

A New Frontier: Pass-through Entity Tax (PTET)

Presented by:

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Welcome



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Today's Topics

- Components of Pass Through Entity Tax - PTET

Basic Provisions of PTET

- Maryland
- Virginia
- North Carolina

Other States & Considerations



What Is Pass Through Entity Tax (PTET)?

- Optional state income tax for Pass-Through Entity taxpayers that avoids SALT cap at individual taxpayer level
- Opportunity for federal tax deduction for state income taxes – without limitation
- Avoids “SALT Cap” for individual filers



In short, PTET gets rid of this situation!

SCHEDULE A (Form 1040)		Itemized Deductions		OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service (99)		<p>▶ Go to www.irs.gov/ScheduleA for instructions and the latest information.</p> <p>▶ Attach to Form 1040 or 1040-SR.</p> <p>Caution: If you are claiming a net qualified disaster loss on Form 4684, see the instructions for line 18.</p>		<p>2021</p> <p>Attachment Sequence No. 07</p>	
Name(s) shown on Form 1040 or 1040-SR				Your social security number	
MARY & JOSEPH TAXPAYER				654 32 1987	
Medical and Dental Expenses	Caution: Do not include expenses reimbursed or paid by others.				
	1	Medical and dental expenses (see instructions)	1		
	2	Enter amount from Form 1040 or 1040-SR, line 11	2		
	3	Multiply line 2 by 7.5% (0.075)	3		
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4		
Taxes You Paid	5 State and local taxes.				
	a	State and local income taxes or general sales taxes. You may include either income taxes or general sales taxes on line 5a, but not both. If you elect to include general sales taxes instead of income taxes, check this box See Statement <input type="checkbox"/>	5a	145,000.	
	b	State and local real estate taxes (see instructions)	5b	10,000.	
	c	State and local personal property taxes	5c	500.	
	d	Add lines 5a through 5c	5d	155,500.	
	e	Enter the smaller of line 5d or \$10,000 (\$5,000 if married filing separately)	5e	10,000.	
	6	Other taxes. List type and amount ▶	6		
7	Add lines 5e and 6	7		10,000.	

Example

		<u>No PTET</u>	<u>w/ PTET</u>
Federal Income		2,500,000	2,500,000
State PTET	5.75%	-	(143,750)
Income per K-1		2,500,000	2,356,250
QBI deduction		(500,000)	(471,250)
Adjusted Taxable income to 1040		<u>2,000,000</u>	<u>1,885,000</u>
Marginal federal tax rate	37%	740,000	697,450
Projected tax savings		42,550	

Unique

- Provisions are passed at state level, therefore, while similar, variations occur from state to state

Similarities

- *Tax is at entity level*
- *Designed to be deductible*
- *Reciprocating benefit*
- *Provision generally ends after 2025*

Variances

- *Qualifying owners*
- *Election process*
- *Tax credit or income reduction*
- *Tax base and calculation*



Maryland



Maryland PTET

- Effective after January 1, 2020
- Entities with both individuals and other entities as owners qualify
- Elect by filing MD Form 511
- Estimated tax payments expected
- Underpayment penalties apply
- PTET tax rates: 8% individuals 8.25% entities



Maryland PTET *continued*

- Adjustment on owner MD return via credit against MD tax liability
- PTET credit refundable on individual owner returns
- Non-resident owners required to file non-resident return



