

How NY's PTET Change Could Save You Taxes

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NY Pass-Through Entity Tax

Buried within New York State's 2023 fiscal year budget, which is the largest ever in the state's history, is a welcome tax savings opportunity for New York "resident S corporation" shareholders. By way of background, in 2021, New York and many other states implemented a Pass-Through Entity Tax (PTET) regime as a way to circumvent the federal cap on the state and local tax (SALT) deduction. Essentially, the electable tax regime permits pass-through entities – partnerships and S corporations – to pay income tax to New York at the entity level and pass these taxes through as a credit that partners and shareholders can then claim on their personal state income tax returns. The benefit of this election is that the pass-through entity can deduct the taxes paid to the state, thereby reducing the amount of income subject to federal income tax. Accordingly, not only do the partners and shareholders get a state credit to offset their New York income, but their federal taxable income is also reduced due to the deduction of the state tax payment.

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Under New York's PTET regime, resident partners of a partnership are eligible for a

PTET credit on all income allocated to them regardless of the state sourcing of the partnership income. The reason for this is twofold: (1) New York taxes residents on all their income wherever it is earned; and (2) partnerships can specially allocate items of income, loss, deductions and credits, which allows resident partners to receive a PTET credit for all income allocated to them, whereas nonresident partners only receive a credit for New York-sourced income. Unfortunately, S corporations are restricted under federal law from treating shareholders inequitably and thus cannot specially allocate income, or in this case PTET credits, differently among shareholders. As a result, New York's PTET regime limited resident shareholder credits to only state-sourced income, which in many cases could be only a small percentage of the shareholders' overall income from the corporation.

However, for 2022, New York found a way to increase the PTET credit and federal deduction for certain qualifying S corporations. Under the state's new rules, an S corporation with all New York State resident shareholders (a "resident S corporation") can now remit PTET on all income allocated to the resident shareholders. To demonstrate how significant this statutory change is at a very high level, see the following example:

Facts:

An S Corp has two New York resident shareholders. The S Corp's total income is \$1,000,000, of which \$200,000 is earned in New York and \$800,000 is earned in Florida. New York's tax rate for this level of income is 6.85%.

Old Rule:

Under last year's PTET rules for S corporations, the two shareholders would be eligible for a New York PTET credit of \$13,700 ($\$200,000 \times 6.85\%$) or \$6,850 each, and reduction of federal taxable income to \$986,300 ($\$1,000,000 - \$13,700$).

New Rule:

With the new law change, the New York shareholders will now receive a PTET credit of \$68,500 ($\$1,000,000 \times 6.85\%$) or \$34,250 each, and a reduction of federal taxable income to \$931,500 ($\$1,000,000 - \$68,500$).

While the above example is for illustrative purposes only and may not reflect all other variables that may come into play, it is clear that this budget change is a welcome opportunity for New York resident shareholders to help lower their overall tax bill. To find out whether you are eligible to take advantage of this update to New York's PTET or if you would like to consider other state or local tax saving opportunities, please contact [Alan Goldenberg](#), Principal and Leader of Anchin's State and Local Taxation and Tax Controversy groups, or your Anchin Relationship Partner.

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