

New York Resident State Credits for Pass-Through Entity Taxes

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With the release of IRS Notice 2020-75 permitting the deduction of state pass-through entity (PTE) tax payments, many taxpayers are considering electing into PTE tax regimes as a workaround for the \$10,000 cap on state and local tax deductions on federal tax returns. To date, New Jersey, Maryland, Louisiana, Oklahoma, Rhode Island and Wisconsin have enacted elective PTE taxes. Connecticut is the only state with a mandatory PTE tax. A number of other states, including New York, are debating the enactment of PTE taxes in 2021.

While the tax benefit of a business deduction for state and local taxes paid by a pass-through entity is certainly enticing for many, a significant question remains regarding credits for nonresident partners. Specifically, will a state grant a partner, member or shareholder a credit for the PTE taxes paid by the entity in nonresident states? Addressing this issue prior to electing into one or more of these tax regimes is vital, since without a credit, taxpayers may be taxed on their nonresident state sourced income in their resident state.

For our New York resident taxpayers, New York Tax Law §620(a) allows a resident credit “for any income tax imposed for the taxable year by another state...upon income both derived therefrom and subject to tax under this article.” Accordingly, the statute does not specifically indicate that the tax has to be paid directly by an

individual taxpayer. Therefore, it seems that PTE taxes are creditable to New York resident partners even when paid by an entity. However, with regard to S corporation shareholders, §620(d) states that the term “income tax” under subsection (a) “shall not include any such tax imposed upon or payable by the corporation.” Based upon this statutory language, it appears that PTE taxes are not creditable for New York resident S corporation shareholders.

Unfortunately, New York’s Department of Taxation and Finance has not provided guidance on this issue. Instead, the Department has pointed to the instructions for Form IT-112-R, New York’s resident credit form, which was updated in 2019 as follows:

A shareholder of a subchapter S corporation or a partner in a partnership is not allowed a resident credit for any income tax imposed upon or payable by the S corporation or partnership to another state, local government, or the District of Columbia. However, a shareholder or partner is allowed a resident credit if taxes are calculated on the income of the S corporation or partnership, but are imposed upon and payable by the shareholder or partner.

While form instructions are not the state law and here do not align with the statutory language, they do offer insight into the Department’s view of permitting such credits on resident tax returns. Therefore, consideration of the above should be factored in when determining whether to elect PTE taxes for those entities with New York resident partners.

New York resident taxpayers evaluating nonresident PTE taxes should consider the following:

1. Recognize that New York may potentially disallow such credits on your partner returns.
2. The election of PTE taxes should likely be limited to partnerships, LPs, LLCs, and LLPs, as these entities appear to have more favorable statutory language permitting the credit.
3. It may not be advisable for S corporation shareholders to elect into the PTE tax regime due to New York’s clear provision disallowing credits for taxes imposed on, and paid by, the corporation.

4. For those New York resident partners choosing to take a credit on their New York resident return for PTE taxes, a statement disclosing the taxpayer's position and credit claimed on the IT-201 is encouraged.

If you have questions with respect to electing PTE taxes and their impact on your resident state credit, please contact Alan Goldenberg, Leader of Anchin's State and Local (SALT) group at alan.goldenberg@anchin.com or your Anchin Relationship Partner.