

New York

Lawmakers: Tax Nonresident Hedge Fund Managers

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Hedge fund managers who work in New York but live in New Jersey or Connecticut would see a tax increase under a proposal being considered by the New York State Legislature.

Faced with a \$9.2 billion budget gap, lawmakers are pushing for a plan to tax the carried interest income of nonresidents who run investment management services. Under the bill, A 9710D/S 6601C, nonresidents' carried interests — income made from managing investments — would be treated as regular income and taxed accordingly. Under current law, nonresident investment fund managers pay New York taxes on their regular income but only pay taxes on their carried interest income in the state in which they live — usually New Jersey or Connecticut. The plan is expected to raise \$50 million for New York.

“All we're doing is creating parity between nonresidents and residents,” said Dan Weiller, spokesman for State Assembly Speaker Sheldon Silver (D).

New York's Fiscal Policy Institute agrees with that assessment and has been pushing for a change for at least a year. It doesn't make sense for small-business owners to pay taxes on all of their income if they are a passthrough entity while other businesses organized as a hedge fund or partnership pay tax on a portion of their income, said James Parrott, deputy director of the group.

“It's treating income from passthrough business entities the same across the board,” Parrott said. “We never thought it made sense to have special treatment for carried interest and never saw it as anything other than income.”

But hedge fund managers said the plan could lead to investors who commute to New York City simply keeping their business in their home states to avoid the tax change.

“New York wants to drive these businesses out of New York,” said Phil Goldstein, founder of Bulldog Investments. “Is that the goal?”

Moving business out of New York wouldn't be difficult, Goldstein said:

“A hedge fund does not require a lot. It's a business that's done mainly electronically; why do you have to be any particular place? It's not like an auto factory or something. You just move your computers and save a lot of money.”

If put into law, the plan could have a ripple effect on tax laws in New Jersey and Connecticut. Residents in those states who work as hedge fund managers in New York could be subject to double taxation if New Jersey and Connecticut don't change their tax laws or offer credits to offset taxes paid to New York.

The Connecticut Department of Revenue is studying the New York legislation and trying to determine how to proceed, spokeswoman Sarah Kaufman told Tax Analysts.

How to tax carried interests has been a hot topic at the federal level, where the U.S. House of Representatives has voted twice since 2006 to make carried interests subject to the same tax as ordinary income; carried interests are currently taxed as capital gains, at a lower rate.

One of the provisions of the American Jobs and Closing Tax Loopholes Act of 2010 (H.R. 4213) would have treated carried interests as a combination of capital gains and ordinary income. But the bill stalled in the U.S. Senate and has been abandoned for the foreseeable future.

Meanwhile, Connecticut Gov. M. Jodi Rell (R) is reportedly trying to woo hedge fund managers who might feel overtaxed by New York.

“Connecticut welcomes you!” Rell wrote in an open letter to New York-based hedge funds, according to *The Day* of New London, Conn. ☆