STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PRICEWATERHOUSECOOPERS, LLP	:	DETERMINATION DTA NO. 821300
for Redetermination of a Deficiency or for Refund of New York City Personal Income Tax under the New York City Administrative Code for the Year 1999.	: :	

Petitioner, PricewaterhouseCoopers, LLP, filed a petition for redetermination of a deficiency or for refund of New York City personal income tax under the New York City Administrative Code for the year 1999.

On June 14 and 22, 2007, respectively, petitioner, by its representative, Gregory Lee, Esq., and the Division of Taxation, by Daniel Smirlock, Esq. (Kevin R. Law, Esq., of counsel), consented to have this controversy determined upon the submission of documents without a hearing. All briefs were to be submitted by October 5, 2007, which date began the six-month period for the issuance of this determination. After due consideration of the entire record, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly required certain nonresident partners of PricewaterhouseCoopers, LLP, to subject one-half of the federal distributive share of net earnings from self-employment allocated to New York City to the New York City nonresident earnings tax for the year 1999.

FINDINGS OF FACT

The parties entered into a stipulation of facts which has been incorporated into the Findings of Fact below.

1. PricewaterhouseCoopers, LLP (PwC) is an international accounting firm with offices throughout the United States.

2. PwC is a limited liability partnership.

3. PwC's taxable year, for partnership taxation purposes, ends on September 30.

4. Prior to 1999, New York City (NYC) imposed a tax on the earnings of individuals who worked in, but did not live in, NYC (commuter tax).

5. On May 27, 1999, with an effective date of July 1, 1999, the New York State Legislature passed a bill which repealed the commuter tax for residents of New York State (NYS) who were nonresidents of NYC (Repeal Bill).

6. For purposes of the commuter tax, the Repeal Bill amended the definition of a nonresident individual to mean an individual who is not a resident of either NYC or NYS.

7. The Department of Taxation and Finance (Department) issued a Technical Service Bureau memorandum dated September 1, 1999 (TSB-M-99[6]I). For full-year NYS residents who were nonresidents of NYC for any part of 1999, TSB-M-99(6)I stated, in part, as follows:

> If the taxable year of your partnership ends on or before June 30, 1999, your entire distributive share of net earnings from self-employment allocated to New York City is subject to the nonresident earnings tax. If the taxable year of your partnership ends on or after July 1, 1999, your entire share of net earnings from self-employment allocated to the city is exempt from the nonresident earnings tax.

8. The Department of Taxation and Finance issued a Technical Service Bureau memorandum dated December 23, 1999 (TSB-M-99[6.1]I). In TSB-M-99(6.1)I, the Department revised its position on how to apply the effective date of the Repeal Bill to the commuter tax.

For full-year NYS residents who were nonresidents of NYC for any part of 1999, the memorandum stated, in part, as follows:

> If you are a full-year New York State resident who was not a resident of New York City for any part of 1999, one-half of your entire federal distributive share of net earnings from self-employment allocated to New York City for the partnership's taxable year ending in 1999 is subject to the nonresident earnings tax (since the New York City nonresident earnings tax applied to you only for the first six months of 1999). This is different than the rule set forth in TSB-M-99(6)I.

9. On April 4, 2000, the New York State Court of Appeals held that the partial repeal of the commuter tax (i.e., repeal of the commuter tax for NYS residents) was unconstitutional.

10. On August 15, 2000, PwC, on behalf of certain electing nonresident partners of PwC (Included Partners), filed its 1999 New York Revised Group Return for Nonresident Partners, Form IT-203-GR (Nonresident Return). The Nonresident Return reported the Included Partners' share of the commuter tax in the amount of $108,797.00. For purposes of the Nonresident Return, the Nonresident Return's tax year ended on December 31, 1999.

11. For Federal and NYS tax purposes, PwC's partnership return reported its tax year as ending on September 30, 1999.

12. All the Included Partners had a taxable year ending on December 31, 1999.

13. During 1999, all the Included Partners were nonresidents of NYS and none of the Included Partners were part-year residents of NYS.

