

SALT Deduction Limitation Bypass via Pass-Through Entity Tax Election (NY Tax Law Sections 860-866 under Article 24-A Pass-Through Entity Tax)

Background:

In response to the \$10,000 SALT deduction limitation imposed on individual federal income tax returns, states began enacting a substitute state-level income tax on pass-through entities (“PTE”). The IRS released Notice 2020-75 which stated that the PTE tax would be deductible at the entity level and included as part of non-separately stated income, with the PTE tax payment not being taken into account in applying the SALT deduction limitation to any individual partner/shareholder. The IRS intends to issue proposed regulations with these details, and states that the rules described in this notice apply to PTE tax payments made on or after November 9, 2020.

Along with a commensurate response from many other states, NYS has enacted a PTE tax as part of the state’s 2021-2022 budget through Article 24-A. NYS’s PTE tax is effective for tax years beginning on or after January 1, 2021. NYS introduced Technical Memorandum TSB-M-21(1)C on August 25, 2021, to provide an explanation of this tax law.

What entities are eligible?

Entities that are eligible to make these tax payments include all non-publicly traded partnerships, limited liability companies treated as a partnership, any NYS S corporation, and limited liability companies treated as an S corporations for federal tax purposes.

How is the election made?

An irrevocable election to file and pay the PTE tax is made annually and is effective for the entire taxable year. An authorized person can opt into the PTE tax on behalf of the entity through the entity’s Business Online Services account. The election may be made at any time during the preceding taxable year of the pass-through entity or at any time during the taxable year of the pass-through entity and on or before the 15th day of the 3rd month of such taxable year (the election must be made by the due date of the first estimated payment). For the 2021 tax year only, the election must be made by October 15, 2021. This date is also applicable to fiscal year filers if their final date of the entity’s taxable year falls before December 31, 2021.

The election can be made only by authorized individuals. In the case of an S corporation, this includes officers, managers or shareholders authorized either under law or by the entity’s organizational documents. For all other qualifying entities, the partners/members with the authority to bind the entity or sign returns may make the election. A partner/shareholder eligible to claim a credit pursuant to N.Y. Tax Law § 606(kkk) is severally liable for the partner/shareholder's direct share of the pass-through entity tax imposed on the electing partnership/S corporation to the extent the tax is not paid. The partner/shareholder is jointly and severally liable for the tax imposed on the electing partnership/S corporation if the partner/shareholder:

- is a general, managing, or controlling partner/shareholder;
- owns more than 50% of the interests or profits of the electing partnership/S corporation;

- is under a duty to act for the electing partnership/S corporation regarding compliance with the pass-through entity tax; or
- is the individual who made the election on behalf of the electing partnership/S corporation.

The PTE tax 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 PTE tax if they have owners that are partnerships, corporations, or tax-exempt entities; income attributable to those non-Article 22 partners would not be taken into account in computing PTE taxable income (NY Tax Law Section 860(g) and (h)). A partnership must not include in its PTE taxable income any amounts of income, gain, loss, or deduction that flow through to a direct partner that is a partnership or an entity not subject to tax under Article 22, even if the income is ultimately taxable to a partner under Article 22 through tiered partnerships. Thus, a lower-tier partnership could not include the items of income, etc., attributable to corporate shareholders or upper-tier partnerships — even if they are ultimately owned by individuals. However, the upper-tier partnership would be able to include its share of the lower-tier partnership's income in its PTE tax base.

What are the requirements once elected?

Four equal and timely estimated tax payments must be made for every quarter of the year. The payments shall be the lesser of: 90% of current year tax according to the return, or 100% of the electing entity's prior year tax, to avoid interest/penalties being assessed. If the electing entity did not make the election to be subject to the PTET for the preceding PTET year, the required annual estimated tax payment is 90% of the PTET required to be reported on the return for the taxable year. Fiscal year entities must follow the same due dates as calendar year filers: March 15th, June 15th, September 15th, and December 15th. The tax election can be applied to short taxable years.

