

MEMORANDUM

DATE: October 8, 2021
TO: File
FROM: Wendy J. Manson, CPA and William J. Palazzolo, Esq.
RE: NY Pass-Through Entity Tax

Conclusion

The PTET election should be made by New York entities that have New York partners or shareholders that have their state and local taxes limited by the SALT cap deduction. The election is made by the taxpayer through their Business Services Account and is an annual election. For 2021 only, the annual election is due by October 15, 2021, otherwise, the subsequent annual election is due by March 15th.

A payment of the estimated tax liability for the PTET needs to be made by December 31, 2021 to be deductible by the PTE. Currently there is no form available to make a payment, however, per the NYS Tax Department, an online estimated tax application for PTET will be available by December 15, 2021.

If you are an owner of multiple pass-through entities, you should be making this election only for the entities that generate taxable income. Do not make this election for an entity that will be generating a taxable loss.

The IRS currently is not challenging this work-around but this could change in the future. The IRS has only announced intentions to issue regulations that clarify the deductibility of these NYS tax payments but as of the date of this memo, have not issued such regulations.

Please call us to discuss your individual tax situation if you have any specific questions.

Overview

New York's 2021-2022 Budget Act includes a new elective pass-through entity tax (PTET). This type of tax has been enacted by a number of states and is generally designed in response to the \$10,000 cap on the federal state and local tax (SALT) deduction as added by the Tax Cuts and Jobs Act (TCJA) in 2017.

The SALT deduction limitation

Internal Revenue Code ("IRC") section 164(b)(6), as added by the TCJA, limits an individual's SALT deduction to \$10,000 for the aggregate amount of the state and local taxes paid during the calendar year including: real property taxes, personal property taxes, income taxes, and general sales taxes. The limitation does not apply to real and personal property taxes paid or accrued in carrying on a trade or business or an activity described in IRC section 212 (relating to expenses for the production of income). This SALT deduction limitation applies to taxable years beginning after December 31, 2017, and before January 1, 2026.

In Notice 2020-75, the Department of the Treasury and the Internal Revenue Service announced an intention to issue proposed regulations to clarify that state and local income taxes imposed on and paid by a partnership or an S corporation (each, a PTE) on its income are allowed as an entity-level deduction in computing non-separately stated taxable income or loss for the taxable year of payment. Furthermore, such payments made by a PTE to a state/local jurisdiction generally are not taken into account in applying the SALT deduction limitation to any individual who is a partner in the partnership or a shareholder of the S corporation.

New York's pass-through entity tax

New York's PTET was enacted in new Article 24-A effective for taxable years beginning January 1, 2021, and is generally applicable to partnerships, limited liability companies treated as partnerships for federal income tax purposes, and New York S corporations (including limited liability companies treated as S corporations for federal income tax purposes that make the New York S corporation election).

Taxpayers generally must make an annual PTET election by March 15 of the tax year, at the same time that the first quarter estimated payment is due. However, for 2021, the election is due on October 15, 2021 and must be made by the taxpayer. The PTE would generally need to pay its PTET liability during calendar year 2021 to be deductible on the 2021 federal return of the PTE and to qualify for the federal SALT tax workaround under Notice 2020-75. Once an election is made for a year, it cannot be revoked.

If you wish to participate in the optional PTET for 2021, the deadline to opt in is October 15, 2021.

To opt in:

1. Log in to your S corporation's or partnership's Business Online Services account. (If the business doesn't have an account, NYS Tax Department recommends creating one by October 8 to avoid missing the election deadline.)
2. Select the *Services* menu in the upper left corner of your *Account Summary* homepage.
3. Choose *PTET web file* from the *Corporation tax* or *Partnership tax* expanded menu, then select *Pass-through entity tax (PTET) annual election*.

Reminder: Per NYS Tax Department, tax professionals cannot make the election on behalf of their clients. The client must opt in themselves.

For each taxable year beginning on or after January 1, 2021, the tax rates are graduated based on total taxable income of the PTE:

| Pass-through entity taxable income | Rate |
|--|---|
| Not over \$2 million | 6.85% |
| Over \$2 million but not over \$5 million | \$137,000 plus 9.65% of the excess over \$2 million |
| Over \$5 million but not over \$25 million | \$426,500 plus 10.30% of the excess over \$5 million |
| Over \$25 million | \$2,486,500 plus 10.90% of the excess over \$25 million |

The PTET is based on income attributable only to partners/shareholders subject to tax under Article 22 (i.e., individuals, trusts and estates). However, PTEs can still elect the PTET if they have partners/shareholders that are partnerships, corporations (not applicable for S corporations), or tax-exempt entities; income attributable to those non-Article 22 partners would not be taken into account in computing PTE taxable income, which is defined as:

- For partnerships, all income from New York sources included in the taxable income of a non-resident partner and all income included in the taxable income of a resident partner.
- For S corporations, all income (attributable to both resident and non-resident shareholders) from New York sources.

The income referred to above would take into account New York addition and subtraction modifications, as applicable (such as decoupling from bonus depreciation). PTET returns cannot be amended without the consent of or otherwise authorized by the Commissioner.

A partner/shareholder of an electing PTE is entitled to a credit against New York personal income tax equal to such partner's/shareholder's "direct share" of the PTET. The New York PTET credit is a dollar for dollar credit. A partner/shareholder who claims a PTET credit must add back the amount of the credit, increasing federal adjusted gross income by such amount in computing New York taxable income.

Beginning in 2021, New York residents can claim a credit for entity-level taxes paid to other states that are "substantially similar" to the New York PTET on account of income both derived from such other state and subject to tax under Article 22. As states have enacted their own unique PTETs, it is not clear how "substantially similar" may be interpreted.

While New York has enacted a credit for New York residents for tax paid to other states, other states may not provide such a credit. As a result, in considering whether to elect into New York's PTET, eligible entities should consider whether New York non-resident partners/shareholders may be able to use New York's PTET credit against the personal income tax in their home states and whether the federal tax benefit would cause a PTE's election of New York's PTET to be favorable regardless of a non-resident's home state benefit.

Electing PTEs generally must make quarterly estimated payments based on the expected income of the PTE. For 2021, such payments are not required, although, as noted above, full payment of the PTET by the PTE generally would be necessary under Notice 2020-75 to qualify for the federal SALT deduction. In addition, for 2021, taxpayers under Article 22, who are partners/shareholders of electing PTEs, must continue to make estimated payments as required by Article 22, calculated as if they were not entitled to the tax credit allowed under the PTET. This double payment of tax will likely create a refundable overpayment for partners/shareholders, which may be partially or fully subject to federal income tax in the year received.

Regarding liability for tax, while the electing PTE is liable for the PTET due, partners/shareholders generally are severally liable for the PTET to the extent not paid by the electing PTE for the partner's/shareholder's direct share of the PTET.

However, a partner/shareholder may be jointly and severally liable for the PTET if the partner/shareholder:

- is a general, managing or controlling partner of the electing partnership;
- is a managing or controlling shareholder of the electing S corporation;
- owns greater than fifty percent of the interests or profits of the electing PTE;
- is under a duty to act for the electing PTE in complying with the provisions of New York Tax Law addressing the PTET; or
- is the individual that made the election on behalf of the electing PTE.

Conclusion

The PTET election should be made by New York entities that have New York partners or shareholders that have their state and local taxes limited by the SALT cap deduction. The election is made by the taxpayer through their Business Services Account and is an annual election. For 2021 only, the annual election is due by October 15, 2021, otherwise, the subsequent annual election is due by March 15th.

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