

State and Local Tax



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New York State Tax Department Issues Guidance on Pass-Through Entity Tax

The New York State Department of Taxation and Finance has issued guidance on the recently enacted New York Pass-Through Entity Tax. [Technical Memorandum, “Pass-Through Entity Tax,” TSB-M-21\(1\)C, \(1\)](#) (N.Y.S. Dep’t of Taxation & Fin., Aug. 25, 2021). We previously summarized the key aspects of the Pass-Through Entity Tax in our client alert, [New York State Enacts Pass-Through Entity Tax as SALT Limitation Workaround \(April 22, 2021\)](#).

BACKGROUND

Effective for tax years beginning on or after January 1, 2021, the New York Pass-Through Entity (“PTE”) Tax is an elective tax that allows eligible partnerships (including LLCs taxable as partnerships) and New York S corporations to elect to be subject to the new tax, at rates equivalent to the current New York State personal income tax rates (6.85 percent of pass-through entity taxable income of up to two million dollars, with excess income taxed at graduated rates up to 10.90 percent). By making the annual election, a qualifying pass-through entity will afford its owners a legal means to fully deduct their New York State income taxes and avoid the \$10,000 federal limitation on state and local tax deductions. Direct partners, members, or shareholders will be entitled to a tax credit for their shares of the PTE tax paid that can be applied against their New York State income tax liabilities.

NEW GUIDANCE

The newly-released guidance addresses a broad range of issues, including the following:

- **Election form.** For 2021, the election must be made by October 15, 2021. The Department has now made available online the PTE tax election application, which can be accessed by creating a business online services account. For 2022 and later years, the annual election must be made by March 15 of the year for which the election is made.
- **Estimated tax payments.** While electing entities are not required to make estimated tax payments for the PTE tax in 2021, such entities will have the option to make estimated tax payments prior to December 31, 2021. An online form will be made available for this purpose by December 15, 2021. It should be noted that although optional, estimated PTE tax will need to be paid in calendar year 2021 in order to be deductible in 2021 for federal income tax purposes.
- **Eligibility.** The guidance makes clear that a partnership is eligible to make the election even if it has one or more direct partners that are not eligible for the PTE tax credit, such as corporate partners that are not subject to New York State personal income tax. However, income attributable to such partners cannot be included in PTE taxable income and is not eligible for the PTE tax credit.

- **Direct partners.** A direct partner, member, or shareholder eligible to claim the credit means one to whom the electing entity issues a federal Schedule K-1.
- **Resident and nonresident owners.** The guidance describes how in computing its PTE taxable income, an electing partnership must classify its direct partners or members as either New York residents or nonresidents and then compute separate resident and nonresident “PTE taxable income pools.” Partners and members can be classified as residents or nonresidents, but not as part-year residents. A partner or member is treated as a resident if a resident for personal income tax (“PIT”) purposes for at least half the year. Otherwise, the partner or member is treated as a nonresident, potentially limiting the amount of PTE taxable income.
- **PTE taxable income.** The guidance makes clear that a partnership cannot include in its PTE taxable income amounts distributed to direct partners, such as partnerships or other entities that are not subject to PIT, even if the income is ultimately taxable to a partner or member through tiered partnerships.
- **Application of PTE tax credit.** The guidance appears to confirm that direct partners, members, and shareholders may apply their share of the credit against their total New York State income tax due for the year, even to the extent the tax relates to income from sources other than the pass-through entity. However, the credit must be claimed on the owner’s separate New York State tax returns; it cannot be claimed on a group return.
- **Resident tax credit for substantially similar taxes.** Owners who are New York State residents are also allowed a resident tax credit for “substantially similar” PTE taxes imposed by other states and localities. The Department says it will post on its website a list of substantially similar taxes that qualify for a resident tax credit.

As noted above, the PTE tax election for 2021 must be made no later than October 15, 2021, and once made it is irrevocable for the year. The Department intends to provide additional guidance on its website as it becomes available. We will continue to monitor those developments.

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