Fust Charles Chambers LLP
CERTIFIED PUBLIC ACCOUNTANTS

NEW YORK STATE ENACTS PASS-THROUGH ENTITY TAX ELECTION

On April 19, 2021, New York Governor Andrew Cuomo signed into law the FY 2022 budget, which includes a Pass-Through Entity Tax ("PTET") election. Similar to the New Jersey Business Alternative Income Tax, this will allow businesses in New York a workaround to the $10,000 state and local tax ("SALT") deduction limitation imposed by the Tax Cut and Jobs Act ("TCJA").

The fiscal year 2022 budget legislation is wide-ranging and provides a number of changes to the state's corporate and personal income tax provisions. Some of these changes include an increase to personal income tax rates, an increase to corporate income tax rates, the postponement of the scheduled phase-out of the business capital tax, and the creation of the pass-through entity tax election.

The election is effective for tax years beginning on or after January 1, 2021. The new PTE election is in keeping with IRS Notice 2020-75, which permits these types of elective PTE regimes that help individuals avoid the $10,000 SALT cap on the federal deduction, as enacted under the Tax Cuts and Jobs Act of 2017.

Mechanics of NYS PTE Tax Election

Generally, PTEs must make an annual, irrevocable election by the due date of the first estimated quarterly payment, which would be March 15 of each year, to opt into the PTE tax. However, for tax year 2021 only, the election must be made by October 15, 2021.

For S corporations, the election must be made by any authorized officer, manager or shareholder. For partnerships, the election must be made by any member, partner, owner or other individual with authority to bind the entity or sign returns.

NYS S corporation shareholders, partners and members are jointly and severally liable for unpaid NYS PTE taxes owed by electing PTEs.

Tax Base and Allocation of Income (Loss) to NYS

An electing PTE's "taxable income" includes the income, gain, loss or deduction derived from or connected with New York sources to the extent included in the taxable income of a nonresident partner, resident partner or New York State S corporation shareholder subject to tax under Article 22 of the personal income tax provisions of the New York Tax Law. The allocation provisions presumably would follow the current partnership allocation formulas under current NYS rules.

Tax Rate

The PTE tax is imposed at graduated rates from 6.85% on the first $2 million of a PTE's taxable income up to a maximum of 10.9% on taxable income in excess of $25 million.

Credit for PTE Taxes Paid

The direct partners, members or NYS S corporation shareholders of an electing PTE will be allowed a NYS personal income tax credit for their proportionate share of the NYS PTE tax paid by the entity. If the credit exceeds the personal income tax due for the applicable tax year, the excess will be treated as a refundable overpayment.

PTE owners also may claim multiple credits for all PTEs that have properly elected to pay the NYS PTE tax. Additionally, NYS individual residents will be allowed a credit against their NYS personal income tax due for all other "substantially similar" state PTE taxes paid to other states by the PTE on their distributive share of income included in their NYS resident return.

Credits are not allowed if the electing PTE does not provide sufficient contact information for its owner, as required under the new bill.

Returns, Due Dates and Estimated Payments

The NYS PTE tax return is due on or before March 15 following the close of the taxable year. Extensions may be granted for up to six months by the NYS Commissioner of Taxation and Finance. Electing PTEs cannot file an amended return without the commissioner's consent or authorization.

Quarterly estimated payments are required for electing PTEs. The required annual payment amount is the lesser of 90% of actual tax owed or 100% of the electing PTE's tax owed in the previous year. As a result, estimated payments are not required for 2021, as it is the first year eligible for PTE elections.

Insights

- The TCJA limited the state and local tax (SALT) deduction available to individuals on their personal income tax returns to $10,000. NYS is the most recent state to attempt to enact a workaround to the TCJA's SALT deduction limitation with an elective PTE tax. Similar bills are pending in other states, including California and Massachusetts.

- State PTE tax elections are of two basic varieties. "Group 1" states (Alabama, Arkansas, Louisiana, Oklahoma and Wisconsin) impose income tax only on the electing PTE. Resident and nonresident owners are not taxable on their distributive shares of PTE income. Thus, a pass-through tax credit is not necessary. New York chose the "Group 2" model of PTE tax elections with a pass-through tax credit similar to Maryland's, New Jersey's and Rhode Island's.

- When allowing credits for other state PTE taxes paid, it will be interesting to see what NYS considers to be "substantially similar." Are the Group 1 states that reduce an individual's taxable income substantially similar to the Group 2 states that provide for a credit? What about jurisdictions like the District of Columbia, New York City, Tennessee, and Texas that have historically imposed entity-level taxes on PTEs? These questions have not been answered.

- Before making a state PTE tax election for NYS or any other state, it is important to model the tax impact resulting from the election, both to the entity itself, but more importantly to the owners, particularly nonresident owners. Among other important considerations, an analysis should be completed to determine whether nonresident owners will be afforded tax credits by their residence state for a share of the PTE tax that was paid by the entity to NYS and/or other PTE tax election states.

We will continue to monitor New York Department of Taxation and Finance's further guidance on this, in the meantime businesses should weigh the potential benefits along with the risks in determining the right course of action. Contact your Fust Charles Chambers LLP engagement team for further assistance.