

**New York State Department of Taxation and Finance**  
**Office of Tax Policy Analysis**  
**Technical Services Division**

TSB-A-06(9)I  
Income Tax  
November 30, 2006

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I060621A

On June 21, 2006, a Petition for Advisory Opinion was received from Michael Sastre, 602 N.E. 59<sup>th</sup> Street, Miami, Florida 33137-2324.

The issue raised by Petitioner, Michael Sastre, is how to determine New York source income for guaranteed payments received by a nonresident partner.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner is a non-equity partner of a law partnership and received guaranteed payments for services rendered. The partnership has offices located both in and outside of New York State. The partnership maintained records of revenue and expenses for the business conducted in each state. Petitioner's 2005 federal Schedule K-1 (Form 1065) listed guaranteed payments of \$161,127, of which \$89,458 was reported to Petitioner as received from New York sources. Petitioner worked exclusively out of the partnership's Florida office. At least 95% of the work performed by Petitioner was for clients whose offices were located outside of New York State. Petitioner does not share in the profits, losses, or capital of the partnership.

**Applicable law and regulations**

Section 601(e) of the Tax Law imposes a personal income tax on nonresidents of New York State who have New York source income and provides, in part:

Nonresidents and part-year residents. (1) General. There is hereby imposed for each taxable year on the taxable income which is derived from sources in this state of every nonresident . . . individual . . . a tax which shall be equal to the tax base multiplied by the New York source fraction.

(2) Tax base. The tax base is the tax computed under subsections (a) through (d) of this section, as the case may be, reduced by the credits permitted under subsections (b), (c), (d) and (m) of section six hundred six, as if such nonresident . . . individual . . . were a resident subject to the provisions of part II of this article.

(3) New York source fraction. The New York source fraction is a fraction the numerator of which is such individual's . . . New York source income determined in accordance with part III of this article and the denominator of which is such individual's New York adjusted gross income determined in accordance with part II of this article. . . . Section 607(a) of the Tax Law provides:

General. Any term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required but such meaning shall be subject to the exceptions or modifications prescribed in this article or by statute. Any reference in this article to the laws of the United States shall mean the provisions of the internal revenue code of nineteen hundred eighty-six (unless a reference to the internal revenue code of nineteen hundred fifty- four is clearly intended), and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time for the taxable year.

Section 631(a) of the Tax Law provides, in part:

General. The New York source income of a nonresident individual shall be the sum of the following: (1) The net amount of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources, including: (A) his distributive share of partnership income, gain, loss and deduction, determined under section six hundred thirty-two, and . . . .

Section 632 of the Tax Law provides, in part:

(a) Portion derived from New York sources.

(1) In determining New York source income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with New York sources of such partner's distributive share of items of partnership income, gain, loss and deduction entering into his federal adjusted gross income, as such portion shall be determined under regulations of the [Commissioner of Taxation and Finance] consistent with the applicable rules of section six hundred thirty-one.

\* \* \*

(b) Special rules as to New York sources. In determining the sources of a nonresident partner's income, no effect shall be given to a provision in the partnership agreement which

(1) characterizes payments to the partner as being for services or for the use of capital, or . . . .

Section 132.15 of the New York State Personal Income Tax Regulations (Regulations) provides, in part:

(a) If a nonresident individual, or a partnership of which a nonresident individual is a member, carries on a business, trade, profession or occupation both within and without New York State, the items of income, gain, loss and deduction attributable to such business, trade, profession or occupation must be apportioned and allocated to New York State on a fair and equitable basis in accordance with approved methods of accounting.

(b) If the books of the business are so kept as regularly to disclose, to the satisfaction of the [Commissioner of Taxation and Finance], the proportion of the net amount of the items of income, gain, loss and deduction derived from or connected with New York State sources, the New York State nonresident personal income tax return of the taxpayer must disclose the total amount of such items, the net amount of such items allocated to New York State, and the basis upon which such allocation is made.

(c) If the books and records of the business do not disclose, to the satisfaction of the [Commissioner of Taxation and Finance], the proportion of the net amount of the items of income, gain, loss and deduction attributable to the activities of the business carried on in New York State, such proportion will, except as provided in section 132.16 of this Part and section 112.7(b) of this Title, be determined by multiplying (1) the net amount of the items of income, gain, loss and deduction of the business by (2) the average of the percentages described in subdivisions (d) through (f) of this section.

(d) Property percentage. (1) General. The property percentage is computed by dividing (i) the average of the values, at the beginning and end of the taxable year, of real and tangible personal property connected with the business and located within New York State, by (ii) the average of the values, at the beginning and end of the taxable year, of all real and tangible personal property connected with the business and located both within and without New York State. . . .

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(e) Payroll percentage. The payroll percentage is computed by dividing (1) the total wages, salaries and other personal service compensation paid or incurred during the taxable year to employees, in connection with business carried on within New York State, by (2) the total of all wages, salaries and other personal service compensation paid or incurred during the taxable year to employees in connection with the business carried on both within and without New York State.

(f) Gross income percentage. The gross income percentage is computed by dividing (1) the gross sales or charges for services performed by or through an office, branch or agency of the business located within New York State, by (2) the total of all gross sales or charges for services performed within and without New York State. The sales or charges to be allocated to New York State include all sales negotiated or

consummated, and charges for services performed, by an employee, agent, agency or independent contractor chiefly situated at, connected by contract or otherwise with, or sent out from, offices, branches of the business, or other agencies, situated within New York State.

Section 132.24 of the Regulations, provides:

Sections 132.15 through 132.23 of this Part are designed to apportion and allocate to New York State, in a fair and equitable manner, a nonresident's items of income, gain, loss and deduction attributable to a business, trade, profession or occupation carried on partly within and partly without New York State. Where the methods provided under those sections do not so allocate and apportion those items, the department may require a taxpayer to apportion and allocate those items under such method as it prescribes, as long as the prescribed method results in a fair and equitable apportionment and allocation. A nonresident individual may submit an alternative method of apportionment and allocation with respect to items of income, gain, loss and deduction attributable to a business, trade, profession or occupation carried on partly within and partly without New York State. The proposed method must be fully explained in the taxpayer's New York State nonresident personal income tax return. If the method proposed by the taxpayer is approved by the department, it may be used in lieu of the applicable method under sections 132.15 through 132.22 of this Part.

Section 1.707-1(c) of the Treasury Regulations provides, in part:

Guaranteed payments. Payments made by a partnership to a partner for services or for the use of capital are considered as made to a person who is not a partner, to the extent such payments are determined without regard to the income of the partnership. However, a partner must include such payments as ordinary income for his taxable year within or with which ends the partnership taxable year in which the partnership deducted such payments as paid or accrued under its method of accounting. See section 706(a) and paragraph (a) of §1.706-1. Guaranteed payments are considered as made to one who is not a member of the partnership only for the purposes of section 61(a) (relating to gross income) and section 162(a) (relating to trade or business expenses). For a guaranteed payment to be a partnership deduction, it must meet the same tests under section 162(a) as it would if the payment had been made to a person who is not a member of the partnership, and the rules of section 263 (relating to capital expenditures) must be taken into account. This rule does not affect the deductibility to the partnership of a payment described in section 736(a)(2) to a retiring partner or to a deceased partner's successor in interest. Guaranteed payments do not constitute an interest in partnership profits for purposes of sections 706(b)(3), 707(b), and 708(b). For the purposes of other provisions of the internal revenue laws, guaranteed payments are regarded as a partner's distributive share of ordinary income. . . .

## Opinion

Guaranteed payments are regarded as a partner's distributive share of ordinary income for federal income tax purposes. See section 1.707-1(c) of the Treasury Regulations.

Section 607(a) of the Tax Law provides that any term found in the personal income tax provisions of the Tax Law shall have the same meaning as the term has for federal income tax purposes unless a different meaning is clearly required.

Section 601(e) of the Tax Law imposes a personal income tax on the taxable income derived from New York sources of a nonresident individual. The tax is equal to the tax computed as if the nonresident individual were a New York State resident for the entire year, reduced by certain credits, and then multiplied by the income percentage (i.e., New York source fraction). The numerator of the fraction used to compute the income percentage is the nonresident individual's New York source income; the denominator of the fraction is the nonresident individual's New York adjusted gross income from all sources for the entire year. The New York source income of a nonresident individual is determined under section 631 of the Tax Law and includes the distributive share of partnership income, gain, loss, and deduction determined under section 632 of the Tax Law.

Pursuant to section 632(a)(1) of the Tax Law, the New York source income of a nonresident partner includes the partner's distributive share of all items of partnership income, gain, loss, and deduction entering into such partner's federal adjusted gross income to the extent such items are derived from or connected with New York sources. The New York source of partnership income is determined by the partnership at the partnership level and, therefore, is determined by the business activity of the partnership both within and without New York. Where a partnership carries on a business, trade, profession, or occupation both within and without New York State and maintains books and records from which the New York income of the business can be determined, a nonresident partner's distributive share of partnership items derived from New York sources will be determined from the partnership's books of account. Where the partnership does not maintain books and records from which New York income can be determined, a nonresident partner's distributive share of partnership items derived from New York sources will be determined from the partnership's business allocation percentage or an authorized alternative method. The business allocation percentage consists of three percentages: property, payroll, and gross income. See sections 132.15(d), (e), and (f) and 132.24 of the Regulations.

Section 632(b)(1) of the Tax Law provides that in determining the source of a nonresident partner's income, no effect shall be given to a provision in the partnership agreement that characterizes payments to a partner as being for services.

In the *Matter of Jablin v State Tax Comm.*, 65 AD2d 891, the payment received by the taxpayer was in the nature of a guaranteed payment from the partnership. It was decided by the

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court that the income constituted a distributive share of partnership income to a partner and was sourced to New York using the same allocation figures used by the partnership.

As a non-equity partner, Petitioner received guaranteed payments for services rendered for the partnership. Petitioner received a Schedule K-1 from the partnership indicating guaranteed payments. Partnerships use Schedule K-1 for federal income tax purposes to report a partner's share of the partnership's income, deductions, credits, etc. Therefore, based on the statutory provisions and case law discussed above, the guaranteed payments received by Petitioner in the present case constitute a distributive share of partnership income and, for State income tax purposes, are sourced to New York pursuant to section 632(b)(1) of the Tax Law and section 132.15 of the Regulations. In this case, it appears that the partnership maintained records of revenue and expenses for the business activities conducted within and without New York. Accordingly, provided that the partnership records allocate items of income, gain, loss, and deduction to New York on a fair and equitable basis in accordance with approved methods of accounting, Petitioner must include in his New York source income the amount of guaranteed payments reported by the partnership as New York source income.

DATED: November 30, 2006

/s/  
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.