

## NEW YORK TAX LAW CHANGES MAY AFFECT RESIDENT TRUSTS

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To Our Clients and Friends:

Recent changes in New York State law could have significant implications for New York resident trusts that have traditionally avoided New York taxation.

Historically, if a New York resident trust (*i.e.*, a non-grantor trust created by a New York domiciliary, either during his or her lifetime or at death under his or her Will) had no trustees domiciled in New York, no real or tangible property in New York and no income or gain from New York sources during a year, it was not subject to New York income tax for that year. Based on this rule, many New York resident trusts fulfill the property and income requirements by owning New York real property through an LLC, C corporation, S corporation, partnership or other entity. Under the former rule, intangible assets like these are sited at the domicile of the out-of-state trustee. So a New York resident trust owning stock in an S corporation that owned a house in New York would not generate New York source income by selling the S corporation stock.

However, under the new law, gain or loss from the sale of an interest in a partnership, LLC, S corporation or non-publicly traded C corporation with 100 or fewer shareholders that owns New York real property comprising at least 50% of the assets of the entity will be considered New York source income. The unexpected consequence is that a New York resident trust formerly not taxable in New York may find all of its undistributed income and capital gains subject to New York income tax for the year in which it sells such an interest. Assets contributed to the entity within two years of sale are not taken into account in determining whether more than 50% of the entity's assets consist of real property.

The new law may also affect New York resident trusts that invest in alternative assets such as private equity funds, as those funds may now generate New York source income if they sell portfolio companies that own New York real property. New York resident trusts should review their alternative investments and the holding structures for such investments in light of the new provision.

The new provision takes effect immediately, but will apply to sales or exchanges of entity interests occurring after May 7, 2009 (*i.e.*, 30 days after the date of enactment). Therefore, trusts considering a sale or exchange of interests in entities holding New York real property

should consider executing those transactions before May 7 to avoid subjecting all of the trusts' 2009 income to New York tax. Long-range planning for such interests should also be reconsidered.

If you have any questions, please feel free to contact any of the undersigned.

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