DAVIS + GILBERT

Taxation

New York State Introduces Elective Pass-Through Entity Tax

The Bottom Line

- Pass-through entities with New York income should examine whether to elect into the PTE Tax to potentially reduce the taxes of their owners.
- Those considering the election should consider whether the taxes are creditable against state taxes for non-residents.

S corporations and partnerships should be aware of a new election that may allow them to reduce the federal income tax of their New York individual owners. New York State's budget for the fiscal year 2022, which was signed into law on April 19, 2021, includes an elective pass-through entity tax (the PTE Tax) with an offsetting credit to the individual owner's state income tax.

The PTE Tax is designed to circumvent the 2017 Tax Cuts and Jobs Act's limitation on the deductibility of state and local taxes. Given IRS Notice 2020-75, which clarified that both elective and mandatory state pass-through entity taxes remained fully deductible at the federal level, it appears the PTE tax presents opportunities for pass-through entity owners who pay New York taxes, but there are also potential issues to consider.

Electing the PTE Tax

Pass-through entities must elect the new PTE Tax by the following deadlines:

- 2021 taxable year: October 15, 2021.
- All subsequent years: No later than the entity's first estimated tax payment date (March 15, for calendar-year taxpayers.)

For the 2021 taxable year no estimated tax payments are required with respect to the new tax. For years after 2021, the PTE Tax must be included in the entity's estimated tax payments for the year.

The PTE Tax allows pass-through entities to pay a graduated income tax at the same rate as individual taxpayers (6.85% to 10.90%) on:

- The taxable income of the entity allocable to New York resident individual partners; and
- New York source income allocable to non-New York resident individual partners.

However, the PTE Tax rate is determined based on the entity's total New York-allocable taxable income, rather than that of an individual partner. Therefore, it is possible for the PTE Tax rate to be higher or lower than an individual partner's tax rate. The amount of the PTE Tax paid by the pass-through entity is creditable by an individual taxpayer against their New York State income tax liability, and is refundable should the tax exceed the individual's New York State income tax.

Further Considerations

The PTE tax has the potential to reduce federal income taxes of certain New York State resident partners and shareholders in S Corporations (or non-residents with New York State sourced income). However, entities considering electing the PTE Tax should consider whether it is creditable against the individual income tax liability of their non-New York resident owners in their states of residence to avoid the elective tax potentially increasing the owners' individual income tax.

For More Information

Please contact the attorneys listed below or the Davis+Gilbert attorney with whom you have regular contact.

Stephen P. Foley

Partner
212 468 4893
sfoley@dglaw.com

Benjamin Snow

Associate
212 468 4844
bsnow@dglaw.com