PTET estimated payments will only be applied to the PTET liability and cannot be applied to any other taxes. In addition, payments may not be transferred between related entities or individuals. Penalties and interest will apply to underpayments or late payments based on the rules in Article 22.

The estimated payment requirement is waived for the 2021 tax year (payments for 2021 are not due until March 2022), including for entities whose fiscal year end is before December 31, 2021. However, it may choose to make optional online estimated tax payments prior to December 31, 2021 (an online estimated tax application for PTET will be available by December 15, 2021). Regardless of whether an electing entity chooses to make optional estimated tax payments for tax year 2021, personal income tax estimated payments must be made by or on behalf of partners, members, or shareholders under Article 22 calculated as if they were not entitled to the PTET credit. Personal income tax estimated payments are not considered prepayment of PTET and may not be applied to PTET liabilities.

Consideration must be given to timing of the PTE tax payment for purposes of taking the federal SALT deduction. The double payment of tax by the entity and its partners/shareholders will likely create a refundable overpayment for partners/shareholders, which may be partially or fully subject to federal income tax in the year received.

An annual PTET tax return is due by March 15th of the following tax year for both calendar year and fiscal year entities, and is filed using the online return application. All PTET tax returns are filed on a calendar year basis. For example, a fiscal year filer whose period end is June 30, 2021, will file its PTE return by

March 15, 2022. A fiscal-year taxpayer does not recompute its income on a calendar-year basis. Instead, its PTE taxable income must be computed for the fiscal year that ends within the PTET calendar year.

On its return, an electing entity must report its total PTET and the direct share of its PTET it is making available to each direct partner, member, or shareholder in the form of a credit (PTET credit). The electing entity may provide PTET credits only to its direct partners, members, or shareholders that are taxable under Article 22 (eligible taxpayers). If the electing entity's total PTE taxable income is zero or less, the eligible taxpayers are not entitled to any PTET credits. Instead, the electing entity may file an annual PTET return to request a refund of any PTET estimated tax payments it made.

The PTE must have an attached "certification of eligibility". This should state that a timely election was made, and that the entity was (at all times throughout the year) eligible to make the election. The certification must be signed by an authorized individual attesting that all of the information is true. The return must identify all partners, members, or shareholders of the electing entity eligible to receive credit, and classify each owner as resident or nonresident. The return shall report the balance of any tax due (and to be paid with the return) after previously paid installments of estimated tax. The return shall identify both the disregarded entity that is an owner, and the individual taxpayer subject to tax and eligible for the credit.

An electing entity may make an online request by March 15th for a six-month extension of time to file its annual PTET return. An electing entity may not amend an annual PTET return for any reason once that return has been filed. The law requires the tax department's consent for any amendments to a return filed. It is not yet clear under what circumstances that consent would be granted or denied or how that process would work.

The PTE tax base ("pass-through entity taxable income" pursuant to NY Tax Law Section 860(h)) would include the income that would be subject to New York State income tax for the specific partner or shareholder:

- For partnerships: all income from New York sources included in the taxable income of a non-resident partner, and all income (not just New York source) included in the taxable income of a resident partner. Thus, to compute its PTE taxable income, an electing partnership must compute both a resident PTE taxable income pool and a nonresident PTE taxable income pool and add these amounts together. The electing entity must then compute each eligible taxpayer's profit and loss ownership percentage within that eligible taxpayer's PTE taxable income pool. To compute an eligible taxpayer's profit and loss ownership percentage within a pool, the electing entity must determine the ratio of each eligible taxpayer's profit and loss ownership percentage in the electing entity to the total profit and loss ownership percentages of all eligible taxpayers in the pool. The total of eligible taxpayers' profit and loss ownership percentages within each pool must equal 100%. See Appendix A for calculation details.
 - A member or partner should be treated as a resident if they are a resident of New York for New York personal income tax purposes for at least half of the year. All other members or partners should be treated as nonresidents.
 - If a member or partner is a trust, the electing partnership must classify the trust as a resident or nonresident of New York State based on the residency status of the trust and not of the beneficiaries.

