

New York's New Pass-through Entity Tax: Frequently Asked Questions

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The [State and Local Tax](#) professionals at Marks Paneth have prepared the following list of Frequently Asked Questions related to New York State's new Pass-through Entity Tax.

While the New York Department of Taxation and Finance has issued guidance on the new law, many questions remain unanswered, and their existing guidance may be altered at a later date. Accordingly, the answers provided below are subject to change.

All references are to sections of Article 22 and 24-A of the New York tax law unless otherwise noted.

Q1: Which entities may elect-in to the new Pass-through Entity (PTE) tax?

A1: Any entity which is taxed as a partnership, other than a publicly traded partnership, and which is required to file a New York partnership income tax return, and New York S Corporations (corporations which have made both a federal and New York S election), are eligible to elect into the new PTE Tax. Federal S Corporations that have not made a New York S Election and are not required to file, as a New York S Corporation may not elect in without first electing New York S corporation status. (§860)

Q2: Can tiered partnerships elect in?

A2: Yes, although the election will be essentially ineffective for partnerships that do not have any individual partners, as the tax base only consists of partnership income that is allocated to individual members (see Q14 below). Although no tax is calculated and paid-in on income of a higher-tier partnership (and no credit is passed through to a higher-tier partnership), the higher-tier partnership can elect to pay its own tax if it has any individual partners. (§860)

Q3: Can single-member LLCs elect in?

A3: No. The entity must either be taxable as a partnership or a New York S Corporation. Single-member LLC's which are taxed as sole proprietorships may not elect in. Therefore, they may want to consider adding a second owner, perhaps a spouse or an S Corporation owning 1% of the company so that it can be taxed as a partnership, or making a check-the-box election to be taxed as an S Corporation, although doing either one will result in the imposition of additional state filing fees plus additional tax compliance costs. If a single-member LLC is owned by a partnership or New York S Corporation then the owner may elect in if it meets the requirements in Q1. (§860)

Q4: Can my business elect in for 2020?

A4: No. The election is only available for years beginning on and after January 1, 2021. (S2509-C/A3009-C §9)

Q5: I own an interest in a pass-through entity via a grantor trust or Disregarded Entity (SMLLC). What effect does that have?

A5: The statute provides that where an interest in a PTE is owned by a disregarded entity and the owner of the disregarded entity is an individual, their distributive share of the entity's income is included in the tax base. However, the PTE must provide the name and tax ID number of the ultimate individual owner to the New York Dept. of Taxation and Finance so that the PTE tax credit can be passed through to them. (§863, §865(e))

Q6: What if one or more partners/shareholders don't want to participate? Can they elect out if the entity itself elects in?

A6: No. There is no mechanism in the statute that allows an investor in an electing PTE to elect out. Consequently, entities who are considering electing in should communicate this to their owners to gauge if there is any opposition to making the election.

Q7: Are trusts and estates considered to be individuals?

A7: Yes. Trusts and estates are taxable entities under Article 22 of the New York tax law so their income from a partnership or S Corporation of a trust is subject to the tax.

Q8: Can a trust or estate which distributes income to its beneficiaries elect-in to the tax?

A8: No. Only partnerships and S Corporations may elect into the tax. (§860)

Q9: How is the election made?

A9: (Updated 8/25/2021) Entities desiring to elect-in to the tax must do so via the NY DTF's website, which has been specially set up for that purpose. For partnerships, the election must be made by an individual partner, member, etc. which is authorized to bind the entity. For S Corporations, the election is made by a corporate officer, shareholder or authorized manager. *The Department has advised that only authorized individuals described above may make the election and that it may not be filed by attorneys, CPA's and other representatives of the taxpayer who are not otherwise officers, members, etc.* (§861)

Q10: When is the election due?

A10: For the 2021 tax year, the election is due no later than October 15, 2021. For tax years beginning after 2021, the election is due by March 15 of the year for which the election is to be effective. Therefore, in order to be effective for 2022, an election must be filed no later than March 15, 2022. When a PTE is not in existence as of January 1, it must make the election no later than the due date of the first estimated tax payment (see Q23 below). (§861(c))

Q11: Is the election revocable?

A11: No. Once made, the election is irrevocable for the tax year that it is made. (§861(c))

Q12: What if Congress repeals the State and Local Tax (SALT) Cap? Can I elect in for 2021 and not for 2022 or later years?