14. On August 15, 2003, PwC, on behalf of the Included Partners, timely filed an amended 1999 New York Revised Group Return for Nonresident Partners, Form IT-203-GR (Amended Return), claiming a refund of the commuter tax in the amount of $108,797.00. In a statement attached to the Amended Return, PwC explained the basis for its claim for refund:

> On the original Form IT-203-GR for FY 99, PwC subjected ½ of the federal distributive share of net earnings from self-employment allocated to New York City to the New York City Nonresident Earnings Tax (the "Commuter Tax"). The tax reflected on the return was computed in accordance with TSB-M-99(6.1)I, which superseded TSB-M-99(6)I. As discussed below, we believe that none of the partners' income from PwC for FY 99 should have been subject to the Commuter Tax.
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> Senate Bill 5594-B repealed the Commuter Tax and §§ 6 and 7 state: "For taxable years commencing on or before June 30, 1999, which include such a date, a taxpayer no longer subject to [the Commuter Tax] . . . shall compute such taxpayer's liability for such taxable year **as if such taxpayer's taxable year for federal income tax purposes ended on June 30, 1999."** (Emphasis as in original.) Under normal income tax accounting rules, if a partner's tax year ends on June 30, 1999, he or she would include in income all of the partnership income or loss for any partnership year ending on or before June 30, 1999. See Internal Revenue Code § 706(a).
>
> Consequently, since PwC's taxable year ends on September 30, 1999, the statute exempts PwC's partners included in the New York State Group Return from the Commuter Tax and, thus, PwC should be entitled to a refund of the Commuter Tax paid of $108,797, plus interest.

15. On October 17, 2003, the Division of Taxation (Division) issued a Notice of Disallowance rejecting PwC's claim for refund. The notice stated PwC's claim for refund was being disallowed for the following reason:

> Due to the elimination of the New York City nonresident earnings tax effective July 1, 1999, one-half of a partner's federal distributive share of net earnings from self-employment allocated to New York City for the partnership's taxable year ending in 1999 is subject to the New York City nonresidents earning tax.

CONCLUSIONS OF LAW [1]

A. Cities in New York having a population of one million or more have been authorized to impose a personal income tax on their residents (Tax Law § 1301). In 1966, the Legislature

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[1]The legislative history of New York City's tax on nonresident commuters is explained in ***The City of New York v. The State of New York*** (94 NY2d 577, 709 NYS2d 122 [2000]). The history set forth above was obtained largely from that decision.

further authorized New York City to adopt and amend local laws imposing a tax on the earnings of individuals who work, but do not live, in the City (the commuter tax) (***see*** General City Law § 25-m, et seq.). That same year, the City imposed the commuter tax on the wages and self-employment earnings of every nonresident individual working in the City (New York City Administrative Code § 11-1902). The term "nonresident" applied to both in-State and out-of-State residents who did not live in the City (New York City Administrative Code § 11-1901[i]).

Chapter 5 of the laws of 1999 amended the definition of "nonresident individual" in Tax Law § 1305(b) and General City Law § 25-m(1)(h) to exclude State residents. Thus, chapter 5 permitted the imposition of the commuter tax on out-of-State residents who worked in New York City, but prohibited taxing commuting residents who came to the City from other New York counties. Consistent with the July 1, 1999 effective date, the Repeal Bill provided:

> For taxable years commencing on or before June 30, 1999, which include such date, a taxpayer no longer subject to the . . . [Commuter Tax] effective as of July 1, 1999, as a result of the enactment of section two of this act, shall compute such taxpayer's liability for such taxable year as if such taxpayer's taxable year for federal income tax purposes ended on June 30, 1999.

Chapter 5 also provided that if the changes to the definition of "nonresident individual" were held to be invalid or unconstitutional, the commuter tax would be retroactively repealed in its entirety as of July 1, 1999, and provided that a taxpayer no longer subject to the commuter tax as a result of an unconstitutional holding would compute such taxpayer's liability as if such taxpayer's taxable year for federal income tax purposes ended on June 30, 1999.

B. The New York State Court of Appeals, in ***The City of New York v. The State of New York*** (94 NY2d 577, 709 NYS2d 122 [2000]), held that the partial repeal of the New York City nonresident earnings tax (commuter tax), effective July 1, 1999 (L 1999, ch 5), whereby the commuter tax was effectively repealed for New York State residents who commute into New

York City but not for out-of-state commuters, was a violation of the Privileges and Immunities and Commerce Clauses of the United States Constitution. The Court of Appeals further held that since the partial repeal was unconstitutional, the alternate provision in the statute repealing the entire commuter tax took effect.

