

NEW YORK STATE CONSIDERING TAXING NON-RESIDENT FUND MANAGERS

The New York State Assembly is considering Bill No. A09710D (the “Act”), which currently contains a provision that would tax partners and shareholders of S corporations who are not New York State residents and who are entitled to carried interests from investment partnerships or S corporations as if such partners or shareholders are receiving payments for services that constitute a trade or business in New York. The effect of such legislation would be that non-resident partners and shareholders of investment partnerships and S corporations will be taxable in New York on their carried interests at ordinary income tax rates. On June 29, 2010, the Act was approved by the Ways and Means Committee and placed on the calendar for consideration by the full Assembly.

Under present law, non-resident partners and shareholders of S corporations are not taxable in New York unless they are performing a trade or business in New York. The purchase and sale of property, such as securities or options, for one’s own account does not constitute a trade or business in New York.

As currently drafted, the Act would modify this rule such that it would not apply to partners or S corporation shareholders performing investment management services. Under the proposed legislation, if a partner performs Investment Management Services for the partnership, the partner “will not be treated as a partner” with respect to such partner’s distributive share of income, gain, loss and deduction that is “in excess of the amount such distributive share would have been if the partner performed no investment management services.” Instead of this amount being a distributive share to a partner, it would be considered “an amount received from a trade, business, profession or occupation carried on in the partner’s own capacity.” If the partner providing the services is an individual, the payment will be allocated in accordance with rules applicable to individuals rendering personal services. If the partner is itself a partnership, the payment will be allocated in accordance with the rules applicable to a business carried on in New York. The foregoing rules would apply equally to shareholders of S corporations who provide Investment Management Services to such corporations.

Investment Management Services would be defined as a substantial quantity of any of the following services: (1) advising the partnership or S corporation as to the advisability of investing in, purchasing or selling any specified asset, (2) managing, acquiring or disposing of any specified asset, (3) arranging financing with respect to acquiring any specified asset, and (4) any activity in support of any of the foregoing services. A specified asset would be defined as securities, real estate held for rental or investment, interests in partnerships, commodities, or options or derivative contracts with respect to any of the foregoing. A special exception would apply to real estate partnerships or real estate S corporations. For such entities, a partner or shareholder will not be deemed to be providing Investment Management Services if at least 80% of the fair market value of the specified assets of the entity consists of real estate.

Under the proposed legislation, carried interests paid to non-resident partners and shareholders of S corporations would be taxed at ordinary income rates as they would be considered amounts paid for services rendered.

If enacted, these provisions would apply to taxable years beginning on or after January 1, 2010.

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