

## State Tax Observations

### New Jersey Carried Interest Tax

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New Jersey legislators recently amended the Gross Income Tax Act by adding a new surtax on carried interest earned in the state. This amendment under Assembly Bill 3088 aims to reclassify hedge fund and private equity fund allocations from being entitled to preferential rates to being taxed as ordinary earned income. This could lead to significantly higher income tax for investment managers whose income meets the statutory criteria.

The intent of New Jersey's new Carried Interest Tax is to account for the disparity in long-term capital gains tax rates with those of earned income rates on certain "investment management services" by assessing a 17% surtax on this income.

#### Timing

In an attempt to dissuade managers from relocating their funds to other jurisdictions, the new tax law is designed to remain in abeyance until such time that legislation of identical effect is passed in Connecticut, Massachusetts and New York. The surtax is also designed to expire with the passing of federal legislation having the same impact.

#### Who Is Affected

Income that is derived from "investment management services" will now be subject to the 17% surtax. Investment management services are defined as providing a substantial quantity of any of the following services to a partnership, LLC, S Corporation or other entity:

1. Consulting as to the advisability of investing in, purchasing or selling a specified asset;
2. Managing, acquiring, or disposing of a "specified asset;"
3. Arranging financing with respect to acquiring specified assets; or
4. Any activity in support of any of the services described in (1) through (3).<sup>1</sup>

Specified assets include securities, real estate held for rent or investment, interests in partnerships, commodities, or options or derivatives contracts. However, if at least 80% of the average fair market value of the specified asset of the partnership, S Corporation or other entity during the taxable year consists of real estate, the return on said assets are excluded from the calculation of "investment management services".<sup>1</sup>

#### Who Is Not Affected

The surtax will not be assessed on:

1. C Corporation partners or shareholders, since presumably a C Corp does not receive the benefit of preferential rates.

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<sup>1</sup> New Jersey State, Legislature. P.L. 2018, Chapter 45, A.3088(2)(a),(b),(c),(d)

2. A partner or shareholder's return on their capital investment, as this is considered conventional investment return, not a carry.
3. Return on a partnership interest, where receipt of the interest was subject to tax under Section 83 of the IRC.

## Potential Implications

This new legislation, along with the proposals currently on the floors of the other requisite state legislatures, are inherently complex with regard to considerations of multistate income nexus and their calculations thereof. Upon enactment of identical effective laws across the specified jurisdictions, passthrough entities may be required to file supplementary forms or supply additional information to the states. Consult your tax professional to determine exactly how this new law may apply under your particular circumstances.

## Contact Us

If you have questions regarding how these rules may apply to your organization, contact the partner named below or any member of your client service team at PKF O'Connor Davies.

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