C. Section 701 of the Internal Revenue Code provides that the partners are liable for the tax on a partnership's net income. Pursuant to section 702 of the Internal Revenue Code, the tax is determined by each partner's reporting his distributive share of, inter alia, the partnership's income, gain and losses. Section 706(a) of the Code requires that each partner's distributive share of the income, gain and loss be included in that partner's taxable income for the taxable year of the partnership ending within or with the partner's tax year. A partner is required to report and pay tax on his distributive share of the net income of the partnership in this manner without regard to whether this amount was actually distributed or distributable to him in that year (***United States v. Basye***, 410 US 441, 35 L Ed 2d 412 [1973], ***reh denied*** 411 US 940, 36 L Ed 2d 402 [1973]).

D. It is well established that the primary consideration of the courts in the construction of statutes is to ascertain and give effect to the intention of the Legislature. To determine legislative intent, courts must first look at the literal reading of the act itself (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 92). Statutory rules of construction provide that "[t]he legislative intent is to be ascertained from the words and language used, and the statutory language is generally construed according to its natural and most obvious sense, without resorting to an artificial or forced construction" (McKinney's Cons Laws of NY, Book 1, Statutes § 94). Where the statute is clear, the courts must follow the plain meaning of its words, and "there is no occasion for examination into extrinsic evidence to discover legislative intent . . . " (McKinney's Cons Laws of NY, Book 1, Statutes § 120; ***see Matter of Raritan Dev. Corp. v. Silva***, 91 NY2d 98, 667 NYS2d 327 [1997]; ***Matter of Schein***, Tax Appeals Tribunal, November 6, 2003). Courts may look elsewhere to interpret a statute that is not clear. However, a court should not add restrictions or limitations where none exist, nor should it interpret a statute which has no need of interpretation. Where, as here, words of a statute have a definite and precise meaning, it is not necessary to look elsewhere in search of conjecture so as to restrict or extend that meaning (***Matter of Erie County Agricultural Society v. Cluchey***, 40 NY2d 194, 386 NYS2d 366 [1976]). As the language of the Repeal Bill is clear, it is appropriate to interpret its phrases in their ordinary, everyday sense (***Matter of Automatique v. Bouchard***, 97 AD2d 183, 470 NYS2d 791 [1983]).

E. As a result of the Court of Appeals decision in ***The City of New York v. The State of New York*** (***supra***), that portion of the Repeal Bill which provided that a taxpayer's tax liability for taxable years commencing on or before June 30, 1999 was to be computed as if such taxpayer's taxable year for federal income tax purposes ended on June 30, 1999 took effect. The language of such provision of the Repeal Bill is clear and unambiguous.

The partnership, PwC, had a tax year end of September 30, 1999. The Repeal Bill states that the Included Partners are to compute their commuter tax liability as if their tax year ended on June 30, 1999. Pursuant to Internal Revenue Code § 706(a), the Included Partners must include their distributive shares of PwC income "for any taxable year of the partnership ending within or with the taxable year of the partner." It is the final day of the partnership year when partners are treated as receiving their distributive shares for purposes of determining which taxable year the distributions are to be included. It is clear that PwC's 1999 taxable year (September 30) does not end within the Included Partners' 1999 taxable year (June 30) as determined by the Repeal Bill. Therefore, when the Included Partners calculate their commuter tax liability for the year ended on June 30, 1999, they are not required to include their distributive shares of PwC income.

