



# TaxNewsFlash

United States



No. 2021-174  
April 20, 2021

## New York State: Tax provisions in enacted budget bills

The governor on April 19, 2021, signed the FY 2022 budget bills (Chapter 59 of the 2021 Laws of New York) that provide for \$212 billion in state spending. The budget package represents a compromise between the governor (who proposed modest tax increases back in January 2021) and the more progressive Democratic-controlled legislature. Last month, both the Assembly and Senate had pushed for significant tax increases—largely focused on corporations and wealthy individuals.

A summary of the key tax changes in the budget bills, which may have implications for the second quarter for financial statement purposes, is provided below.

### **KPMG observation**

New York City's tax laws generally 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 fiscal year that begins April 1. Whether the City enacts any significant tax changes in the next few months remains to be seen.

### **Corporate franchise tax rate changes (Article 9A of N.Y. Tax Law)**

Under Article 9A of New York tax law, taxpayers are required to compute tax under three alternative bases—an income tax imposed on entire net income, a tax imposed on business capital, and a fixed-dollar minimum tax. A taxpayer pays tax based on whatever computation yields the highest amount of tax.

For Article 9A corporate franchise tax purposes, the bills adopt two rate changes.

- For tax years beginning on or after January 1, 2021, and before January 1, 2024, the rate applicable to entire net income increases from 6.5% to 7.25% if the taxpayer's business income base exceeds \$5 million.
  - The rate increase is structured as a "cliff" rate, rather than a graduated rate, so that all income is 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.

**KPMG observation**

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 will 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)).

It is worth noting that the final corporate franchise tax increase is 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 insurance tax regime. 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 reinstate and increase the rate of the alternative tax on "business capital" that was phased out at the State (but not the 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 is imposed at a 0.1875% rate. The bills anticipate the tax sunseting as of the 2024 tax year. The existing "caps" (such as the \$5 million maximum business capital tax) and certain special lower rates will remain in place (i.e., the law during 2020) during its three-year revitalization. The City's business capital tax rate remains unchanged at 0.15% and the maximum City business capital tax is \$10 million.

**Individual (personal) income tax changes (Article 22 of N.Y. Tax Law)**

For the seven calendar tax years of 2021-2027, the bills establish three new marginal rate brackets. Previously, the highest individual (personal) income tax rate of 8.82% was imposed on joint filers with income over \$2,155,350. For joint filers, the new rate brackets and rates are as follows:

- 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
- 10.90% for joint filers with New York taxable income in excess of \$25 million.

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

**KPMG observation**

The combined New York State and City maximum individual income tax rate imposed on residents is now the highest in the nation, at 10.90% (State) + 3.876% (New York City) = 14.776%. By contrast, California, until now the highest, tops out at 13.3% for income over \$1 million.

**Pass-through entity tax (PTET) (new Article 24-A of N.Y. Tax Law)**

With the signing of the budget bills, New York joins a number of states that have taken advantage of IRS approval of the so-called "SALT workaround" to address the "Tax Cuts and Job Act" provision limiting an individual's deduction for state and local taxes to \$10,000 for taxpayers that itemize. 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, the

governor included a workaround plan. Later in the legislative session, each chamber tweaked that plan, and certain lobbying groups proposed their own plans. The final plan, captured in the budget bills, allows 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 applies 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 whether the entity has a calendar or fiscal year-end.

For the 2021 tax year, the election must be made by October 15, 2021, and there are no estimated payments required of the PTET, although the individual income tax partners and S corporation shareholders must continue to pay their quarterly New York personal income tax for 2021 irrespective of the PTET election. Thereafter, the entity must elect into the PTET annually by the due date of the first estimated tax payment (March 15) 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.

