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## New York State SALT Limitation Workaround for Individual Members of Pass-Through Entities

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**April 15, 2021** – On April 7, 2021, the New York State Legislature passed the 2021-22 budget bill, which is expected to be signed by Governor Cuomo and enacted in its present form. The legislation includes a “Pass-Through Entity Tax” that is intended to allow an individual member (“Member”) of a partnership (other than a publicly traded partnership), S corporation or other entity (such as an LLC) treated as a partnership or S corporation for federal income tax purposes (the “Pass-Through Entity”) to avoid the annual \$10,000 (\$5,000 for married individuals filing separately) limitation on deducting state and local taxes for federal income tax purposes (the “SALT Limitation”) with respect to New York State tax on his or her allocable share of income from the Pass-Through Entity. Investment partnerships are included as Pass-Through Entities for this purpose.

Pursuant to the New York legislation, the Pass-Through Entity may annually elect to pay New York taxes at the entity level on its “pass-through entity taxable income,” which for a partnership is generally equivalent to the sum of (i) the partnership’s taxable income that is allocable to New York resident individual partners and (ii) the partnership’s New York source taxable income that is allocable to individual non-resident New York partners.

Generally, an S corporation’s “pass-through entity taxable income” equals the amount of New York source taxable income that is allocable to its shareholders. The legislation does not apply to New York City taxes.

The Pass-Through Entity Tax would be imposed at the following rates:

Pass-Through Entity Taxable Income	NYS Tax Rates
Up to \$2 Million	6.85%
From \$2 Million to \$5 Million	9.65%

Pass-Through Entity Taxable Income	NYS Tax Rates
From \$5 Million to \$25 Million	10.30%
Over \$25 Million	10.90%

Members would receive a refundable credit for their share of the Pass-Through Entity Tax against their New York individual income tax liability, with the result that there should be no incremental New York State tax liability with respect to their share of income from the Pass-Through Entity. Members that are New York State residents may also receive a credit for substantially similar taxes paid by the Pass-Through Entity to other states.

A Member's share of Pass-Through Entity Tax is expected to be deductible against his or her federal taxable income, regardless of whether the Member itemizes deductions, and is not subject to the SALT Limitation pursuant to IRS Notice 2020-75. In that Notice, the Treasury Department and the IRS stated that they intend to propose regulations that would allow individual members of partnerships (including entities treated as partnerships for federal income tax purposes) or S corporations to receive a full deduction for their pro rata share of income taxes paid by a partnership or a S corporation to a State or a political division of State, even if the imposition of the tax is the result of an election by the entity and the tax is creditable against the member's individual state income tax liability. It is unclear from the Notice whether the deduction is reduced if the member receives a net credit against individual tax liability that is greater than the New York State tax liability that would have been imposed on the individual had the income been earned directly (*e.g.*, if a New York resident with an individual rate of 6.85% is a partner in a partnership subject to Pass-Through Entity Tax at a 10.9% rate), although a reduction would appear to be appropriate.

Pass-Through Entities with corporate Members should carefully consider the consequences of making the election and ensure that the applicable entity agreement permits the special allocation of the Pass-Through Entity Tax to the individuals that are eligible to receive the credit. Also, payment of the tax will reduce cash available for distribution.

Pass-Through Entities should also ensure that they will have sufficient cash to meet their liability for the Pass-Through Entity Tax. The general partner, manager and/or controlling Member (including any Member with a greater than fifty percent stake) of an electing Pass-Through Entity are jointly liable for the entirety of the Pass-Through Entity Tax.

The Pass-Through Entity Tax regime applies to all taxable years beginning on or after January 1, 2021. Generally, the Pass-Through Entity would be required to make the annual election by March 15 of the applicable calendar year and to make quarterly estimated tax payments. Under a transitional rule applicable to calendar year 2021, the election must be made by October 15, 2021, the Pass-Through Entity is not required to pay estimated taxes, and individual members are required to pay estimated taxes as if the Pass-Through Entity Tax did not apply. The Pass-Through Entity Tax rules are complex, and their details are beyond the scope of this alert.

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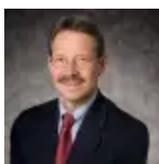
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