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Refund Opportunity for New Yorkers Paying Tax in Two Different States

Recently the United States Supreme Court decided Comptroller of the Treasury of Maryland v. Wynne, 135 S. Ct. 1787, 2015, a case involving a Maryland county income tax on residents' income derived from a "S corporation" doing business outside the State of Maryland. In a 5-to-4 decision, the Court held that the U.S. Constitution's dormant Commerce Clause was violated when Maryland imposed a county tax on all of Wynne's income and did not allow a credit for taxes paid to other jurisdictions on that same income.

Using the 'internal consistency test,' the Court found that Maryland's county tax scheme placed an unreasonable burden on interstate commerce as compared to intrastate commerce. While the case dealt with income from a pass-through entity engaged in a trade or business, there are implications for other situations where a taxpayer is required to pay tax to multiple jurisdictions on the same income.

The double tax situation with the greatest impact on taxpayers may be that which occurs when a person is deemed to be a resident of two (or more) states (a person can only have one domicile but can be a resident of more than one jurisdiction). For example, New York, like many other states, imposes a resident income tax on all income when a person is domiciled in New York or is a statutory resident (i.e., maintains a permanent place of abode in NY and is present for more than 183 days). In that circumstance, the resident can claim a credit for taxes paid to another state on income earned or sourced to that state. However, the resident cannot claim a credit for taxes paid on income from intangibles (interest, dividends, and gains on sales of stock) subjecting that income to double taxation.

For example, consider someone with a New Jersey domicile who works every weekday in New York City and has a pied-a-terre in the City. She earns a salary of \$500,000 and has \$1 million in income from sales of stock, dividends, and interest. As a domiciliary of New Jersey, she will be taxed on all of her \$1.5 million income and be able to claim a credit for the taxes paid on the \$500,000 salary earned in New York. But, since she has a permanent place of abode and was in New York for more than 183 days, she is a statutory resident of New York State and City and she will pay both the New York State and City tax on the entire \$1.5 million income with no credit for any tax paid to New Jersey. The effect is that the investment transactions are subject to tax in both states. Even more commonly, a resident of New York State and City

earning income in a state with a high tax rate (such as California, with a maximum rate of 13.3 percent) is currently only allowed a credit against the New York State tax (at an 8.82 percent maximum rate) with no credit against the City's (3.876 percent) tax, possibly running afoul of the Court's decision.

There also may be issues relating to the New York City (City) unincorporated business tax (UBT) imposed on partnerships, LLCs, and sole proprietors doing business in the City. The UBT provides a limited credit against the resident income tax for UBT paid but gives no credit to nonresidents raising questions as to whether this discriminates in favor of the City residents.

Although the Wynne case did not address multiple residency situations or income from intangibles, the internal consistency test applied by the Court could call into question this aspect of the New York tax system. Taxpayers paying tax in several jurisdictions should consult their tax professional about any potential refund claims as a result of Wynne and carefully review their filings going forward.

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