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KPMG report: State-level passthrough entity tax; election considerations and upcoming deadlines

In response to the federal $10,000 cap on state and local tax itemized deductions, many states have enacted legislation allowing a passthrough entity to elect to pay the tax and provide an owner a credit or deduction for the tax paid by the passthrough entity.

There are several considerations in determining whether a passthrough entity can take advantage of this election.

- Preliminarily, a passthrough entity must consider whether it is eligible to make the election. Some states allow passthrough entities with only individual owners to make the election. For example, Oregon allows partnerships and S corporations with only individual owners or passthrough entity owners held by individual owners to elect to pay the tax.

- Other states disallow passthrough entities with partnership owners to make the election. For example, Minnesota does not allow a partnership or S corporation that has an owner that is a partnership, non-disregarded limited liability company, or corporation to elect to pay the tax.

Also, a passthrough entity must consider how long the election lasts. Some states provide that the election is binding until the entity revokes the election. For example, in Alabama, the election is binding until the entity files paperwork to revoke the election on or before the 15th day of the third month after the tax year. Other states require the election to be made on an annual basis. For example, in California, the election must be made annually on a timely filed return.

Finally, a passthrough entity must consider whether the states provide any relief for estimated tax payments in the initial effective tax year. For example, in New York, a passthrough entity was not required to make any estimated tax payments for the passthrough entity tax (PTET) for the tax year 2021 but was permitted to make optional online estimated tax payments prior to December 31, 2021.

Modeling

In determining if there will be a benefit to participating in one or more elective PTETs, it will be important to prepare computations that show the effects for the passthrough entity and its owners. These computations would include numerous elements such as the tax implications at the passthrough entity level; how the deduction will be split among the owners; how the passthrough entity tax credit or income exclusion or deduction will affect the owner's individual or personal state income tax filings; how the credit for taxes paid computed for an owner's resident state will be affected; the cash implications for the owners; the treatment of state credit refunds as additional federal income; and the federal tax implications on the owners.

Determining whether a passthrough owner's resident state will allow a credit for taxes paid by the entity to other states requires consideration of the rules and any guidance issued by the resident state.

- Some states have specifically indicated that one or more other states' PTETs would not be included in a resident individual's credit for taxes paid (e.g., Maine).

- Some states have noted the PTETs are not includable in a resident partner's credit for taxes paid even though it would be includable in the computation of an S corporation shareholder's credit for taxes paid (e.g., Missouri, Pennsylvania).

- Some have indicated they would allow a credit for PTETs that are "substantially similar" to that state's PTET and have released lists of which other states impose "substantially similar" PTETs that the state will permit a resident owner to include in their computation of credit for taxes paid (e.g., Illinois and New York).

In addition, other state legislatures currently have bills that would adopt elective passthrough entity taxes (e.g., New Mexico, Virginia).

Next steps

The deadlines for making the election for tax year 2021 and for making estimated payments for 2022 are included in a **February 2022 report** [PDF 171 KB] prepared by KPMG LLP.

There are March 15 deadlines and April 15 deadlines. Any remaining payments for 2021 generally must be made by the original due date of the return, and **not** the extended due date.

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