A12: The election is annual. Other than for 2021, it must be made by March 15 of each year in order to be effective for the year. Since there is talk of the SALT cap being repealed, a PTE may want to defer electing in for 2021 until the last possible minute (October 15) while we wait and see what happens in Washington D.C. However, even if the SALT cap is repealed, the PTE tax may still be a viable tax planning opportunity as it may reduce individual partners' self-employment income and federal AGI and the taxes will presumably not be an AMT adjustment item. (§861(c))

Q13: Can a late election be made?

A13: Presumably no. The statute provides that the election *must* be made no later than October 15, 2021, for the 2021 tax year and by the due date of the first estimated tax payment for all other tax years (March 15, except for short-year returns). It does not appear to give the New York Department of Taxation and Finance any leeway in accepting a late-filed election. (§861(c))

Q14: What is the tax base?

A14: For an entity that is taxed as a partnership, the tax base is:

1. All items of income, gain, loss or deduction connected with New York sources to the extent that they are included in the taxable income of an individual non-resident partner, plus;
2. All items of income, gain, loss or deduction to the extent they are included in the taxable income of an individual New York resident partner.

Note that for a partnership the tax base includes both the New York source income of all non-resident partners plus 100% of the income of New York Resident partners, even income sourced outside of New York. For a law firm taxed as a partnership that does business in New York, New Jersey and Connecticut with partners residing in all three states, the tax base would be equal to the New York source income of all non-resident partners and 100% of the income of all resident partners, even their income which is sourced to New Jersey and Connecticut.

Update: Based on the Department's guidance issued 8/25/2021, the tax base includes guaranteed payments to partners. Also, the guidance provides that losses and deductions are included in the tax base even though at the individual level they may be limited for various reasons (such as the overall limit on capital losses, passive loss rules, basis and/or at-risk rules, etc.).

For an entity which is taxed as a New York S Corporation, the tax base is the entity's net New York source income (federal income as adjusted for NY purposes and sourced to NY using a single sales factor formula). Unlike partnerships, no special consideration is given to resident vs. non-resident shareholders of NY S corporations. (§860(h))

Q15: Can I take some or all of my individual investment portfolio, contribute it to a partnership that is also owned by my spouse, elect-in to the New York PTE tax and get an ordinary federal tax deduction for it?

A15: The answer to this question is uncertain. Under IRS Notice 2020-75, any PTE-level income tax paid by a pass-through entity is treated as an item of non-separately stated income. However, potentially conflicting regulations exist which, for an investment partnership which does not engage in a trade or business, may require a reclassification of such taxes as non-deductible portfolio deductions for years prior to 2026.

Q16: What is the tax rate?

A16: The tax is imposed at graduated rates as follows:

- 6.85% on taxable income up to \$2,000,000
- 9.65% pm taxable income from \$2,000,001 to \$5,000,000
- 10.3% on taxable income from \$5,000,001 through \$25,000,000
- 10.9% on taxable income in excess of \$25,000,000

Note that the tax rates above roughly follow the New York individual tax rates imposed on individuals but without the benefit of the rates imposed below 6.85% on incomes below \$2 million. Presumably, New York resident and non-resident owners of PTE's will still want to elect-in to paying the higher New York tax rates because the federal tax savings may be greater than the additional New York tax. Also, the fact that the tax paid comes back to the owner in the form of a refundable credit (see Q31 below) should at least partially if not completely nullify this issue. (§862)

Q17: Is the tax calculated on an owner-by-owner basis or on an aggregate basis?

A17: The tax is calculated on an aggregate basis. That is, the combined New York source incomes of all non-resident individual partners are added to the combined total incomes of all New York resident individual partners and their combined incomes are subjected to the tax rates shown above. For S Corporations (which by definition are prohibited from having corporations or partnerships as shareholders), the tax is on the entity's entire net income allocated to New York using a single sales factor. (§860(h))

Q18: When are returns due?

A18: Returns are due by March 15. This is even the case for fiscal-year entities, in which case the return is due March 15 of the calendar year after the calendar year in which the entity's tax year ends. For instance, the return for an entity with a fiscal year ending June 30, 2022, will be due March 15, 2023. (§865(a))

Q19: When is the tax due?

A19: The tax is due by March 15 of each year. This is the case even if the entity has a fiscal year. (§865(a))

Q20: May an extension be filed?

A20: Yes. An extension of time to file, but not pay, of up to six months may be obtained. (§865(f)(1))

Q21: May amended returns be filed?

A21: No. The statute provides that amended returns may not be filed unless permission of the Commissioner of Taxation and Finance is granted. (§865(f)(2))

Q22: Who is liable for the tax?

