Private Client Alert

March 2025

NY Legislature Considers Change to Income Tax Status of QSBS

New York state tax law currently provides that a New York resident person, including a trust, that owns stock that is qualified small business stock (QSBS) under Section 1202 of the Internal Revenue Code is exempt from state income tax on the proceeds of the sale of the QSBS to the same extent that the taxpayer is exempt under federal law. The New York State Senate recently included in its 2026 – 2027 budget a proposal to tax capital gains on sales of QSBS that would "decouple" New York's treatment of QSBS from the federal exemption under IRC Section 1202. As proposed, the decoupling would be retroactive to Jan. 1, 2025 (15 months ago).

The proposal is not yet final. Part of the Senate's One-House Budget Resolution, it is subject to negotiation with the State Assembly until April 1, the deadline for passing the budget and by which the final proposal needs to be presented in the Legislature.

If the QSBS exclusion becomes unavailable to New York resident trusts for state income tax purposes, taxpayers and trustees should consider whether their trusts can avoid income tax on gains from the sale of QSBS by qualifying as "exempt resident trusts" under New York law. Exempt resident trusts fall under a narrow exception in the tax laws that provides that New York resident trusts are not subject to state income tax if they have (1) no New York fiduciaries, (2) no New York source income, and (3) no New York real or tangible property. The rules are complex and nuanced, however, and planning needs to be undertaken well in advance of any transaction.

If you are a New York resident or were a New York resident at the time you created an irrevocable trust that owns QSBS, please reach out to discuss planning for the potential tax consequences..

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