

N.J. and Nonresident Partner Tax Implications

State tax planning is becoming increasingly more important. In addition to business taxes, taxpayers need to be aware of many other potential tax liabilities, including, but not limited to, real property transfer taxes. In addition, mandatory withholding requirements for nonresident partners of partnerships are becoming more prevalent. There is much confusion as to when withholding is required and when it is not. Below are two scenarios along with New Jersey's position on both.

Scenario A

An LLC (X) distributes real property owned by the partnership to the partners who then contribute the property to a newly formed LLC (Y) with the same ownership percentages as X. Will the transfer be subject to the New Jersey real property transfer tax?

Under N.J.S.A. 46-15-5(a), New Jersey imposes the real property transfer tax on grantors of title to land, tenements or other real property that is sold, assigned or transferred. However, under N.J.A.C. 18:16-5.1, the state allows the recording of a deed without the payment of the transfer tax in certain circumstances.

Some of these exemptions are:

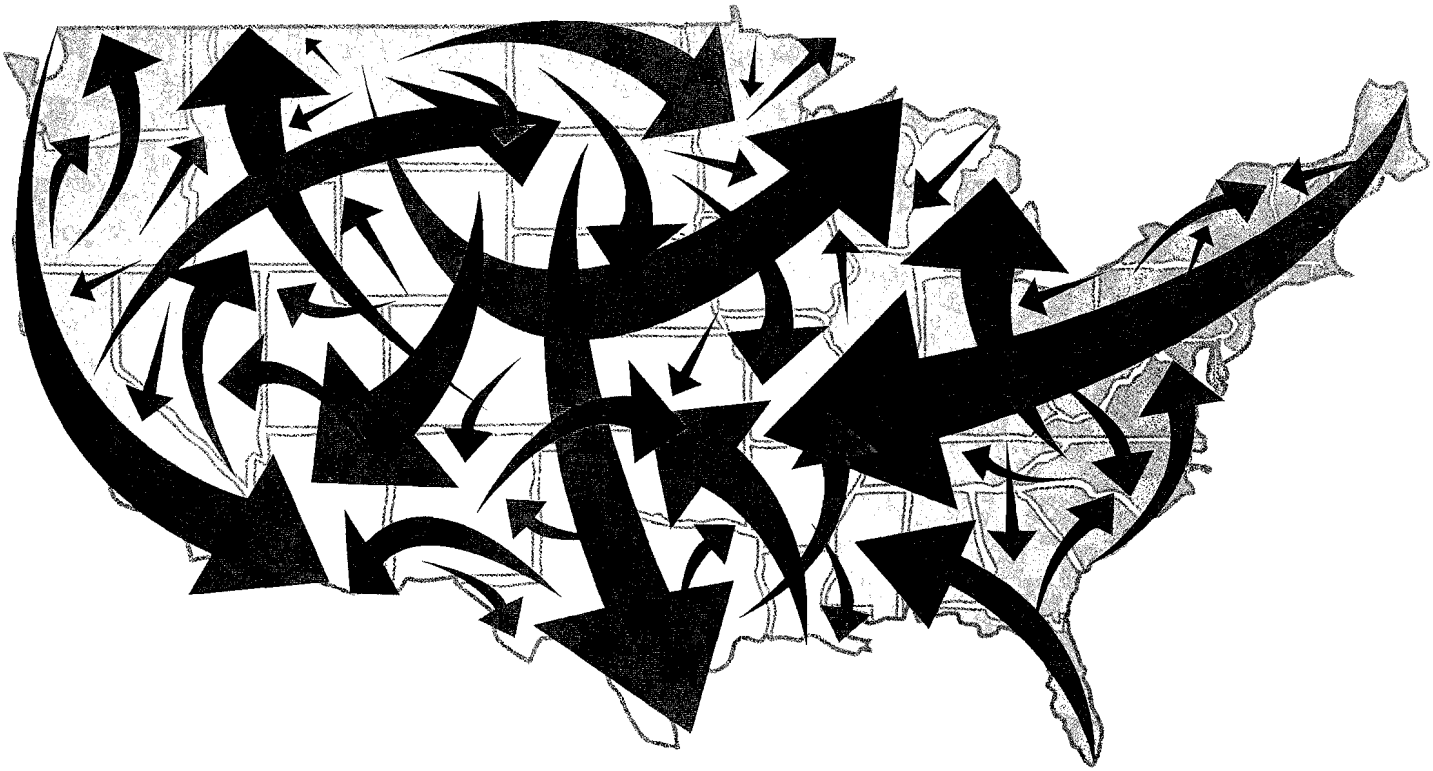
- For consideration of less than \$100.
- By or to the United States of America, New Jersey or any instrumentality, agency or subdivision thereof.

- Solely in order to provide or release security for a debtor obligation.
- To confirm or correct a previously recorded deed.
- On the sale for delinquent taxes or assessments.
- On partition.
- By a receiver, a trustee in bankruptcy or liquidation, or an assignee for the benefit of creditors.
- Between husband and wife or parent and child.
- Conveying a cemetery lot or plot.
- In specific performance of a final judgment.
- Releasing a right of reversion.
- By an executor or administrator of a decedent to a devisee or heir to affect distribution of the decedent's estate in accordance with the provisions of the decedent's will or the intestate laws of New Jersey.
- Recorded within 90 days following the entry of a divorce decree that dissolves the marriage between the grantor and grantee.

As the regulation indicates, there is no exemption provided from the realty transfer fee for real property transferred from an existing partnership to its partners, who then contribute the real property to a new LLC. Accordingly, without a specific statutory or regulatory exemption, the transfer of the real property from X to its partners will be subject to the New Jersey realty transfer fee even though the real



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property is transferred to a new LLC, regardless of the ownership structure.

Under N.J.A.C. 18:16-5.9(a), in the case of a transfer of real property to partners by a partnership in liquidation, no attempt will be made to project value on the basis of consideration passing between grantor and grantee, since such a transaction, in general, represents a return of capital. In addition, this regulation provides that a transfer made in liquidation is not subject to the transfer fee if there is no consideration involved. Thus, in the event that there are no mortgages, liens or other encumbrances on the property, the transfer of real property will not be subject to any realty transfer fees. Therefore, the distribution of real property from X to the partners would be subject to the transfer tax, unless the transfer is made in a total liquidation of the LLC.

Scenario B

An LLC (X) only holds marketable securities. Will the investment income earned on the marketable securities be subject to the New Jersey nonresident partner gross income tax withholding rules?

X should be treated as a hedge fund for New Jersey purposes, which means

withholding of gross income tax for the nonresident partners will not be required.

When determining income from sources within New Jersey, N.J.S.A. 54A:5-8(c) provides that nonresident taxpayers are not deemed to be carrying on a trade, profession, business or other activity in the state or to be providing personal services in the state if the business activity is limited only to the purchase, holding and sale of intangible personal property. In addition, the business activities related to the intangible personal property must only be for the account of the business, and the business cannot hold the intangible personal property for sale to customers.

Intangible personal property includes, but is not limited to, commodities and securities, as defined in Internal Revenue Code Sec. 475(c)(2), and includes the purchase, holding and sale of intangible personal property, including activities that are incidental to the income earned from commodities and securities. These incidental activities include, but are not limited to, commitment fees, breakup fees and income from securities lending.

Accordingly, income earned by nonresident taxpayers through the purchase, holding and sale of intangible personal property is not subject to the

New Jersey gross income tax. The fact that this activity occurs through a New Jersey partnership does not change the taxability of the income. Therefore, since the income is not taxable in New Jersey, there is no withholding requirement for the nonresident partners of X. ❏

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