

Notice 2020-75 Clarifies State & Local Tax Deduction Cap Does Not Apply to Passthrough Entities

November 11, 2020

Notice 2020-75

Recently issued Notice 2020-75 provides that Treasury and the IRS intend to issue proposed regulations to clarify the longstanding question of whether the SALT Cap applies to passthrough entities or S-corporations. The answer—it does not. Specifically, the Notice provides that if a partnership (including LLCs taxed as partnerships) or an S corporation make a Specified Income Tax Payment to a domestic state or local jurisdiction, the entity is allowed a deduction for the tax payment without being subject to the SALT Cap.

Amounts paid by a partnership or an S corporation as a result of a state or local jurisdiction imposing income tax on the entity shall qualify as a Specified Income Tax Payment. This is true irrespective of whether the state tax regime is mandatory or whether the partners/shareholders receive a deduction, exclusion or other tax benefit based on their share of the amount paid on their behalf.

PTE Taxes and The Tax Cuts & Jobs Act of 2016

The Tax Cuts & Jobs Act (TCJA) significantly limited the ability of individuals to deduct state taxes paid. For those taxpayers that itemize their deductions, the TCJA imposed a limit of \$10,000. Following the passage of the TCJA, the newly limited SALT deduction was one of the more controversial provisions as it meant a significant lost deduction in states where higher income, property, and sales tax rates applied.

In an attempt to mitigate the impact of the SALT cap, certain states quickly adopted PTE level taxes as a potential solution. Rhode Island, Louisiana, Oklahoma, and Wisconsin all passed measures to adopt elective PTE taxes which generally permit a credit or exclusion to the individual owners of the entities for taxes paid. Connecticut also provided for a PTE tax, but it has a notable difference in that it is not elective. Until the issuance of Notice 2020-75, Treasury had not yet opined on whether a state PTE tax was limited by the terms of the TCJA.

Considerations

In the current environment, it remains an open question of whether Notice 2020-75 will be an impetus for additional states to adopt a PTE entity level regime. For those states with PTE tax in place, taxpayers should consider the impact of Notice 2020-75 on allowable deductions.

For more information regarding the state taxation of passthrough entities and how they may affect you, please contact:

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