

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

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Corporation Tax
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**New York State Tax Treatment of Employee Trusts
for Purposes of the Unrelated Business Income Tax**

Based on the May 23, 2006, decision of the United States Court of Appeals for the Second Circuit in *Hattem v. Schwarzenegger* (449 F.3d 423, 37 Employee Benefits Cas. 2436), the New York State Department of Taxation and Finance has concluded that an employee trust as described in section 401(a) of the Internal Revenue Code (IRC) is subject to New York State's Unrelated Business Income Tax (UBIT) imposed by Article 13 of the Tax Law if it is carrying on an unrelated trade or business in New York State.

In 2003, the New York State Tax Appeals Tribunal held in Matter of McKinsey Master Retirement Plan Trust (May 8, 2003, DTA 817551) that employee trusts described in section 401(a) of the IRC are exempt from New York's UBIT because the federal Employee Retirement Income Security Act of 1974 (ERISA) prohibits taxation of such trusts under Tax Law Article 13.

On May 23, 2006, the United States Court of Appeals for the Second Circuit in *Hattem v. Schwarzenegger* (449 F.3d 423) determined that an employee trust described in section 401(a) of the IRC is subject to California's tax on unrelated business taxable income. The court ruled that ERISA does not prohibit taxation of such employee trusts by California. Since the New York UBIT is substantially similar to California's tax on unrelated business taxable income, the issue before the court was the same as the issue before the Tax Appeals Tribunal. Furthermore, since New York State is part of the Second Circuit and the issue concerns the interpretation of a federal statute, it is the Tax Department's position that the United States Court of Appeals decision supersedes the decision of the tribunal. In addition, the United States Court of Appeals specifically mentioned the Tribunal case and rejected the reasoning of the Tribunal.

Therefore, any employee trust described in section 401(a) of the IRC that is carrying on an unrelated trade or business in New York State must file returns (Form CT-13, *Unrelated Business Income Tax Return*) and pay the UBIT for tax years beginning on or after January 1, 2006.