similarly, the application of statutory residence rules can lead to the treatment of an individual as domiciled in one state while a statutory resident of another, or as a statutory resident of more than one state. To take a simple example, a commuter from Connecticut or New Jersey who owns or rents a home or apartment in New York can be considered a domiciliary of Connecticut or New Jersey and a statutory resident of New York as well.

Individuals who are considered residents of more than one state often experience multiple state taxation of the same income, with no effective credit mechanism to relieve the burden of duplicative taxation. For example, an individual who is a resident of both New York and Connecticut is fully taxable in both states on his or her dividends, interest income and capital gains; neither state currently provides a tax credit for the taxes of the other state, because each state considers itself, as the state of residence, to be the source of such income.

A similar problem of double taxation arises when an individual is a resident of two states but earns income in a third state (or overseas). Both states of residence tax the individual's worldwide income, and neither provides a credit for the other's taxes (since the income is not sourced in either state of residence, but is instead derived from the third state).

Double taxation may also arise because states use different sourcing rules. For example, when an employee works within and without the state, New York allocates income from services performed out-of-state to New York unless the employee worked in the other state because of "employer necessity"; other states, by contrast, may-source the employee's income based upon the location where the services were performed.

Individuals may also experience procedural problems that result in multiple taxation. For example, statutes of limitations on refund claims may prevent an individual from recovering taxes paid to one state after he or she is found to be domiciled in another state.

These examples illustrate the problems that can be encountered by individuals who have contacts with a number of states.¹ We believe that the imposition of multiple state taxes on the same income is incorrect as a matter of basic tax policy. We are therefore writing to encourage New York and its sister states to take steps to eliminate duplicative state taxation of individuals who are "resident" in more than one state. We note that the members of the North East State Tax Officials Association have recently undertaken a project to consider these issues. We commend NESTOA for this initiative, and would be happy to offer our assistance in such a project.

In considering the appropriate solution to these problems, we have identified a number of different types of changes that would ameliorate or eliminate the current problem. Enacting targeted changes to statute of limitations provisions would eliminate the purely procedural constraints that preclude

¹ This issue is discussed in greater detail in a report of the Association of the Bar of the City of New York entitled "Individual Double Taxation in the Tri-State Region," reprinted in State Tax Notes Magazine, April 12, 1993.

consistent treatment state-to-state. Adopting uniform sourcing rules and uniform definitions of domicile and statutory residence, and coordinating the interpretation and application of these rules to specific cases, would eliminate duplicative taxation that arises solely because of conflicting definitions and interpretations. For example, if New York and its sister states either accepted one another's conclusions as to an individual's domicile, or established a joint forum for resolving that question, the anomaly of treating an individual as domiciled in multiple states would be eliminated.

Changes to state income tax credits would also go a long way toward resolving the problem of duplicative taxation. When states permit taxpayers to claim credits for taxes paid to other states, multistate taxpayers end up paying tax at the highest applicable state tax rate, but avoid paying multiple taxes on the same income. If existing state tax credit regimes were expanded such that, for example, a state permitted statutory residents to claim credits for taxes paid to their state of domicile, without regard to the source of the income taxed by the domicile state, the primacy of the domicile state would be recognized, and the statutory residency regime, while resulting in taxation at the highest applicable state tax rate, would no longer produce duplicative taxes like those illustrated by the example of the two-state commuter.² More sophisticated changes would be needed to coordinate the taxation of taxpayers who are statutory residents of two or more high-tax jurisdictions but domiciled in a low-tax jurisdiction, for here the credit for taxes paid to the state of domicile would not offset the higher, and duplicative, taxes imposed by both states of statutory residence. This problem is not without solutions, however.

² The District of Columbia currently provides for such credits. See B.C. Code §47-1806.4, B.C. Muni. Reg. §114.2 (c)

A unilateral solution, albeit clearly entailing some revenue loss, would be to permit statutory residents to credit against their New York income tax the taxes paid to other states of statutory residence, without regard to the source of the income taxed. A bilateral or multilateral solution would be for states to agree among themselves on the allocation of a single tax collected from persons resident in more than one state.³

There are thus a number of different approaches, some more comprehensive than others, that would reduce or eliminate duplicative state taxation caused by the treatment of individuals as resident in more than one state. Some solutions are relatively simple to implement; others require a multistate effort to coordinate statutes, audits and the resolution of controversies.⁴ We believe, however, that New York and its sister states will be well served by taking steps to ameliorate this problem, particularly given the high number of individuals who commute between, and work in, more than one state in this relatively high-tax region of the country. We urge you and your fellow Commissioners to explore solutions to the problems of multistate residency. We would be pleased to participate in this effort; please contact us if we can be of assistance in formulating responses to this problem.

Very truly yours,

Carolyn Joy Lee
Chair

³ N.Y. Tax Law §978(a) currently provides this kind of mechanism for allocating estate tax liability among the states who claim to be an individual's state of domicile.

⁴ A similar multistate effort in which New York participated successfully led to the development of uniform rules for sourcing the income of professional athletes. See N.Y. Reg. §132.22. That kind of experience should provide a foundation for ongoing multistate cooperation to resolve similar kinds of problems, like the duplicative taxation of multistate residents.

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