

TAXES ARE GOING UP: HIGHLIGHTS FROM THE NYS 2021-2022 BUDGET

Hodgson Russ State & Local Tax Alert
April 12, 2021

On April 7, 2021, the Legislature passed and sent to the Governor the bills constituting the 2021-22 budget legislation (the "Budget"). New York's lawmakers had exhibited considerable restraint in the recent past, generally keeping spending increases—and thus revenue increases—at about the level of inflation. But pent-up spending demand, the COVID pandemic, one-party control of the Senate and Assembly, and a fiscally-conservative Executive perceived as politically weakened, resulted in lawmakers muzzling spending restraint, at least for the next few years. And with the spending increases comes a panoply of revenue-raisers which, given the already unprecedented exodus of wealthy taxpayers from New York over the past year, makes one wonder who will be left to pay such taxes!

As of this writing, the Governor has not yet signed the Budget. But he will. So let's take a closer look at 204-page bill number A. 3009-C/S. 2509-C (the "Act") which contains the revenue portion of the Budget.

Temporary income tax rate increases for high-income-earners: Part A of the Act increases the income tax rates on super-earners with income over \$25 million from 8.82% to 10.9%. That's more than a 20% increase in the rate.

The old 8.82% rate, which had been the highest New York State rate, is abolished and replaced with three new graduated rates of 9.65% (for married-filing-joint-return incomes over \$2,155,350, but not over \$5 million), 10.3% (for incomes over \$5 million, but not over \$25 million), and 10.9% (for incomes over \$25 million). The 9.65% rate kicks in at a lower income for heads-of-households and separate filers, but the 10.3% and 10.9% rates are triggered at the same over-\$5 million and over-\$25 million hurdles for all taxpayers. The tax bracket benefit is phased out as income increases and is completely gone once taxpayers earn \$50,000 more than the threshold amounts for the new tax brackets. So a taxpayer who earns \$25,050,000 will pay an extra \$521,400 in New York taxes compared to last year. This also puts New York City taxpayers in this bracket in the unenviable position of paying the highest combined state and local taxes in the country.

Attorneys

Paul Comeau
Timothy Noonan
Joseph Endres
Christopher Doyle
Elizabeth Pascal
Andrew Wright
Daniel Kelly
Debra Herman
Joshua Lawrence
Ariele Doolittle
K. Craig Reilly
Emma Savino
William Comiskey
Paul Baldwin Jr.
Thomas Collura
Katherine Cauley
Richard Campbell
Catherine Eberl

Practices & Industries

State & Local Tax

TAXES ARE GOING UP: HIGHLIGHTS FROM THE NYS 2021-2022 BUDGET

The new rates are effective (or one might say retroactive to) the beginning of **the 2021 tax year**, and prevail through 2027. In 2028, the rates will revert to the pre-2021 schedule. Elsewhere in the Budget is a provision legalizing sports betting. If Vegas was to place odds on the rates being reduced in 2028 in accordance with the Budget, they'd probably be around 2-5.

Part A of the Act also includes employer withholding tax guidance and a provision waiving any penalties for underpayments of Q1 – Q2 estimated taxes if the underpayments result from the rate changes wrought by the Budget and the underpayments are cured on or before September 15, 2021.

Pass-through entity tax: Part C of the Act enacts New York's new pass-through entity ("PTE") tax.

Some background: On November 9, 2020, the Internal Revenue Service issued Notice 2020-75 introducing proposed regulations addressing the deductibility of state and local income taxes ("SALT") paid by partnerships or S-corporations treated as pass-through entities (outlined by us [here](#)). The proposed regulations clarify that entity-level taxes paid upon the net income of a partnership or S-corporation on or after the date of the notice are not subject to the \$10,000 SALT deduction limit enacted as part of the 2017 Tax Cuts and Jobs Act.

The Act takes advantage of the IRS-blessed workaround by creating the PTE tax under new Article 24-A of the Tax Law, **effective for tax years beginning on or after January 1, 2021**. Under the proposal, qualifying partnerships and New York S-corporations can elect to pay an entity-level tax equal to 6.85% of the entity's New York taxable income if its annual pass-through taxable income is not over \$2 million. The rate is progressively increased from 6.85% to 10.90% for entities with annual pass-through taxable incomes in excess of \$25 million, paralleling the new, higher personal income tax rates (*see above*).

For partnerships, the PTE tax base will be the sum of: (1) the partnership's New York taxable income attributable to New York resident members, and (2) New York *source* taxable income attributable to nonresident members. Income allocated to corporate partners is not included in the tax base.

S-corporation income subject to the PTE Tax will include only income derived from New York sources, even for resident shareholders. While this limits the benefit to S-corporation shareholders, it is assumed to be necessary to avoid an argument that residents and nonresidents own different "classes" of stock in the S-corporation which could invalidate the federal S election.

TAXES ARE GOING UP: HIGHLIGHTS FROM THE NYS 2021-2022 BUDGET

Qualifying partnerships and S-corporations include multi-tiered entities and partnerships with members subject to taxes other than the personal income tax (think corporate partners). In order to participate, eligible entities must make an *annual* election by the due date of the first estimated payment for the current taxable year (March 15 for calendar year taxpayers). **For the 2021 tax year only, the election must be made no later than October 15, 2021**, and no estimated taxes are required to be made for the 2021 year. However, one would think that a federal deduction for 2021 taxes will not be available to the owners of a flow-through entity on the cash basis of accounting if taxes aren't paid in 2021. Furthermore, individuals must continue to pay their 2021 estimates under the assumptions that the election will not be (or has not been) made and the owner-credit (*see below*) will not be available. The election is irrevocable. A certification of eligibility will be required to be filed with every return (due on or before March 15 following the close of the taxable year), including identification of individual owners of disregarded entities who are partners/shareholders, and a statement of the classification of each beneficial partner and/or member as a resident or nonresident. Notably, once a PTE return has been filed by an electing partnership or electing S-corporation, it may not be amended without the consent or authorization of the Commissioner.