The PTET is imposed on the entity, but in general, each partner or S corporation shareholder has "several" liability for that person's direct share of the PTET (i.e., each partner/shareholder is liable only for the direct share of the tax, not for the entire amount due by the entity). In certain instances, such as when a partner or shareholder owns greater than 50% of an entity, is a controlling partner or member, or was the individual that made the election, that individual partner or member may be jointly and severally liable for the tax imposed on the electing partnership or S corporation.

Having a corporate partner does not 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 personal income filers' itemized deduction limitation concern—the entity pays the PTET only with respect to the distributive share of its income attributable to Article 22 individual income tax filers. The PTET base includes the income that would be subject to New York State income tax for the specific partner/shareholder.

For nonresident partners and both resident and nonresident S corporation shareholders, the PTET is paid by the entity on the "New York source" amount using either the Article 22 rules (for partners) or the Article 9A sourcing rules (for S corporation shareholders) to determine the New York-source amounts. For New York State resident partners, the PTET is paid by the entity on the entire (i.e., unapportioned "worldwide") amounts. It is not clear why the legislation limits an S corporation PTET to just the New York source amount with respect to a New York resident shareholder when, by contrast, a partnership pays the PTET on even the non-New York-source portion of the distributive share of a resident partner.

Resident and nonresident taxpayers are entitled to a credit, against their New York State individual income tax liability, for their share of the PTET that was paid in their behalf. An individual claiming the credit must add back to income an amount equal to the amount of the credit. If the PTET credit for an individual exceeds their New York State individual income tax due, the excess is 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.

## Other notable tax changes

There are other tax changes, many related to credits, included in the budget bills including:

- The bills extend a sales and use tax exemption applicable to tangible personal property and taxable services sold to certain related entities that were required to reorganize under the Dodd-Frank Act. As a result of the mandated reorganizations, transactions that occurred within the same legal entity were required to occur between separate legal entities, thus subjecting those transactions to sales and use tax. The exemption is extended through June 30, 2024.
- The budget bills require an addition modification for “any gain excluded from federal gross income for the taxable year by subparagraph (A) of paragraph (1) of subsection (a) of section 1400Z-2” of the Internal Revenue Code (IRC). This is the gain that is initially deferred under the federal Qualified Opportunity Zone rules. A subtraction modification applies for the gain that was deferred under IRC section 1400Z-2(a)(1)(A) that is later recognized for federal income tax purposes (but was previously recognized for New York State purposes). The effective date for this change, which applies to taxpayers filing under New York State Articles 9A, 22 and 33, as well as the New York City individual income tax, business corporation tax, bank tax and general corporate tax, is for tax years beginning on or after January 1, 2021.
- The bills revise the real estate transfer tax provisions to mandate that the tax is owed by the grantor, unless the grantee and grantor contract otherwise for the payment of the tax to fall on the grantee. When the grantor fails to pay, the grantor and grantee are jointly and severally liable for the tax. However, the bills adopt new language providing that in this situation, the grantee will have a cause of action against the grantor for recovery of the tax, interest, and penalties paid by the grantee. In the case of a residential property subject to the additional so-called “mansion tax” imposed under N.Y. Tax Law section 1402-a., if the tax is paid by the grantee pursuant to a contract between the parties, the amount of such tax will be excluded from the calculation of the consideration subject to the transfer tax under N.Y. Tax Law section 1402. These changes apply to conveyances effected on or after July 1, 2021, except for such conveyances made pursuant to a binding written contract that was entered into no later than April 1, 2021.

## Tax measures not included in the budget bills

Several controversial items that were widely discussed in the national press, but **not** included in the budget bills are:

- The revitalization of the essentially dormant New York State Stock Transfer Tax
- A new broad tax on financial transactions
- An expansion of the mortgage-recording tax to capture real property security interests relative to mezzanine debt and private equity investments
- Imposition of tax on individuals with second homes in New York
- A provision that would have ended the ability of federal S corporations to be non-electing New York State C corporations

The governor’s budget proposal would have allowed the New York Tax Appeals Tribunal to appeal taxpayer favorable rulings. This also was not included in the final bills.

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