Virginia



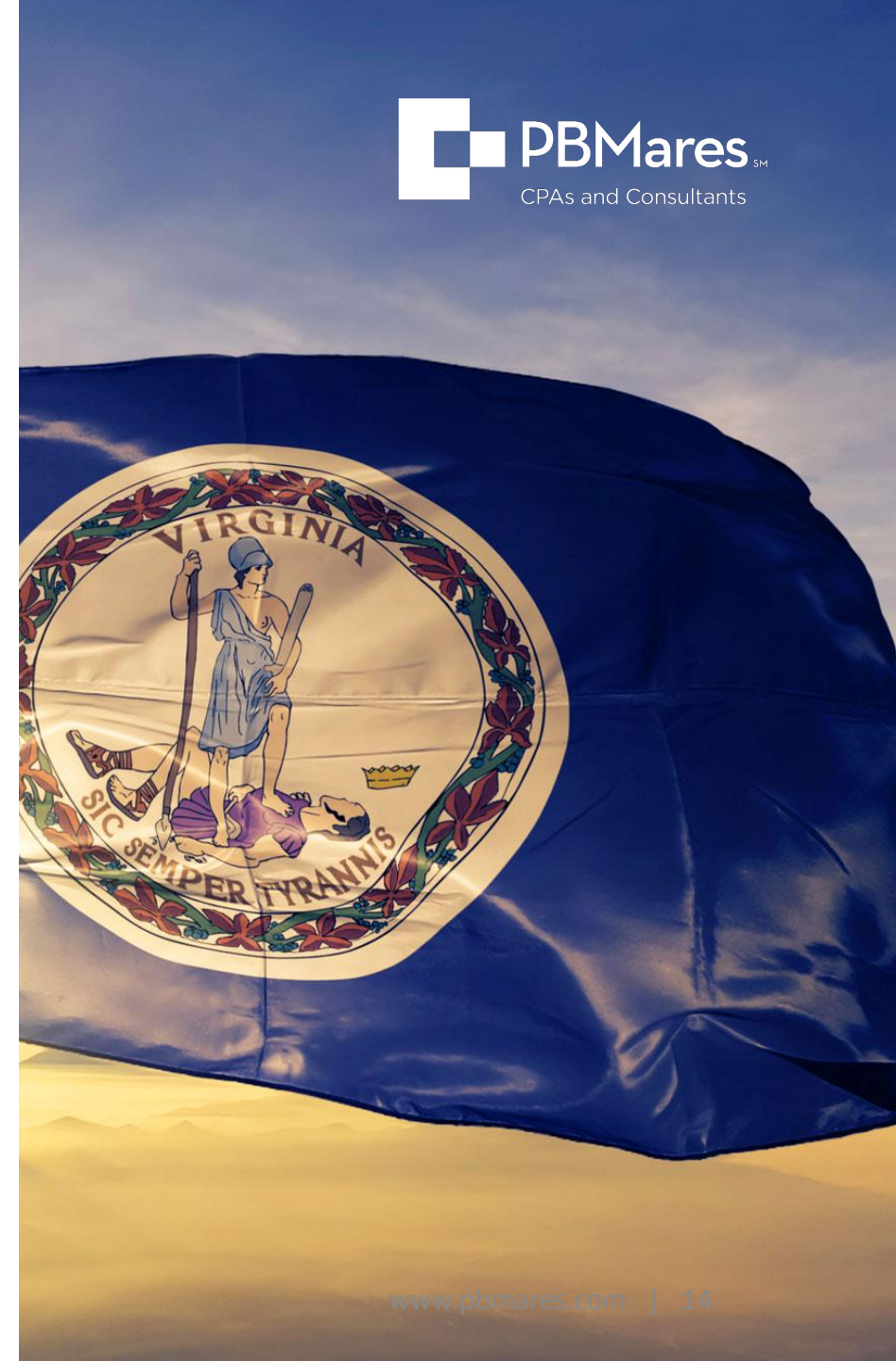
Virginia PTET

- Effective January 1, 2022 *but retroactive for 2021*
- Only entities owned 100% by “natural individuals” eligible to participate
- Elect by filing VA Form 502PTET
- Estimated tax payments expected, but not required for 2022
- PTET tax rate: 5.75%



Virginia PTET *continued*

- Virginia resident owners taxed on 100% of allocated income, regardless of apportioned income to VA
 - *Non-resident owners taxed only on income apportioned to VA*
- PTET allocation to owners based on share of income taxed to PTET
- Adjustment on owner VA return via credit against VA tax liability, refundable
- Non-resident owners NOT required to file non-resident return



Virginia PTET

Credits for Taxes Paid
to Other States



North Carolina



North Carolina PTET

- Effective January 1, 2022
- Participation limited to entities owned by individuals, certain trusts, exempt organizations
- Elect by timely filing NC PTET return
- Estimated tax payments expected, but not required for 2022
- PTET tax rate: 4.9% - 2022



North Carolina PTET *continued*

- NC resident owners taxed on 100% of allocated income, regardless of apportioned income to VA
Non-resident owners taxed only on income apportioned to NC
- PTET allocation to owners based on share of income taxed to PTET
- Adjustment on owner NC return via deduction from income
- Non-resident owners NOT required to file non-resident return