- For S corporations: all income (attributable to both resident and non-resident shareholders) from New York sources (i.e., use only New York source income). Each eligible taxpayer's PTET credit is computed by multiplying the electing entity's total PTET by the eligible taxpayer's ownership percentage.

Partnerships will need to review their partnership agreements to determine whether the allocation of credits under the New York law is consistent with provisions in the existing agreement regarding distributive share.

If the electing entity is an S corporation, each eligible taxpayer's PTET credit is computed by multiplying the electing entity's total PTET by the eligible taxpayer's ownership percentage.

How much is the tax?

The following table shows the tax rates for the PTE tax:

If the PTE taxable income is:	then the PTET due is:
\$2 million or less	6.85% of PTE taxable income.
greater than \$2 million but less than or equal to \$5 million	\$137,000 plus 9.65% of the excess of PTE taxable income greater than \$2 million.
greater than \$5 million but less than or equal to \$25 million	\$426,500 plus 10.30% of the excess of PTE taxable income greater than \$5 million.
Greater than \$25 million	\$2,486,500 plus 10.90% of the excess of PTE taxable income greater than \$25 million.

What are the effects on the shareholder?

Partners or shareholders of the electing entity are provided a tax credit for their share of the PTE tax paid (NY Tax Law Section 606(kkk)). Eligible taxpayers that receive a PTET credit from an electing entity may claim the credit on Form IT-653, Pass-Through Entity Tax Credit, and attach it to their New York State personal income tax return. The total credit reported on the individual's income tax return is the aggregate total of all credits calculated separately for each electing PTE of which the individual is a shareholder/partner.

An eligible taxpayer claiming the PTET credit must make an addition modification to federal adjusted gross income or federal taxable income on the eligible taxpayer's New York State personal income tax return for an amount equal to the amount of the PTET credit claimed. See Form IT-225-I, Instructions for Form IT-225, New York State Modifications, for more information.

A trust, other than a trust that is disregarded for tax purposes, that is a direct partner, member, or shareholder in an electing entity is allowed a PTET credit on the trust's personal income tax return, but it is not permitted to distribute any PTET credit it receives to its beneficiaries.

Excess tax paid shall be treated as an overpayment to be credited or refunded without interest.

Eligible taxpayers allowed a PTET credit must file an individual personal income tax return to claim the credit. The PTET credit may not be claimed on Form IT-203-GR, Group Return for Nonresident Partners, or Form IT-203-S, Group Return for Nonresident Shareholders of New York S Corporations.

For tax years beginning on or after January 1, 2021, resident partners, members, or shareholders will be allowed a resident tax credit against their New York State personal income tax for any pass-through entity tax imposed by another state, local government, or the District of Columbia, that is substantially similar to the PTET imposed under Article 24-A8 paid by a partnership or New York S corporation to another jurisdiction (NY Tax Law Section 620(b)). A list of substantially similar taxes that qualify for the resident tax credit will be posted on the NYS DTF website.

This includes any taxes paid by an LLC treated as a partnership or S corporation for New York tax purposes. In the case of taxes paid by an S corporation, the S corporation must be treated as a New York S corporation. An ineligible S corporation will be deemed to have met this requirement to the extent it is treated as a New York S corporation for purposes of computing the New York adjusted gross income of the resident shareholder.

Resident partners, members, or shareholders must make an addition modification to federal adjusted gross income or federal taxable income on their New York State personal income tax returns equal to the amount of pass-through entity tax paid to another state, local government, or the District of Columbia on their behalf and that is the basis for computing the resident credit.

Note that other states may not provide a resident tax 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 PTE tax 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 PTE tax to be favorable regardless of a non-resident's home state benefit.

Which entities are prime candidates to opt in?

Entities with all resident partners and mostly all New York-sourced income are prime candidates.

Additional guidance

Additional PTET guidance will be posted on the department's website as it becomes available. To receive notification emails about any additional guidance, sign up for the PTET subscription service (www.tax.ny.gov/help/subscribe.htm).

