

New York Imposes Estate Taxes on Non-Residents Owning New York Real Property

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New York imposes estate taxes on a non-resident who owns New York real property in his or her own name. In addition, the estate will have to be administered, at least in part, in New York to be able to transfer title to the distributee or legatee under the decedent's will (or, if there is no will, under the applicable intestacy rules).

In response to these pitfalls, non-residents have been advised to transfer their NY real estate interests to an entity such as a partnership, a corporation, or a limited liability company that elects to be taxed as a corporation or partnership. The reasoning? New York does **not** tax a non-resident on interests in personal property that are held outside of New York, nor on intangible personal property even if located in New York. If the non-resident transfers his NY real estate to an entity in exchange for an ownership interest in that entity, the non-resident should escape NY estate taxes on the real estate because the ownership interests in those entities are considered **personal** property, not **real** property (even though the entity's assets may consist entirely of New York real estate) under New York's tax laws.

Moving real estate into a corporation that elects to be taxed as a corporation may not get the best tax results, however, because upon the owner's death, the real estate does not receive a "step-up" in tax basis; the step-up would only apply to the corporate stock. Consequently, in most cases the better solution is to move the real estate into a partnership or a limited liability company that elects to be taxed as a partnership.

Individuals looking for the simplest solution are often advised to transfer title in NY real estate into a single member limited liability company (SMLLC). After all, under the reasoning above, because New York law recognizes any ownership interest in an LLC (even a SMLLC) as personal property and specifies that the LLC owner does not own any interest in the assets of the LLC (NY LLC Law Section 601), a 100% ownership interest in the SMLLC by a non-resident is still considered personal property and therefore should escape New York estate taxes.

But your heirs may have to fight that out with the NY Department of Taxation and Finance!! In a recent Advisory Opinion (which confirms a similar opinion issued in 2008), the Department ruled that unless the 100% owner of the SMLLC elects under the IRS's check-the-box regulations to have the SMLLC taxed as a corporation, the entity will be completely disregarded **for estate tax purposes** and the real estate held in the SMLLC will be subject to NY estate taxes. This flies in the face of a 2009 U.S. Tax Court opinion in *Pierre v. Commissioner*, where the Tax Court disagreed with the IRS's argument that a SMLLC entity must be disregarded and the real estate valued at full value when valuing the decedent's interests in the SMLLC (the decedent's estate had applied discounts to the value of the SMLLC on the decedent's estate tax return).

Note that this issue does not arise if the LLC is multi-member, since the LLC interests would be considered either interests in a partnership or a corporation (depending on the election, or default election, under the check-the-box regulations).

If you are a non-resident with New York real estate, you should keep in mind the Department's current thinking. Moving real estate into a SMLLC, while simple at the outset, may result in significant costs to the family in defending against NY's claim for taxes. You might consider using multi-member LLC's with others holding some interest. What if you transfer NY real estate into a limited partnership with a SMLLC as a 1% general partner and you retain a 99% limited partnership interest?

Before you embark on any of these options, we'd be happy to discuss the ramifications with you to come to an effective strategy.