New York budget increases tax rates and makes other changes

April 7, 2021

In brief

Update: Governor Cuomo signed the legislation on April 19, 2021.

On April 7, the New York Legislature approved comprehensive tax legislation (S2509-C/A3009-C) as part of the state's FY 22 budget. The legislation includes increased taxes on businesses and high-income individuals and a pass-through entity tax option. Other provisions include amendments to the real estate transfer tax and the impact of a remote workforce on state tax benefits.

Several noteworthy items that had been under consideration did not make it into the final bill, including provisions tying S corporations to their federal election for state purposes and allowing the Department of Taxation and Finance to appeal decisions of the Tax Appeals Tribunal.

Action item: Taxpayers may be surprised to learn of the corporate tax rate increases since they were not included in the original budget. The increased rates take effect in 2021 and will require taxpayers to immediately assess their impact. Similarly, eligible pass-through entities will need to quickly assess whether to make the election to pay the new tax.

In detail

Corporate tax rates - Part HHH

The legislation increases the corporate franchise tax rate to 7.25% from 6.5% for tax years beginning on or after January 1, 2021 and before January 1, 2024 for taxpayers with a business income base greater than $5 million.

In addition, the scheduled phase-out of the capital base tax has been delayed. The rate of the capital base was to have been 0% starting in 2021. The legislation imposes the tax at the rate of 0.1875% for tax years beginning on or after January 1, 2021 and before January 1, 2024, with the 0% rate to take effect in 2024. However, the delay does not apply to deemed small businesses.

Personal income tax rate - Part A

The legislation increases the personal income tax rates on higher incomes from 2021 through 2027. Currently, the highest state income tax rate is 8.82%. The legislation increases the rate to 9.65% on income over (a) $2,155,350 but not over $5 million, for married individuals filing jointly; (b) $1,646,450 but not over $5 million, for resident heads of household; and (c) $1,077,050 but not over $5 million, for unmarried individuals, married individuals filing separately, estates, and trusts.

In addition, the legislation creates two additional tax brackets, with income over $5 million but not over $25 million taxed at a rate of 10.3%, and income over $25 million taxed at a rate of 10.9%. These thresholds and rates apply to all classes of taxpayers. The legislation also updates the state's tax table benefit recapture provisions to correspond with the new increased rates.

Note: These tax increases, when coupled with New York City (NYC) personal income taxes, will result in the nation's highest state and local personal income tax rates for affected taxpayers. For example, a NYC resident with taxable income over $25 million will pay personal income tax at a combined rate of 14.776% (10.9% for New York State plus 3.876% for NYC).

Optional pass-through entity tax - Part C

The legislation allows, starting in 2021, partnerships (as defined under IRC Section 7701(a)(2)) and S corporations to make an annual election to pay a pass-through entity income tax at the rates ranging from 6.85% to 10.9% on the entity's taxable income. An offsetting personal income tax credit is allowed for the electing partnership's direct partners or members or the S corporation's direct shareholders.

Taxable income of an electing partnership equals the sum of (1) all items of income, gain, loss, or deduction derived from or connected to New York sources to the extent such items are included in the taxable income of a nonresident partner subject to the state's personal income tax and (2) all items of income, gain, loss, or deduction to the extent such items are included in the taxable income of a resident partner subject to the state's personal income tax. For electing S corporations, taxable income equals the sum of all items of income, gain, loss or deduction derived from or connected to New York sources to the extent included in the taxable income of a shareholder subject to the state's personal income tax.

The legislation provides additional details for making the election, claiming the credit, estimated tax payments, filing deadlines, what information must be included in the annual return, and other procedural provisions.

Real estate transfer tax - Part O

The legislation deems anyone who is an officer, employee, manager, or member under a duty to act for a corporation, partnership, LLC, or individual proprietorship to be a person responsible for complying with the provisions of the state's real estate transfer tax. The legislation also clarifies that responsibility for the tax lies with the grantor. This provision applies to conveyances made on or after July 1, 2021, except for conveyances that are made pursuant to binding written contracts entered into on or before April 1, 2021, provided that the date of contract execution is confirmed by independent evidence.

In addition, publicly traded companies, REITs, and mutual funds that are members of LLCs are exempt from the requirement to disclose all of their members/shareholders on a real estate transfer tax return in a sale of a building with up to four residential units. The legislation does not make corresponding changes to the New York City real property transfer tax.

Remote work - Tax benefits - Part NN

The legislation allows, for the duration of the state-declared COVID-19 disaster, a taxpayer that required some or all its employees to work remotely to designate the remote work as having been performed at the location where it was performed prior to the emergency declaration for purposes of tax benefits based on maintaining a presence in the state or a specific area in the state. This provision expires on December 31, 2021, or the date the COVID-19 disaster is declared over, whichever is earlier.

Qualified opportunity funds - Part DDD

The legislation disallows any federal exclusion for capital gains from the sale or exchange of property to an unrelated party in the tax year of the sale or exchange to the extent the amount of gain is reinvested in a qualified opportunity fund within 180 days of the sale or exchange (*see,* IRC Sec. 1400Z-2(a)(1)(A)). This provision applies to the corporate franchise tax, insurance premium tax, personal income tax, and NYC taxes, starting with tax years beginning on or after January 1, 2021.

Other provisions

In addition, the legislation:

- (Part F) extends the film production and post-production credit programs an additional year to expire after 2026 (previously 2025);
- (Part M) extends until June 30, 2027, the exemption from sales and use tax for certain sales or services transacted between financial institutions and their subsidiaries related to the Dodd-Frank Protection Act;
- (Part PP) establishes a new musical and theatrical production credit for NYC.

Omissions

The final legislation does not include provisions under consideration that would have:

- delayed the phased-in reduction of "the middle class personal income tax rate cuts" by one year;
- imposed a 1% tax on both short and long-term capital gains;
- allowed the Department of Taxation and Finance to appeal decisions of the Tax Appeals Tribunal;
- required all federal S corporations that are subject to tax in New York or that have qualified S corporation subsidiaries subject to tax in New York to be treated as S corporations for New York tax purposes, starting in 2022;
- subjected mezzanine debt and preferred equity investments to the mortgage recording tax;
- imposed a "supplemental surcharge on owners of certain non-primary residence properties" in NYC with a five-year average market value of $5 million or more (the *pied-a-terre tax*).

The takeaway

While debate over the necessity for and the breadth of tax increases continued even after the state received billions of dollars from the federal government, most observers foresaw that significant increases were likely. The 2021 applicable dates of the tax increases mean that New York taxpayers must quickly consider the impact.

The optional pass-through entity tax is intended as a work-around of the federal $10,000 cap on the state and local tax itemized deduction. It comes on the heels of the IRS November 9 Notice 2020-75, which clarifies that state and local income taxes imposed on, and paid by, a partnership or an S corporation on its income are allowed as a deduction in computing the entity's nonseparately stated taxable income or loss for the tax year of payment. Under the regulations announced in the notice, partnerships and S corporations could deduct state and local income taxes against ordinary income, with no addback required at the individual partner or shareholder level. (See our insight on Notice 2020-75, here.)

Note: Several proposals that attracted media attention never formally were considered in the budget, specifically a stock transfer tax and a billionaire's marked-to-market net worth tax.

Let's talk

For questions about the legislation, please contact:

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