

## State Tax Observations

# New York State Pass-Through Entity Tax: An Overview (So Far)

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In keeping with its northeast neighbors, namely Connecticut and New Jersey, New York State (NYS) enacted a pass-through entity (PTE) tax. Effective for tax years beginning on or after January 1, 2021, eligible pass-through entities that make the election will pay income tax at the entity level rather than at the individual level. New York's PTE tax provides certain individual taxpayers a viable workaround of the 2017 Tax Cuts and Jobs Act's \$10,000 State and Local Tax (SALT) deduction limitation.

### Eligible Entities

Eligible entities include partnerships and limited liability companies (LLCs) that elect to be treated as partnerships for federal income tax purposes, NYS S corporations and LLCs that elect to be treated as a NYS S corporation whose shareholders are solely individuals. A single member LLC is ineligible to make a PTE tax election.

### Election

For S corporations, in order to be effective, an annual irrevocable election must be made by an authorized officer, manager, or shareholder. For other than S corporations, the election must be made annually by any member, partner, owner, or other individual with authority to bind the entity or sign returns.

For calendar year entities, to be effective for 2021, the election must be made by October 15, 2021. For years after 2021, the election must be made by March 15th of the calendar year to which the election relates.

### Tax Rates

The tax rates are graduated based on PTE income which ranges from 6.85% on \$2 million or less to 10.9% on PTE income over \$25 million.

### Pass-Through Entity Income

For LLCs and partnerships that elect to pay the PTE tax, the entity's NYS income would include (A) all partnership income for resident partners regardless of where earned, plus (B) non-resident partners' NYS source income derived from the entity based upon the entity's NYS allocation percentage averaging the wage, property and sales factor percentages.

For electing S corporations, PTE income is NYS source income apportioned to NYS based on the corporation's percentage of sales in NYS.

### Disregarded Entities

If a PTE is owned by a disregarded entity and the owner of the disregarded entity is an individual, the distributive share of the PTE's income is included in the tax base. However, the PTE must provide the name and tax ID number of the ultimate individual owner to the New York Department of Taxation and Finance so that the PTE tax credit can be passed through to the owner.

## Filing Due Date

For calendar year PTEs, the return and payment is due March 15th following the close of the tax year. For fiscal year PTEs, the return is due March 15th following the close of the calendar year that contains the final day of the PTE's tax year.

## Estimates

For 2021, no estimates are required to be made by the PTE. However, partners and shareholders of electing entities must compute their 2021 estimate NYS personal income tax payments as if they will not receive any PTE tax credit. Correspondingly, penalties for underpayment of such estimated taxes are computed as if the partner or shareholder was not entitled to a credit.

For years after 2021, four equal installments are due from the PTE on March 15th, June 15th, September 15th and December 15th.

## NYS Income Modification

For NYS personal income tax purposes, an addition modification must be made to NYS income equal to the amount of NYS PTE credit.

## Credit in NYS

A PTE tax credit for individual owners (not corporate partners or other partnerships) is available based on their NYS taxable income which it will pass through to them. This credit will be claimed as a refundable tax credit against the individual owner's NYS income tax liability.

Moreover, for tax years beginning in 2021 and thereafter, a NYS resident who is a partner/LLC member in a partnership/LLC or shareholder in a NYS S corporation doing business in another state and such entity is subject to a similar tax, can claim credit against their NYS tax for their share of the other state's PTE tax.

## Will Other States Give a Resident State Credit for NYS's PTE Tax?

If the individual owner lives in Connecticut or New Jersey, those states will likely allow a credit for NYS PTE tax. Currently, Pennsylvania is taking the position that partners in partnerships cannot claim a credit for an entity-level tax but S corporation shareholders can.

## Questions/Observations

- For partnerships and LLCs, federal taxable income is generally allocated based on the allocation provisions in the entity's operating agreement. Hence, the PTE tax paid by the entity is allocated in the same manner. Therefore, such entities may want to consider updating their operating agreements to have this deduction specially allocated only to individual partners in accordance with their share of PTE income.
- For 2021, an electing PTE must pay its PTE tax no later than March 15, 2022. However, entities using the cash method of accounting and some accrual method entities will not be able to deduct the 2021 PTE tax on their 2021 returns unless they actually pay the tax in 2021. At the same time, on the same income as discussed above, partners and shareholders of electing entities must pay their 2021 estimated NYS personal income tax quarterly throughout 2021. This combination results in duplicative payments for an extensive period of time, particularly for those filing and taking their PTE credit as late as the extended due date of October 15, 2022.
- There appears to be an inconsistency in the law regarding calculating PTE estimates. As stated above, one law section provides that the PTE pay four quarterly "equal" estimates. However, another section of the law provides that all laws that cover individual income taxes apply. Thus, the provision that allows annualizing income in computing quarterly estimates would apply.
- There also appears to be an inconsistency in the law between the PTE tax and the PTE tax credit. Certain law sections provide that only a "direct" partner or shareholder is eligible for the PTE tax

credit equal to their direct share of the PTE tax. However, another law section provides that the PTE tax base does not include the word "direct." This could cause an issue, for example, where a partnership consisting of NY residents and another unrelated individual own an indirect interest in another partnership and both partnerships make the PTE election.

## Contact Us

Eligible entities may want to consider whether their partners, members or shareholders may benefit from making the NYS PTE election. Also, there are numerous issues remaining to be resolved. If you have any questions or need assistance regarding the NYS PTE, or state taxes generally, contact your client partner or the following:

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