



MULTISTATE INCOME/FRANCHISE TAX

Overview of New York's new pass-through entity tax Tax Alert

Overview

New York's 2021-2022 Budget Act (including [S2509C/A3009C](#), among other bills) enacted on April 19, 2021, 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.

This Tax Alert summarizes the new PTET and highlights some open issues.

The SALT deduction limitation

Internal Revenue Code ("IRC") section 164(b)(6), as added by the TCJA, limits an individual's deduction under section 164(a) 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, notwithstanding that the PTE's tax payments are creditable against the individual's state income taxes.

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. The PTE would generally need to pay its PTET liability (or be deemed to have paid under the so-called “recurring-item exception”) during calendar year 2021 to qualify for the federal SALT tax workaround under Notice 2020-75 and to be deductible on the 2021 federal return of the PTE. Once an election is made for a year, it cannot be revoked.

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 PTE tax. 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 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.

In subsequent years, it appears that an electing PTE may be relieved of the estimated payment requirements under N.Y. Tax Law section 658(c)(4), as estimated payments from the PTE required under N.Y. Tax Law section 864 (together with other credits, as applicable) may reduce amounts otherwise due and potentially eliminate such obligation. In addition, due to PTET required estimated payments (which may be at a higher rate than the rate applicable to its partners/shareholders), partners/shareholders of the PTE may be entitled to a personal income tax refund.

The PTET return is due on March 15 following the close of the taxable year (with an extended due date of September 15) for both calendar year taxpayers and fiscal year taxpayers. Every return filed must include a certification by an individual authorized to act on behalf of the electing PTE that the PTE: (1) made a timely, valid election to be subject to the PTET; and (2) that all statements contained therein are true. The PTET return would include:

- Identifying information of all partners/shareholders eligible to receive a credit;
- Each partner’s/shareholder’s share of the PTET imposed on the electing PTE; and
- For a partnership, each partner’s distributive share of the PTE taxable income and the classification of each partner as a resident or non-resident for purposes of calculating the PTE taxable income.

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.

These provisions should be considered carefully so that responsible party partners/shareholders are aware of their obligations.

Considerations

As New York's PTET applies for taxable years beginning January 1, 2021, and the election for 2021 is due on October 15, 2021, eligible entities may want to consider whether their partners/shareholders may benefit from electing into the new tax. This analysis would include the value of the federal tax benefit as well as the potential ramifications to non-resident partners/shareholders who may or may not be entitled to a personal income tax credit in their home states for tax paid to another state.

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