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New York State: Tax measures in 2021 budget agreement

New York State legislature and the governor on April 6, 2021, reached an agreement on this year's budget legislation, which calls for approximately $200 billion in state spending.

Finalized in the late afternoon of April 6, 2021, the agreement comes after days of negotiations between the governor who proposed modest tax increases, and the more progressive Democratic controlled legislature. Both the Assembly and Senate had pushed for significant tax increases—largely focused on corporations and wealthy individuals.

The two chambers have updated their websites for the text of the bills—Assembly Bill **A3009C** and Senate Bill **S2509C** (hereafter referred to as the budget bills).

KPMG observation

The following summary of the key tax changes assumes these bills will soon be passed by both chambers and signed by the governor. The budget was due April 1. Query whether this has implications as a second quarter event for calendar year financial statements.
In general, New York City tax laws are not affected by New York State budget legislation. The City's fiscal year, which starts on July 1, is different than the State's, which commences April 1. Whether New York City enacts any significant tax changes in the next few months remains to be seen.

Corporate franchise tax rate changes under Article 9A of the New York State tax law

Two important legislative amendments are directed at the Article 9A corporate franchise tax.

For tax years beginning on or after January 1, 2021 and before January 1, 2024, the rate applicable to entire net income would increase from 6.5% to 7.25% if the taxpayer's business income base exceeds $5 million. The rate increase appears to be structured as a "cliff" rate, rather than a graduated rate, so that all income would be subject to the 7.25% rate if the $5 million income base is exceeded. The $5 million "business income base" amount referred to in the bills is a reference to the post-apportioned net income subject to tax in New York. The relatively short three-year period for the 7.25% rate could complicate the determination of the value ascribed to a corporation's deferred tax accounting.

With this change, the highest combined New York State and City tax rate on corporations would be 18.275% (7.25% New York State plus 2.175% Metropolitan Transit Authority plus 8.85% New York City (9% for large financial institutions)).

KPMG observation

Note that the final corporate franchise tax increase would be less than that proposed by the legislature last month. The Assembly had proposed a temporary three-year surcharge of 18% across all New York's corporate taxes, including those under the Article 9 tax regime, the Article 9A regime, and the Article 33 life insurance company income tax. The Senate, in contrast, had proposed to permanently increase the 6.5% rate to 9.5% for taxpayers with over $5 million in business income.

The second significant amendment is that the budget bills also would reinstate and increase the rate of the alternative tax on "business capital" that was phased out at the New York State (but not the New York City) level for tax years beginning after 2020. For tax years beginning on or after January 1, 2021, and prior to January 1, 2024, the business capital tax would be imposed at a 0.1875% rate. The bills anticipate the tax sunsetting as of the 2024 tax year.

The existing "caps," such as the $5 million maximum business capital tax, and certain special lower rates would remain in place (i.e., the law during 2020) during its three-year revitalization. New York City's business capital tax rate would remain unchanged at 0.15% and the maximum City business capital tax would be $10 million.

Individual (personal) income tax changes under Article 22 of the New York State tax law

For seven calendar tax years—2021-2027—the top marginal tax rate for New York State individual income taxes would temporarily rise from the current 8.82% on income over $2,155,350 to as high as 10.90% for New York taxable income in excess of $25 million. The bill also establishes two new marginal rate brackets for joint filers:

- 9.65% for joint filers with New York taxable income in excess of $2,155,350 but not more than $5 million
- 10.30% for joint filers with New York taxable income in excess of $5 million but not greater than $25 million

The same tax rate increases for single filers would basically commence at commensurate lower thresholds than those for joint filers.

KPMG observation

The combined New York State and City individual income tax rate imposed on residents would be the highest in the nation, at 10.90% (State) plus 3.876% (New York City) or 14.776%. By contrast, California, until now the highest, tops out at 13.3% for single filers with income over $1 million. In New York State, a legislative proposal was floated to impose an additional "capital gains surcharge" on certain individuals with capital gains income, but that did not make it into the final budget deal.

Pass-through entity tax (PTET) imposed under new Article 24-A of New York State tax law

New York State joins a number of states that are taking advantage of recent IRS approval of the so-called "SALT workaround" of the 2017 "Tax Cuts and Jobs Act" (the federal tax law that limited itemized deductions for state and local individual income taxation). The workarounds vary, but generally include imposing tax at the partnership level and allowing a credit for the partner's pro rata share of the tax paid.

In his Executive Budget proposal in January 2021, Governor Cuomo had included a workaround plan. Later in the legislative session, each chamber tweaked that proposal, and certain lobbying groups proposed their own plans. The final plan, captured in the budget bills, would allow eligible entities, including any entity taxed for federal purposes as a partnership (other than a publicly traded partnership) and New York State S corporations, to elect into the regime.

The PTET tax would apply to tax years beginning on or after January 1, 2021, with the PTET tax return due—for partnerships and S corporations—by March 15th of the following tax year for both calendar year and fiscal year entities. For fiscal year entities, the return is due on or before March 15th following the close of the calendar year that contains the final day of the entity's tax year. Estimated tax payments are made on the 15th day of March, June, September, and December, regardless of whether the entity has a calendar or fiscal year end.

The entity would need to elect into the PTET annually by the due date of the first estimated tax payment (March 15 for calendar year filers) of the tax year for which the election is effective. Once made, the annual election is irrevocable for the given tax year. In addition, once filed, a PTET return cannot be amended absent permission by the State Tax Commissioner.

KPMG observation

It is not clear how the 2021 PTET election would be administered given that March 15, 2021, has already passed and the budget bill was not (and still has not been) enacted into law.

The PTET would be imposed on the entity, but each partner or S corporation shareholder would have "several" liability for their direct share of the PTET (i.e., each partner/shareholder would be liable only for the person's direct share of the tax, and not for the entire amount due by the entity).

KPMG observation

It does not appear that having a corporate partner would block the ability for the partnership to elect PTET status. Apparently to deal with the corporate partner scenario—and because the PTET is a workaround geared to individual income filers' itemized deduction limitation concern—the entity would pay the PTET only with respect the distributive share of its income attributable to Article 22 personal income tax filers.

The PTET base would include the income that would be subject to New York State income tax for the specific partner or shareholder. For nonresidents, the PTET would be paid by the entity on the "New

York source” (per Article 22) amounts. For New York State residents, the PTET would be paid by the entity on the entire (i.e., unapportioned “worldwide”) amounts.

Resident and nonresident taxpayers would be entitled to a credit, against their New York State individual income tax liability, for their share of the PTET that was paid on their behalf. An individual claiming the credit would add back to income an amount equal to the amount of the credit. If the PTET credit for an individual exceeds that person’s New York State individual income tax due, the excess would be available as an overpayment-credit or as a refund (without interest).

The PTET tax rates range over several brackets, commensurate with many of the individual income tax brackets, with the initial PTET bracket set at 6.85% for PTET taxable income of less than $2 million, to as high as 10.90% on PTET taxable income exceeding $25 million. Article 22 includes a “resident credit” for New York State residents’ share of the PTET’s payment of a “substantially similar” PTET to other states.

KPMG observation

There are other tax changes, many related to credits, included in the lengthy budget bills, but the items discussed above are likely the most significant. Importantly, several controversial items that were widely discussed in the national press, but **not** included in the budget bills, were the revitalization of the essentially dormant New York State Stock Transfer Tax, an expansion of the mortgage recording tax to capture real property security interests relative to mezzanine debt and private equity investments, the imposition of tax on individuals with second homes in New York, and a provision that would have ended the ability of federal S corporations to be non-electing New York State C corporations.

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