With the new tax imposed at the entity level, the Act allows for a dollar-for-dollar personal income tax credit for owners of electing partnerships and S-corporations for the portions of the PTE tax paid by the entity that are attributable to said owners. Also, the Act subjects general, managing and controlling partners to joint-and-several liability for PTE taxes that are unpaid by their entities.

Finally, separate from the creation of the PTE tax, the Act amends Tax Law § 620 to recognize other state PTE tax schemes by allowing New York resident taxpayers who own entities that pay “substantially similar” PTE taxes in other states, a resident tax credit for their share of pass-through entity taxes paid to other states. This is an issue [we have been following closely](#), and while we believe there's a good argument under current law that some taxpayers could claim the credit, it is good to have this position made official and expanded to all taxpayers with this new legislation. As with the PTE tax, these resident credit provisions are effective as of the 2021 tax year.

Temporary corporate income tax rate increase and reinstatement of capital base tax: This change came a bit out of nowhere, and was not part of the Governor's executive budget proposal. But why not raise taxes on corporations too?! Part HHH of the Act increases the corporate income tax rate from 6.5% to 7.25% for the 2021-2023 tax years. The rate increase applies only to corporate taxpayers with more than \$5 million of taxable income.

Part HHH also reinstates the capital base tax for non-manufacturing corporations at a rate of 0.1875%. The reinstatement also terminates after the 2023 tax year.

No more Opportunity Zone benefits: Under the federal Opportunity Zones Program, taxpayers may defer—and sometimes avoid—tax on current gains if those gains are reinvested in Qualified Opportunity Funds. Beginning with the 2021 tax year, Part DDD requires an add-back modification for gains deferred under the Opportunity Zones Program in the year of the deferral. To the extent federally-deferred-gains-not-deferred-for-New-York-purposes are recognized for federal tax purposes in subsequent years, New York will permit a subtraction modification.

TAXES ARE GOING UP: HIGHLIGHTS FROM THE NYS 2021-2022 BUDGET

Pandemic Recovery and Restart Program: Part PP creates a trio of incentives to jump-start the economy as soon as the pandemic is in the rearview mirror. The incentives include: A **Small Business Recovery Grant Program**; a \$5,000-per new full time equivalent employee **Restaurant Return-to-Work Tax Credit** for eligible (generally smaller) businesses (capped at \$50,000 per business); and a 25% **NYC Musical and Theatrical Production Tax Credit** for qualified businesses with at least \$1 million in qualified expenditures (capped at \$500,000 per business). The credits have limited appropriations, and allocations of the credit must be applied for. So, it will be best to be at the front of the line.

Extension/modification of existing credits/exemptions: The following credits/exemptions are extended, modified and/or enhanced: The Film Production Credit (Part F); Child Care Credits (Part D); Sales Tax Exemption for Certain Dodd-Frank Transactions (Part M); Brownfield Program Credit (Part AA); Alternative Fuels Exemption (Part EE); Farm Workforce Retention Credit (Part FF); Low Income Housing Credits (Part GG); Hire-a-Vet Credit (Part II); Economic Transformation and Facility Redevelopment Program Credit (Part JJ).

Real Property Tax Relief credit: Part III of the Revenue Act enacts a new credit for individuals with qualified adjusted gross incomes ("QAGI") of less than \$250,000 if New York real property taxes on their New York principal residence exceed 6% of QAGI. The credit is based on the real property tax paid in excess of the 6% floor, and the rate of credit is determined on a sliding scale that decreases from 14% to 0% as QAGI increases from \$75,000 to \$250,000.

Real Property exemption for renewable energy projects extended: Part X provides an extension of the exemption for most renewable energy facilities to those built prior to January 1, 2030. Prior law would have excluded facilities built after January 1, 2025. Part X also requires the Tax Department to develop and publish a uniform valuation approach for such facilities using the discounted cash flow method.

Real Estate Transfer Tax ("RETT") amendments: Part O prohibits grantors from transferring RETT responsibility to grantees other than through a written agreement. Further, grantees who pay the tax in the absence of a written agreement are now permitted to bring an action against the grantors for reimbursement of the RETT the grantee pays. Other technical amendments were made.

Employees working outside of New York due to COVID: Part NN protects New York businesses claiming certain tax credits and incentives requiring a minimum level of New York employment against claw-backs merely because New York-based employees may have worked from a non-New York location during the pandemic. Note that the Act doesn't address the personal income tax consequences of remote work, but [the Tax Department has already made its position clear](#) on this issue.

Proposals floated but not enacted: This budget season was more active than most. Here are some proposals from the Governor's Proposed Executive Budget (discussed [here](#)) and from various legislative proposals that were NOT enacted:

- A provision allowing the Tax Department to appeal adverse Tax Appeals Tribunal decisions
- A provision requiring *all* Federal S-corporations doing business in New York to also be treated as S-corporations for New York tax purposes
- A provision permitting the Tax Department to extend the period of time for which it was not required to accrue and pay interest on big (>\$100,000) refund claims

TAXES ARE GOING UP: HIGHLIGHTS FROM THE NYS 2021-2022 BUDGET

- A tax on VRBO-type rentals, including a requirement for marketplace-provider collection
- An increase in the estate tax rate
- A pied-à-terre real property tax on non-primary residences in New York City (discussed [here](#))

If you would like more information about the above budget or tax issues, contact [Christopher Doyle](#) (716.848.1458), [Elizabeth Pascal](#) (716.848.1622) or [Timothy Noonan](#) (716.848.1265).