F. Initially, the Division of Taxation agreed with this interpretation of the Repeal Bill, issuing its *Important Notice for Estimated Tax Filers* (TSB-M-99[6]I). The notice stated, in part, that "[i]f the taxable year of your partnership ends on or after July 1, 1999, your entire share of net earnings from self-employment allocated to the city *is exempt from the nonresidents earnings tax*" (emphasis added). However, following the Tax Appeals Tribunal's decision in ***Matter of Greig*** (September 16, 1999), the Division altered its position, issuing *Revised Notice for Partners Making Estimated Tax Payments of the New York City Nonresident Earnings Tax* (TSB-M-99[6.1]I), dated December 23, 1999. The revised notice, based upon the proration concept presented in ***Greig,*** stated as follows:

> If you are a full-year New York State resident who was not a resident of New York City for any part of 1999, one-half of your entire federal distributive share of net earnings from self-employment allocated to New York City for the partnership's taxable year ending in 1999 is subject to the nonresident earnings tax (since the New York City nonresident earnings tax applied to you only for the first six months of 1999). This is different than the rule set forth in TSB-M-99(6)I.

Following the Court of Appeals decision in ***The City of New York v. The State of New York*** (***supra***), the Division issued Important Notice N-00-10, dated February 1, 2000, entitled *Partnerships Filing Group Returns for Nonresident Partners: Elimination of the New York City Nonresident Earnings Tax*, which stated, in part, that "only one-half of a partner's federal distributive share of net earnings from self-employment allocated to New York City for the partnership's taxable year ending in 1999 is subject to the New York City nonresident earnings tax." Thus, the Division relied, and continues to rely, on the ***Greig*** decision which permitted a nonresident partner to prorate his income between his resident and nonresident periods for purposes of New York State income tax liability.

G. The taxpayer in ***Greig*** was a partner in a law firm located in New York City. On August 1, 1982, the taxpayer and his family moved from New York City to Hong Kong. In July 1987, the taxpayer and his family moved from Hong Kong to Japan, to work in the law firm's Tokyo office. On July 4, 1992, the year in issue, the taxpayer and his family returned from Japan to New York City, where he resumed work in the law firm's New York City office.

For the year 1992, the taxpayer apportioned his distributive share of partnership income to his resident and nonresident periods based upon the number of days he was in each such status during the year. In response, the Division allocated 100 percent of the taxpayer's distributive share of partnership income to the resident period, reasoning that as the partnership's taxable year ended during the period that the taxpayer was a resident of New York, the distributive share is to be included in its entirety as New York source income.

In its decision, the Tax Appeals Tribunal compared Tax Law former § 654 (in effect until December 31, 1987) with Tax Law former § 638 (applicable to tax year 1992) and the regulations enacted by the Division pertaining to each section. The Tribunal noted that the Court of Appeals, in ***Matter of McNulty v. New York State Tax Commn.*** (70 NY2d 788, 522 NYS2d 103 [1987]), had invalidated the Division's regulation pertaining to Tax Law former § 654 (20 NYCRR former 148.6). That regulation required taxpayers who moved in or out of New York State during the tax year to treat partnership gains or losses as having all accrued in the portion of the taxable year in which the partnership's own tax year ended. Taxpayers were prohibited from prorating gains and losses between their resident and nonresident periods. The Court concluded that this reporting methodology did not take into account when the income from the partnership was actually received. The Court found a clear legislative intent in Tax Law former § 654 that most forms of income, as well as exemptions and standard deductions, should be allocated between the taxpayer's resident and nonresident returns. Thus, the Court held that taxpayers had to be allowed to report partnership distributions in a manner that either reflected the date of receipt or encompassed a proportionate distribution.

In 1987, following the Court of Appeals decision in ***McNulty***, the Tax Law was amended to provide for a single return for part-year residents. In ***Greig***, the Division argued that since part-year residents were no longer required to prorate exemptions and deductions, the problem addressed by ***McNulty*** no longer existed, and proration of partnership income should no longer be allowed. The Tax Appeals Tribunal rejected the Division's argument, concluding that there was nothing in ***McNulty*** which would limit its holding to situations where only mismatching of exemptions and deductions is present. According to the Tribunal, the statutory scheme present in ***McNulty*** is similar to that found in the ***Greig*** case, and the statutory exceptions found in Tax Law § 637 and former § 638(c) indicate that it continued to be the intent of the Legislature that most forms of income should be allocated between the taxpayer's resident and nonresident periods to reflect the actual date of receipt or expenditure or encompass an annual amount distributed on a proportionate basis. The Tribunal concluded that the taxpayer should be permitted to prorate the annual amount of the partnership distributions and allocate the amount proportionately between the resident and nonresident periods.

