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State & Local Tax Advisory ▪

APRIL 13, 2021

New York's FY 2022 Budget Bill Crosses Finish Line

On April 7, just a few days after the April 1 constitutionally imposed deadline for passing the state budget, the budget bill (S.2509-C/A.3009-C) was delivered to Governor Andrew Cuomo for his signature. From a tax perspective, the bill provides a mixed bag: tax increases for some and tax decreases for others. The bill also expands existing tax credits and creates tax credits aimed at helping businesses that have been most impacted by the COVID-19 pandemic.

Personal Income Tax

Personal income tax (PIT) rates, which currently top out at 8.82%, will increase to 9.65% for individual filers with income over $1,077,550 and joint filers with income over $2,155,350. Two new tax brackets will be established: 10.3% for taxpayers with income over $5 million and 10.9% for taxpayers with income over $25 million. The PIT rate increases on wealthy individuals is expected to raise $2.75 billion in fiscal year (FY) 2022 and $3.3 billion in FY 2023. The governor had sought to impose surcharges limited to 2021 through 2023, but as enacted, the rate increases apply through 2027.

PIT rate reductions for the middle class, which the governor had sought to delay by one year, will go into effect as scheduled. The rate-reduction phase-in began in 2018 and is currently scheduled to be fully phased in by 2025.

The bill provides for a PIT credit to taxpayers with incomes under $250,000 and who pay property tax exceeding 6% of their incomes; the credit is capped at $350 per year and applies to years beginning on or after January 1, 2021.

The bill authorizes the tax department to waive interest due to underpayment of taxes caused by insufficient withholding on unemployment compensation for 2020.

Corporate Franchise Tax

Corporate franchise rates will increase to 7.25% from 6.5% for corporations with a business income base of more than $5 million.

For years beginning on or after January 1, 2021 and ending before December 31, 2023, the capital base is reinstated at a 0.1875% rate for businesses that are not categorized as small businesses (net incomes less than $390,000 and less than 100 employees); qualified manufacturers, qualified emerging technology companies, and cooperative housing corporations continue to be exempt from the capital base.

These corporate franchise tax changes are expected to raise $750 million in FY 2022 and $1 billion in FY 2023.

New Elective Pass-Through Entity Tax

A new elective pass-through entity (PTE) tax was enacted for years beginning on or after January 1, 2021, with a 6.85% tax rate for taxable income up to $2 million, with rates increasing to 9.65% for entities with taxable income between $2 million and $5 million, 10.3% for entities with income between $5 million and $25 million, and 10.9% for entities with income over $25 million. Partners, members, and shareholders of electing PTEs would be allowed to claim a tax credit on their proportionate or pro rata share of taxes paid by the entity. The elective PTE tax functions as a workaround to the SALT cap imposed by the 2017 Tax Cuts and Jobs Act.

The legislature rejected the governor's proposal that would have established the PTE tax for years starting in 2022 and would have allowed a credit of 92% of the partner's, member's, or shareholder's share of the entity's PTE tax.

Sales Tax

The bill provides a technical correction to the sales volume threshold for requiring remote vendor registration in Tax Law § 1134(a)(1)(i) to reflect that the correct threshold is $500,000.

Tax Credits

The bill expands the excelsior investment tax credit for participants in the excelsior jobs program to include expenditures for child care services by providing an additional 5% credit and creates a new 6% excelsior child care services tax credit for new child care services expenditures for the operation, sponsorship, or direct financial support of a child care services program.

The empire state film production credit and empire state film post production credit were extended an additional year through 2026, and the tax credit can be used by recipients in additional jurisdictions.

The musical and theatrical production credit was extended for regions outside New York City for an additional four years, through January 1, 2026. The bill also increased the annual tax credit cap from $4 million to $8 million.

A new restaurant return-to-work tax credit program provides a credit for $5,000 per each full-time equivalent net employee increase up to $50,000 in total credits per business entity. The bill provides for the issuance of up to $35 million in these tax credits through 2021.

A new New York City musical and theatrical production tax credit was enacted. The tax credit is 25% of qualifying production expenditures not to exceed $3 million and is available to qualifying musical and theatrical productions whose first performance is during the first year in which the tax credit's applications are accepted. The maximum amount is decreased to $1.5 million for productions whose first performance is during the second year in which the tax credit's applications are accepted. The tax credit is available for 2021 through 2023.

Miscellaneous

The bill increases penalties for the failure to provide complete and accurate wage reporting and withholding reports from $50 per employee to $100 per employee and increases the maximum penalty that can be imposed on employers from $10,000 to $20,000. The penalty increases are expected to increase revenue by $2 million annually and apply to Form NYS-45s that are filed on or after June 1, 2021. The governor's proposal sought to increase the maximum penalty per employer to $50,000.

The bill authorized mobile sports wagering. It requires that the state issue requests for applications this year in order to award licenses to operate the wagering platform. Legalization of sports wagering is expected to annually increase revenue by $500 million once the infrastructure is in place.

Takeaways

Since the middle-class rate reduction was part of a scheduled phase-in enacted before the COVID-19 pandemic, the rate reduction should not run afoul of the mandate in the American Rescue Plan Act of 2021 that prohibits any state from accepting federal financial assistance if directly or indirectly lowering the tax burden on its citizens for the next four years. We will have to wait to learn how the American Rescue Plan impacts the bill's continued middle-class rate reduction. Treasury Secretary Janet Yellen recently announced that further guidance on the scope of the American Rescue Plan will be issued.

While the bill contained an expansive list of tax items, some of the governor's tax-related budget proposals were not enacted. Notably, the governor's proposal to require "vacation rental marketplace providers" such as Airbnb and VRBO to collect and remit sales tax on vacation rentals they facilitate was eliminated. Additionally, the proposal to extend the interest-free period from three months to six months for the tax department to process sales tax refunds over $100,000 was eliminated. Finally, the proposal that would give the tax department the right to appeal adverse State Tax Tribunal decisions was stricken from the final bill.

While the bill does raise taxes on certain wealthier taxpayers, it also provides benefits in the form of lower taxes and tax credits to low- and middle-income taxpayers and businesses hit the hardest during the pandemic. Only time will tell if the increases in tax revenue from the re-emergence of the capital tax and increases to both the corporate tax rate and individual tax rate on wealthy individuals will offset a potential exodus of wealthier individuals and businesses to more tax-friendly climates.

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