



STATE AND LOCAL TAX SERVICES

Pass-Through Entity Tax Services

Many states now allow pass-through entities (PTEs) to elect to be taxed at the entity level to help Individual owners mitigate the state and local tax deduction limitation established by the Tax Cuts and Jobs Act. PTE elections can result in significant federal tax savings.

State Laws Create Opportunities to Alleviate the Limitations

Significant legislative changes in recent years at the state level allow partnerships and S corporations the option for income tax to be imposed at the entity-level. PTEs making this election may be allowed to deduct these state income taxes on their Federal return as an ordinary business expense and avoid the SALT-cap limits that may otherwise apply to individual PTE owners. This would allow the PTE to deduct these taxes for Federal tax purposes as an ordinary business expense and avoiding the limits that may otherwise apply to individual PTE owners. Individual owners of electing PTEs generally receive a tax credit or reduction of pass-through income on their state individual income tax return for income taxed at the entity-level.

In November 2020, the IRS released Notice 2020-75 to announce that proposed regulations will be issued outlining the deductibility of income taxes paid by an electing PTE. Until these proposed regulations are issued, the IRS stated that taxpayers may rely on Notice 2020-75 for guidance.



Individual Income Tax Credit Changes for Multistate Taxpayers

Generally, individual multistate taxpayers are allowed an individual income tax credit by their resident state for income taxes paid in another state. PTE owners are typically allowed resident state credits when the PTE has withheld income tax in another state on behalf of the owner, or the owner has elected to participate in a nonresident composite return. However, many states have yet to address whether they will allow residents to claim a credit for taxes paid to other states where the income tax is imposed on the PTE itself.

Key Areas of Consideration

When evaluating PTE taxes, there are many key considerations to keep in mind including:

- ▶ Qualifications and methods for making the election
- ▶ Multistate PTE owners' ability to claim resident tax credits (or other relief) when the PTE has elected to pay income tax to another state at the entity-level
- ▶ Timing of deductions
- ▶ Impacts on corporate and nonprofit PTE owners
- ▶ Tax accounting considerations, such as ASC740

How We Can Help

PTE elections can provide significant benefits to owners of pass-through entities. Many states have enacted, or are currently considering legislation aimed at reducing the taxpayer's federal tax burden with increased deductions for state income taxes.

Given the significant differences among the state PTE tax election statutes that have been enacted or proposed, including some with unique tax provisions and others that could present potentially adverse tax consequences for PTE owners, business owners are strongly encouraged to evaluate each state's requirements. Consideration should be given to qualification requirements, election due dates, estimated tax payment requirements, and evaluating whether the potential tax benefits outweigh the increased complexity and possible increased volume of tax filings. Potential tax impact and associated costs should be modeled before making final election decisions.

Our State & Local Tax practice can interpret the pass-through entity tax elections and help you understand the potential impact to your business.

Your Guide Forward



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About Cherry Bekaert

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