Appendix A – Partnership Calculations by Pool

If the nonresident PTE taxable income pool and the resident PTE taxable income pool are each **more than zero**, the PTET credits are computed as follows:

Nonresident pool

- The electing entity must divide the nonresident PTE taxable income pool by the total PTE taxable income to determine a percentage.
- Then, the electing entity must multiply the total PTET by this percentage to determine the nonresident PTET credit pool.
- The PTET credit for each eligible taxpayer classified as a nonresident is computed by multiplying the electing entity's nonresident PTET credit pool by the eligible taxpayer's profit and loss ownership percentage within the nonresident PTE taxable income pool.

Resident pool

- The electing entity must divide the resident PTE taxable income pool by the total PTE taxable income to determine a percentage.
- Then, the electing entity must multiply the total PTET by this percentage to determine the resident PTET pool.
- The PTET credit for each eligible taxpayer classified as a resident is computed by multiplying the electing entity's resident PTET credit pool by the eligible taxpayer's profit and loss percentage within the resident PTE taxable income pool.

Under no circumstances may the sum of the resident PTET pool and the nonresident PTET pool exceed the electing entity's total PTET.

If the **nonresident** PTE taxable income pool is **zero or less**, PTET credits are computed as follows:

- all nonresident eligible taxpayers receive zero PTET credit, and
- each eligible resident taxpayer's PTET credit is equal to the total PTET multiplied by the profit and loss ownership percentage within the resident PTE taxable income pool of the eligible resident taxpayer.

If the **resident** PTE taxable income pool is **zero or less**, PTET credits are computed as follows:

- all resident eligible taxpayers receive zero PTET credit, and
- each eligible nonresident taxpayer's PTET credit is equal to the total PTET multiplied by the profit and loss ownership percentage within the nonresident PTE taxable income pool of the eligible nonresident taxpayer.

Example: Partnership XYZ has five partners:

Partner	Profit and loss ownership percentage
Partner A (nonresident)	15%
Partner B (nonresident)	25%
Partner C (resident)	20%
Partner D (resident)	30%
Corporate Partner Q	10%

Partnership XYZ computes a nonresident PTE taxable income of \$4 million and a resident PTE taxable income of \$10 million, for a total PTE taxable income of \$14 million. Partnership XYZ computes and pays a PTET of \$1,353,500 on its PTE taxable income.

Corporate Partner Q is not eligible for a PTET credit as a corporation and Corporate Partner Q's income from Partnership XYZ was not included in PTE taxable income.

To compute the nonresident PTET credit pool, Partnership XYZ first divides \$4 million by \$14 million to get 28.57%. Partnership XYZ then determines the nonresident PTET credit pool is \$386,694.95 ($\$1,353,500 \times 28.57\%$).

Partner A and Partner B, combined, have a profit and loss ownership percentage of 40% of Partnership XYZ so the partnership computes their profit and loss ownership percentages within the pool to be 37.5% for Partner A and 62.5% for Partner B. Partnership XYZ computes Partner A's PTET credit to be \$145,010.61 ($\$386,694.95 \times 37.5\%$) and Partner B's PTET credit to be \$241,684.34 ($\$386,694.95 \times 62.5\%$).

To compute the resident PTET credit pool, Partnership XYZ divides \$10 million by \$14 million to get 71.43%. Partnership XYZ then determines the resident PTET pool is \$966,805.05 ($\$1,353,500 \times 71.43\%$).

Partner C and Partner D, combined, have a profit and loss ownership percentage of 50% of Partnership XYZ so the partnership computes their profit and loss ownership percentages within the pool to be 40% for Partner C and 60% for Partner D. Partnership XYZ computes Partner C's PTET credit to be \$386,722.02 ($\$966,805.05 \times 40\%$) and Partner D's PTET credit to be \$580,083.03 ($\$966,805.05 \times 60\%$).

Partner	PTET Credit
Partner A	\$145,010.61
Partner B	\$241,684.34
Partner C	\$386,722.02
Partner D	\$580,083.03
Corporate Partner Q	0
Total PTET paid	\$1,353,500