The Tribunal also rejected the Division's argument that its position conformed with the federal principle embodied in section 706 of the Internal Revenue Code that partnership items are recognized by a partner at the time the partnership taxable year ends. The Tribunal reviewed principles of partnership taxation contained in the Internal Revenue Code and concluded that section 706(a) of the Code does not mean that the partner's distributive share of the partnership's gain or loss was earned or sustained by the partner on the last day of the taxable year of the partnership ending with or within the partner's tax year. Rather, the language merely describes in which taxable year the partnership items should be included in the taxable income of the partner. Section 706(a) is compatible with the concept that the partner is deemed to have earned the income at the same date it is earned by the partnership. The Tribunal concluded that, under such circumstances, section 706(a) does not support the Division's position and, in fact, complements the position of the taxpayer that the partnership income received by the taxpayer be reported ratably throughout the year.

H. The Division appears to rest its position in the present matter on that portion of ***Greig*** which held that a partner is deemed to have earned the income at the same date as it is earned by the partnership, and as the income is earned throughout the taxable year, a partner is properly allowed to report such partnership income ratably throughout the year. It appears to be the position of the Division that as the income is earned throughout the year, a partner with a year ending date of June 30, 1999 (as stated in the Repeal Bill) is required to report partnership income earned up to such date when computing the commuter tax.

I. Unfortunately for the Division, the ***Greig*** case is both factually and legally distinguishable from the present matter. The taxpayer in ***Greig*** was a part-year resident, having spent the first half of the year in Tokyo, Japan, and the second half in New York. The issue of the proration of the taxpayer's distributive share of partnership income arose as a result of the taxpayer's changing his residence during the year. In contrast, the Included Partners were full-year nonresidents during the year 1999. Additionally, in ***Greig***, both the partnership and the taxpayer were calendar year taxpayers, whereas in the present case the Repeal Bill created a different year end date for the Included Partners from that of the partnership. The Tribunal addressed only the issue of whether the taxpayer could prorate his distributive share of partnership income, as it was not necessary to consider the circumstances that arise in the present case where the partner's tax year does not match up with the partnership's tax year.

J. The issue in ***Greig*** involved an issue of sourcing of partnership income, while the present case concerns the timing of the inclusion of partnership income in the income of a partner. Pursuant to Internal Revenue Code § 706, a partner includes his distributive share of partnership income for any taxable year of the partnership ending within or with the partner's taxable year. The partner applies section 706 to determine the appropriate year in which to include the partnership distributions. In ***Greig***, the taxpayer's tax year matched the tax year of the partnership, rendering it unnecessary for the Tribunal to consider the appropriate timing of the inclusion of the partnership's distributive share. As the tax years of the partnership and partner were the same, section 706 directed that all of the distribution of partnership income was to be included in the partner's tax year; the only issue to be resolved was what portion of the distribution was to be included in the taxpayer's resident and nonresident periods. The Tribunal addressed only the issue of the sourcing of the distributive share and not its timing, which is the issue in the present matter.

K. The proration method applied in ***Greig*** involved an analysis of how to source the partnership distribution. There was no analysis necessary of the timing of the distributive share as the tax years of both the partnership and the taxpayer partner were the same, and thus no question as to which taxable year of the partner to include the distributive share of the partnership income. The Tribunal did address the issue of whether to apply the proration method to source the taxpayer partner's distributive share of partnership income between his resident and nonresident periods. Thus, the Tribunal never addressed the timing issue present in this matter, and the Division cannot rely upon such decision in support of its position.

L. In the present matter, the partnership, PwC, had a tax year end of September 30, 1999. The Repeal Bill states that the Included Partners are to compute their commuter tax liability as if their tax year ended on June 30, 1999. Pursuant to Internal Revenue Code § 706(a), as PwC's 1999 taxable year (September 30) does not end within the Included Partners' 1999 taxable year (June 30) as determined by the Repeal Bill, the Included Partners are not required to include their distributive shares of PwC income when calculating any commuter tax liability for the year ended on June 30, 1999.

M. The petition of PricewaterhouseCoopers, LLP is granted, and the Division of Taxation is directed to issue to petitioner a refund in the amount of $108,797.00, plus interest.

DATED: Troy, New York
April 3, 2008

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE