



Recent Massachusetts Ruling Illustrates Differences in the Taxation of Investment Income Among Connecticut, Massachusetts, and New York

A recent Massachusetts Letter Ruling serves to remind us of the dangers involved in being domiciled in one state and a "statutory resident" in another. Like all the income taxing states, Massachusetts, New York and Connecticut tax all of the income of those who are residents of the state. In the case of these three states, however, a resident is not only one whose permanent home or "domicile" is in that state but also a "statutory resident," which means a person who has a permanent place of abode in the state and is physically present there for more than 183 days in a taxable year. While New York, Connecticut and Massachusetts have credit provisions that in most cases operate effectively to eliminate double taxation of earned income, these credit provisions generally do not eliminate the risk of double taxation with respect to investment income for one who is a resident of more than one of these states. This occurs because the three states apply this credit differently.

Massachusetts

In the Massachusetts Department of Revenue Letter Ruling, [1](#) a domiciliary of New York conducted business in Boston, which required his presence there more than 183 days a year. He also rented an apartment in Massachusetts. On these facts the individual met the Massachusetts definition of a "statutory resident" and was subject to Massachusetts income tax on all of his income. In applying the Massachusetts credit "for taxes due any other state, territory, or possession of the United States [...] on account of any item of Massachusetts gross income," [2](#) the Ruling concludes that the New York domiciliary is entitled to a credit for any taxes paid to New York on New York source income earned while working in New York or arising from property located or business conducted in New York. Importantly, he is also due a credit for tax paid on income that has no specific source, such as investment income, but is properly taxable in the first instance in his state of domicile. The practical result is that Massachusetts will tax only the income this taxpayer earns in Massachusetts and any other income properly sourced to Massachusetts, but will defer to New York the right to tax his investment income.

New York

Like Massachusetts, New York statutes provide a credit for a tax imposed on the resident's income by other states. [3](#) However, New York permits the credit only for tax on income earned in the other state, which means there is no credit for tax on investment income unless that income arises from property employed in a business, trade or profession carried on in the other state. [4](#) Thus, if the situation in the Massachusetts letter ruling were reversed so that a Massachusetts domiciliary were working in New York for more than 183 days a year and had an apartment in New York, the taxpayer would be given no credit for the tax paid to his home state of Massachusetts and would suffer double taxation of all of his investment income.

Connecticut

Connecticut's position on this issue falls between those of New York and Massachusetts. The Connecticut statute provides a statutory resident a credit against taxes imposed by and paid to the state in which the individual is domiciled. However, this credit is allowed only if the state of domicile allows a reciprocal credit for individuals domiciled in Connecticut. [5](#) The effect of this statutory restriction is that the Connecticut credit will operate to save a Massachusetts domiciliary from double taxation, but will not operate to save a similarly situated New York domiciliary from double taxation of her investment income.

The End Result

The result of these disparities in the law is illustrated in the following table:

<i>Home State</i>	<i>Statutory Residence</i>	<i>Credit of Statutory Residence State Applies?</i>	<i>Double Tax on Investment Income?</i>
Connecticut	New York	No	Yes

Connecticut	Massachusetts	Yes	No
New York	Massachusetts	Yes	No
New York	Connecticut	No (no reciprocity)	Yes
Massachusetts	Connecticut	Yes	No
Massachusetts	New York	No	Yes

The NESTOA Agreement

This is not a new problem. The Massachusetts letter ruling bases its holding in part on the terms of a 1996 agreement among the tax commissioners of the twelve northeastern states, including Massachusetts, Connecticut and New York (the "NESTOA Agreement").⁶ This agreement was intended to promote consistency in the treatment of the states' residents and reduce the incidence of double taxation. To remedy potential double taxation, Sections 3 and 4 of the NESTOA Agreement give explicit preference to the state of domicile by requiring that the state claiming statutory residence provide a credit for taxes paid to the state of domicile on both income from intangibles, or investment income, and on income sourced to, but not taxed by, the state of domicile. The NESTOA Agreement specifically recognizes in paragraph 4 that existing state laws or regulations may preclude some of the state tax administrators that are parties to the agreement from avoiding double taxation of investment income. In paragraph 4 of the NESTOA Agreement, the participating tax administrators commit to using "every reasonable effort to seek a legislative or regulatory change that would allow for the utilization of this preferred method" to avoid double taxation.

Remedial legislation proposed in New York State in 1997⁷ did not pass and neither New York nor Connecticut has attempted to address the issue of double taxation of residents' income since then. So, twelve years after the NESTOA Agreement, dual residents of New York, Connecticut and Massachusetts may still find their investment income double taxed, with no effective credit mechanism to provide relief.

Individuals who are at risk of being treated as a resident of more than one state must be aware of the risk of double taxation of their investment income. Moreover, it is imperative that individuals who fall into an area of the matrix where state credits will not cure such double taxation plan accordingly.

¹ Letter Ruling 08-11, Taxpayer Domiciled in New York, Resident in Massachusetts, (August 7, 2008).

² Mass. Gen. Laws. ch. 62, § 6(a).

³ N.Y. Tax Law § 620.

⁴ 20 N.Y.C.R.R. § 120.4(d).

⁵ Conn. Gen. Stat. § 12-704(d).

⁶ NESTOA's members are the state tax commissioners of Connecticut, Delaware, the District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont.

⁷ New York Senate Bill 1997 S. 5208.

If you have any questions regarding potential double taxation of investment income or any other tax-related questions, please contact Jack Shaughnessy (jshaughnessy@rc.com) or Felicia Hoeniger (fhoeniger@rc.com) in Robinson & Cole's State Tax Representation Group.

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