A22: The entity itself is liable for the tax. If the entity does not pay the tax, all partners and shareholders are separately liable for their share of the entity's tax. Also, any general, managing or controlling partner or any individual who owns more than 50% of the entity is both jointly and severally liable for the tax. (§866(c))

Q23: Are estimated tax payments required?

A23: Yes. For years after 2021 estimated taxes equal to 25% of the tax due for the year must be paid on or before the fifteenth day of March, June, September and December (NOT January). The Commissioner is directed to draft regulations that address short-year filers. Presumably, those regulations will also govern when a short-year return filer is required to make an election to be subject to the tax. (§864(b))

Q24: Are partnerships who elect-in to the PTE tax still required to pay in estimated taxes for their non-resident partners?

A24: Unfortunately, the statute does not provide any guidance on this issue. It would seem reasonable to conclude that an electing partnership would not have to pay estimated taxes on behalf of its non-resident individual partners (it would still have to pay in estimated taxes on behalf of corporate partners who do not provide a waiver), but as we have seen with New Jersey and partnerships that elect into its entity-level tax, non-resident estimated payments may still be required. Unless/until guidance from the New York Department of Taxation and Finance is provided, the best practice here would probably be to have the partnership obtain estimated tax waivers from all of its non-resident partners, perhaps as a condition of electing into the entity-level tax. (§658(c)(4))

Q25: The law was signed on April 19 and the March 15 deadline for making an estimated payment for 2021 has already passed. Will my entity face an estimated tax penalty for 2021?

A25: For the 2021 tax year only, the requirement to pay estimated taxes does not apply. However, cash basis entities that elect in may want to pay the tax by December 31, 2021, to ensure that it is deductible on their 2021 federal return. Conceivably accrual-method PTE's may pay the tax after December 31, 2021, and still take a deduction on their 2021 returns using the recurring item exception as long as the tax is paid by the earlier of the date the return is filed or the due date of the return, including extensions. (S2509-C, A3009-C §8(a))

Q26: How are estimated taxes paid?

A26: (Updated 8/25/2021) The Department's guidance issued 8/25/21 provides that it will require payments to be made electronically via its website. They plan on having the ability to receive payments no later than December 15, 2021. (§866)

Q27: If my business elects in, does that mean I can avoid making New York estimated tax payments this year?

A27: While the law provides that the entity does not have to make estimated tax payments for 2021, it also provides that individual owners of PTEs who elect into the tax for 2021 are NOT absolved of their requirement to pay estimated taxes for 2021 even though they will be entitled to a credit against their tax for their share of the tax paid at the entity level. For the 2021 tax year, the individual estimated tax penalty must be calculated without consideration of any PTE tax credit. Therefore, you need to weigh the imposition of the estimated tax penalty against the time value of money for any significant tax overpayment that you could have as a result of paying both estimated taxes and the PTE credit. (S2509-C/A3009-C §8(b))

Q28: My partnership operates in several states and has a mixture of both non-resident and resident partners as well as a partner which is a corporation or another partnership. If the partnership elects into the tax, which is deductible from federal ordinary income, won't some of the tax deductions be going to the corporate/partnership partner? Also, won't some of the New York tax on the New York resident partners also be reducing the federal income of the non-resident partners?

A28: Yes, it is possible that a partnership's tax deduction for the tax could be shared by all partners based on the profit and loss splitting formulas contained in the entity's operating agreement. Therefore, entities that are taxed as partnerships and which decide to elect in must seriously consider having their operating agreements updated so that the deduction can be specially allocated only to individual partners in accordance with their share of the partnerships' taxable income under the PTE tax. This may also be a good time to clean up and address other issues in your operating agreement, such as those that deal with the new federal partnership audit rules which went into effect in 2018.

Q29: Is there an estimated tax safe harbor?

A29: Yes. The applicable safe harbor is 90% of the current year's tax or 100% of the previous year's tax, whichever is less. (§864(b)(3))

Q30: Can a PTE whose income varies throughout the year annualize its estimated tax liability?

A30: While the statute does not directly address annualizing estimated taxes, it does provide that all other provisions of Article 22 of the New York Tax Law (which covers individual income taxes) apply, so conceivably a taxpayer whose income varies throughout the year may be able to utilize annualization. Hopefully, the New York Department of Taxation and Finance will provide guidance later this year. (§866(a))

Q31: How does the crediting provision work?

