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Client Alert

A report for clients and friends of the Firm

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Advisory Opinion Addresses Conversion of Real Property into Intangible Assets By New York Non-residents To Avoid State Estate Tax

As we have previously reported, many states (such as California and Florida) no longer impose a state estate tax. Although the estates of residents of these states no longer have to pay state estate taxes to their resident state, they may still have to pay state estate taxes to other states (such as New York, New Jersey, Connecticut and Massachusetts) if the resident owned real property or tangible personal property (i.e., residences, furnishings, boats, etc.) in a state, such as New York, which still imposes an estate tax. For example, upon the death of a Florida resident who owns real or tangible personal property in New York, state estate taxes may be owed to New York.

If estate taxes will be owed to a state where real property or tangible personal property is owned, one way to ameliorate the impact of the state estate tax is to convert these assets into intangible assets. We previously have reported that one way to convert these assets into intangible assets is to transfer out-of-state assets to a partnership, limited liability company (LLC) or corporation and retain an interest in the entity as a partner, member or shareholder, respectively. Upon death, the estate only owns an interest in an entity, which may be considered an intangible asset, and thus, not subject to non-resident state estate tax.

The New York State Department of Taxation and Finance recently published an Advisory Opinion (TSB-A-08(1)M - the "Advisory Opinion") providing guidance on the conversion of real property or tangible personal property into intangible assets by non-residents of New York. The issue raised in the Advisory Opinion is whether a non-resident decedent's interest in either an S corporation or a single member LLC owning real property in New York is subject to New York State estate tax. The taxpayer was not domiciled in New York but was considering the purchase of a condominium situated in New York. The taxpayer requested guidance on the New York estate tax consequence of forming an S Corporation or single member LLC under Florida law and having the newly formed entity purchase the condominium (which is considered real property under New York law).

The Advisory Opinion concluded that an interest in an S Corporation owning New York real property is considered an intangible asset and, as a result, is not included in a non-resident decedent's New York gross estate so long as the corporation's purpose is the equivalent of a business activity or is followed by the carrying on of business by the corporation. If the corporation does not meet this "business purpose test," the value of the condominium would be included in the non-resident decedent's New York gross estate. Although not discussed in the Advisory Opinion, it is likely that a corporation formed for the sole purpose of owning assets would not meet the "business purpose test."

Likewise, the Advisory Opinion concluded that an interest in a single member LLC owning New York real property is also considered an intangible asset and, as a result, is not included in the non-resident decedent's New York gross estate so long as the single member LLC is treated as a corporation for Federal income tax purposes (an LLC will be treated as a corporation for Federal income tax purposes if certain elections are made with the Internal Revenue Service). However, the LLC would also have to meet the same "business purpose test" discussed in the prior paragraph.

As a result, if a non-resident of New York owns an interest in an S Corporation or a single member LLC (that elects to be treated as a corporation for Federal income tax purposes) that owns real property or tangible personal property, unless there is a business purpose, the interest in the entity will be included in the non-resident decedent's estate and, thus, will be subject to New York estate taxes.

We have been recommending to our clients that non-residents of New York utilize a multi-member LLC rather than a single member LLC. Although the Advisory Opinion does not address the utilization of a multi-member LLC, it is somewhat troubling that the Advisory Opinion requires a business purpose for the entity. It is conceivable that New York also would apply this "business purpose test" to a multi-member LLC.

It is important to note that an Advisory Opinion is limited to the facts set forth in the particular Advisory Opinion and is only binding with respect to the taxpayer to whom it is issued. It is also important to note that we are unaware of any existing New York law which indicates that a business purpose is necessary.

In any event, if in addition to the state where you are domiciled, you (1) own real property or tangible personal property in a state which has a state estate tax, or (2) own an interest in an entity which owns real property or tangible personal property in a state which has a state estate tax, please contact us immediately to discuss the impact of the Advisory Opinion on your particular situation.

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