



Questions and answers on pass-through entity elections *Partnerships now have the option to pay income tax on behalf of members*

SANTA FE—The Taxation and Revenue Department has published answers to questions it is receiving about a new law allowing pass-through entities to pay New Mexico income tax on behalf of their partners or members.

In the past, individual members of a pass-through entity were responsible for paying tax on income received from the entity. Under legislation passed by the 2022 New Mexico Legislature and signed into law by Gov. Michelle Lujan Grisham, pass-through entities such as partnerships, S-Corporations and Limited Liability Companies now have the option of filing directly if they elect to do so.

More information, including answers to some of the most common questions being received by the Department, are available on the [Pass-Through Entity page](#) at tax.newmexico.gov and lower in this release.

The Department cannot advise taxpayers on whether it would be beneficial for a pass-through entity to choose to be taxed directly or on how it might affect partners' individual state or federal taxes. Pass-through entities and their partners should consult with their tax professionals before making an election.

Below are the Department's responses to frequently asked questions.

When does the PTE have to make the election to be taxed directly?

The PTE will make the election to be taxed directly at the entity level when it files its Form PTW-D, the Pass-Through Entity Detail Withholding Report. This form has a box that the PTE will check to indicate that it is electing to pay taxes directly. The box is labeled "4b(iii) 7-1-13(G) Payment Election".

How does the PTE decide how to make the election? Do all the partners or members of the PTE have to agree?

The partners or members of the PTE have to determine whether the PTE will make the election. The agreement among the partners or members should control that decision. Note that the election will affect all the partners or members. The entity cannot elect to pay tax directly on the income of some of its partners or members, but not others. The election is to pay tax directly on all distributed net income.

How does the election impact the duty to pay estimated taxes? For the PTE? For the partners or members?

The PTE does have a duty to pay estimated taxes. But for most PTEs, such estimated tax payments are due on or before the due date of the federal tax return required for the PTE.

The 2022 PTW-D does allow for estimated payments and return payments for the Entity Level Tax. For those taxpayers who would like to make an estimated payment, the Department will release a PTW-ES voucher type in January of 2023. If a taxpayer wishes to make an estimated payment prior to the end of tax year 2022, they can make a return payment against the PTW account on the [Taxpayer Access Point \(TAP\)](#).

If you are a new taxpayer or do not currently have a PTW account in TAP, you can use a paper payment voucher. We have provided our 2022 PTW-ES and PTW-PV on our website: <https://www.tax.newmexico.gov/forms-publications/>. To locate the vouchers, use the following folder path: Tax Professionals > PTW Payment Vouchers. Please note this is a temporary solution to meet the needs of the taxpayers as we make a full transition in to the 2022 PTW-D changes.

Is the election irrevocable, or can it be changed each tax year?

The election is made for each tax year on Form PTW-D and applies only to that tax year. Note, however, that once the election is made for a tax year, the election for that tax year cannot be changed by filing an amended return.

What if the PTE withheld and paid taxes for its partners or members, and then elects to be taxed directly? Can the amounts withheld be re-characterized as payments by the PTE?

Yes. Any payment made for the benefit of a partner or member may also be a payment for the PTE if the entity elects to pay entity level tax when filing the return. However, in order to avoid any complications with recharacterization of amounts already paid on behalf of another, the Department suggests that the taxpayer file amended returns and applications for refunds, and that the PTE then pay the tax directly itself.

How does the election affect the partners or members of the PTE?

Net income subject to the entity-level tax is exempt from income taxation. Any net income on which the PTE does not pay tax is not exempt.

What income of the PTE is taxed directly? Is any income excluded?

Four categories of income are excluded from the PTE's taxable net income: (1) allocations of income to the United States or the State of New Mexico and any of its political subdivisions; (2) allocations of income to a federally recognized Indian nation, tribe or pueblo located wholly or partially in New Mexico, or any political subdivision thereof; (3) allocations of income to 501(c)(3) organizations; and, (4) allocations of income to a corporation that would include the

income in its New Mexico corporate income tax return as part of its unitary business income. The rest of the PTE's net income is taxed directly when it makes the election.

The law says that the PTE is taxed at the highest tax rate. Is that the highest personal income tax rate or the highest corporate income tax rate?

The taxable net income of the PTE is taxed at the higher of the personal or corporate income tax rate. The highest rate for both personal and corporate income taxes is currently 5.9%.

How does the PTE treat deductions? Are the same deductions that are available to the partners or members also available to the PTE?

The Department believes that deductions that are available to a partner or member should also be available to the PTE when it elects to pay tax directly, to the extent that the deduction relates to income earned by the PTE. For example, if the PTE has capital gain income, since the individual partners would be entitled to a deduction, the PTE would also be entitled to the deduction under Section 7-2-34 for that income. Note that the deduction would be in proportion to the amount of distributed net income allocated to partners eligible for the deduction. In other words, the deduction may only be taken against the net income on which the PTE is paying tax directly that would be allocated to individuals, which excludes any capital gains allocable to the four categories set out above. The Department notes that while it believes this is the intent of the legislation, the statutory language is unclear as to the treatment of deductions with respect to direct tax paid by PTEs, and we expect that we or others will be seeking clarification from the Legislature.

How does the PTE treat credits, especially credits that are refundable or that may be carried forward?

Any credit that is specific to a corporate or individual partner cannot be claimed if the election to pay at the entity level is made. If the partners have a credit that they can claim on either the personal income tax return or a specific corporate return, they should file and claim that credit on that income tax return. Many credits in the Income Tax Act and the Corporate Franchise Tax Act are specific to those individuals or entities and can only be claimed by those specific individuals or entities on the appropriate income tax return called for by each credit in statute.

Note that there is an exception for the Film Production Tax Credit, which may be claimed by the PTE. The Film Production Tax Credit may be claimed directly by the PTE on its information return and may therefore be applied directly towards entity-level tax.

How does the PTE treat net operating losses, ("NOLs")?

PTEs with NOLs should not elect to pay income taxes directly at the present time. The Department will develop rules governing use of NOLs by PTEs, and the carry-forward effects of an election by a PTE that has NOLs.

If one of the partners or members of the PTE is a corporation, can the PTE elect to pay taxes directly? Can the PTE pay the taxes owed by a corporate partner or member of the PTE?

The PTE cannot pay income tax directly with respect to any income allocable to a corporate partner that would include the income from the PTE in its New Mexico corporate income tax return as part of its unitary business income. The PTE will continue to withhold income taxes on behalf of such partners or members.

What if one of the partners or members of the PTE is itself a PTE, such as a tiered partnership? Can each partner or member make the election?

Yes, each partner in a tiered partnership makes its own, separate election. Each partner at each level of a tiered partnership may determine whether or not to make the election. So, for example, if Partnership A is a partner of Partnership B, both A and B can separately decide whether to make the election.

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