A31: When a PTE elects into the tax, it will calculate a PTE tax credit for each individual owner (not corporate partners or other partnerships) based on their New York taxable income which it will pass through to them on their New York K-1 or similar form developed by the Department of Taxation and Finance. At the individual level, this credit will be claimed as a refundable tax credit against the individual owner's New York income tax liability. (§863, §606(kkk))

Q32: If an entity's tax payments for the year exceed its tax liability, can the excess be passed-through to its investors?

A32: No. Guidance published on 8/25/2021 provides that where an overpayment of tax exists at the entity level, the entity may not pass the excess through to its investors in the form of a credit. Instead, the entity must file a tax return and request a refund of the overpayment. Unfortunately, the guidance does not address whether such an overpayment may be applied toward the entity's estimated tax for the succeeding year.

Q33: If a trust or estate receives a PTE credit from a partnership or S Corporation, can it pass some or all the credit through to its beneficiaries?

A33: No. Per the guidance released 8/25/2021, where a trust or estate receives a PTE Credit, it may not pass that credit through to its beneficiaries. The Credit must be claimed at the trust/estate level, which may result in a refundable overpayment.

Q34: May PTE credits be claimed on a group non-resident/composite return filed by a Partnership or NY S Corporation?

A34: No. The guidance published on 8/25/2021 states that no PTE credit can be claimed on a group non-resident/composite tax return filed by a pass-through entity. Presumably this will most preclude electing entities from filing group returns for their non-resident investors.

Q35: If my federal taxable income was reduced by the tax paid at the PTE level, and I received at least a partial refund of that tax, don't I then have to include the refund in my taxable income?

A35: Yes, you do unless it can be demonstrated that you did not receive a federal tax benefit for the deduction (See Rev. Rul. 93-75 and section 111 of the Internal Revenue Code).

Q36: Is the entity-level tax required to be added-back to the New York tax base?

A36: Yes. Each individual must make an additional adjustment to their New York income in the amount of their New York PTE credit which will, in turn, increase their New York taxable income by the amount of the credit. In addition, due to what may either be a drafting error in the law or a purposeful action on the part of the NY Legislature, any NY PTE tax which was deducted at the federal level must also be added-back to NY income, thereby resulting in a potential double-addition to income for what is essentially the same item. For instance, assume that a New York resident individual receives a K1 from a partnership that reports \$100,000 of income and a New York PTE tax credit of \$6,850, of which \$5,000 was deducted as an expense on the entity's tax return and thus reduced their federal AGI. Under a literal reading of the law, they have to add both the \$6,850 PTE tax credit and the \$5,000 deduction (which is already part of the \$6,850) to the \$100,000 in K1 income and will therefore have to include \$111,850 in their New York gross income. **Although guidance on this issue has been requested by the NY State Bar Association, it was not provided in the guidance released on August 25, 2021.** (§612(b)(3) &(43))

Q37: Will New York allow its residents to claim credit against their New York tax for similar PTE taxes paid to other states?

A37: Yes. For tax years beginning in 2021 and thereafter, where a New York resident is an investor in a partnership or New York S Corporation doing business in another state and that entity is subject to a similar tax, New York will allow that individual to claim a credit against their New York tax for their share of the other state's PTE tax. Note that for S Corporation shareholders, the entity must be a New York S Corporation. (§620(b))

Q38: What about for years prior to 2021? Is a credit for PTE taxes paid to other states available?

A38: For years prior to 2021, if the entity is a Partnership, it is debatable as to whether or not a credit is available against a New York resident individual's tax for their share of a PTE tax paid by the partnership to another state such as Connecticut or New Jersey. The instructions to New York Form IT-112-R and the guidance published on 8/25/2021 provide that no credit is available for entity-level taxes paid to other states, but for partners and partnerships, that position is not supported by the statute. If the entity is an S Corporation, the law is quite clear that no credit is allowed for entity-level taxes paid to other states for years prior to 2021. (§620 prior to amendment by S2509-C/A-3009C)

Q39: If individual owners of a PTE which elects-in to the new tax live outside of New York, will their home state(s) allow them to claim a credit against its tax for the PTE tax paid by the entity to New York?

A39: The answer to this question depends on the state where the owner resides. If they live in Connecticut or New Jersey it is likely that their home state will grant them a credit. Currently, Pennsylvania is taking the position that partners in partnerships cannot claim a credit for an entity-level tax but S Corporation shareholders can. If an entity is deciding whether or not to elect-in to the tax and it has nonresident owners, it should consult with them first before deciding whether or not to elect in so that all parties are aware of the state tax consequences.

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