North Carolina PTET

Credits for Taxes Paid
to Other States



Highlights of Other States

- All states follow the same basic structure:
 - PTE pays tax on its business income
 - PTE deducts the tax paid
 - K-1 income is passed through to owners, who thereby circumvent the SALT cap on their 1040
 - Owners report the K-1 income on their individual state return and either
 - deduct the income already taxed at the entity level, or
 - receive a tax credit for the taxes already paid on that income



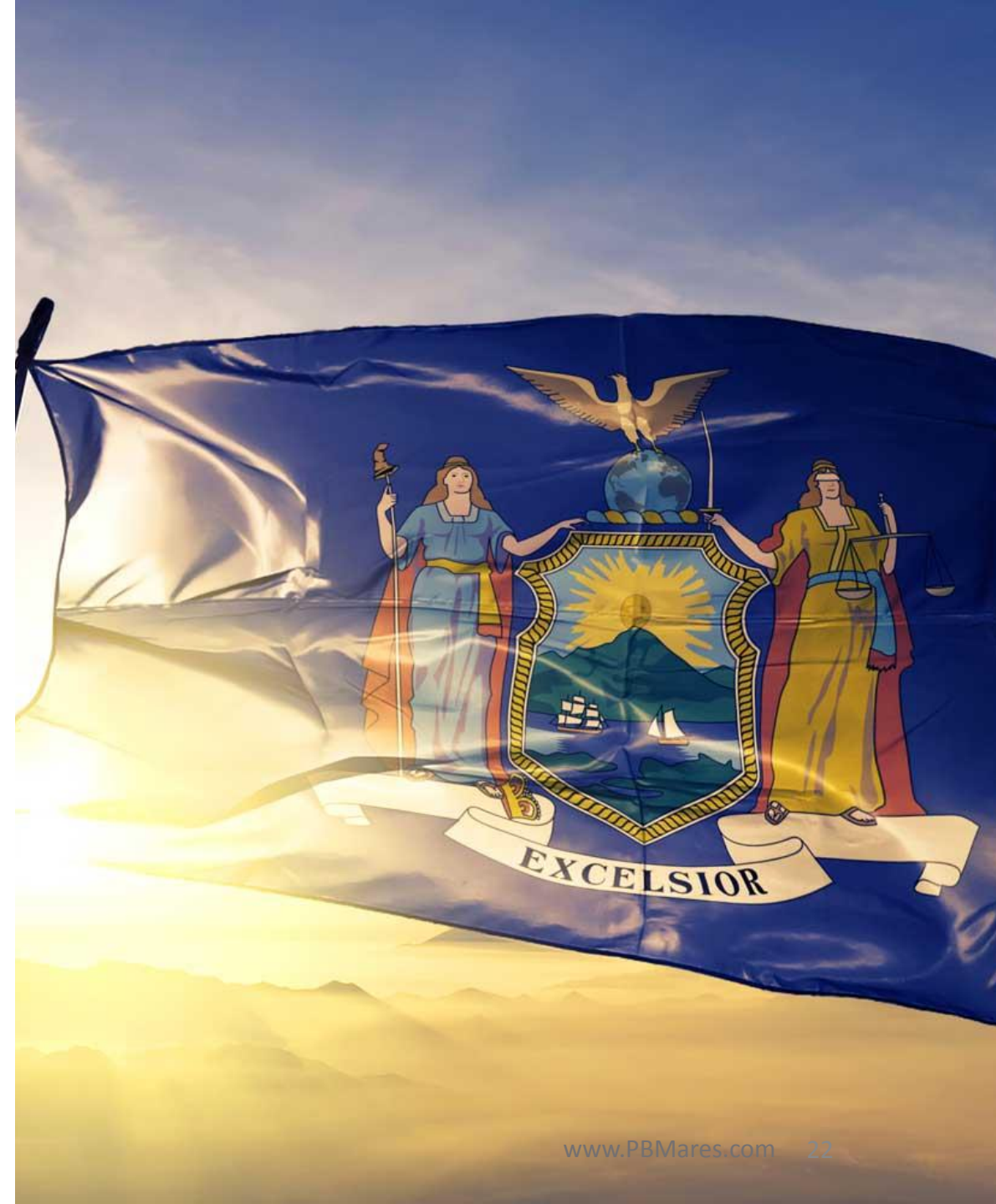
Highlights of Other States



Highlights of Other States

New York

- Must be elected by *March 15 of the tax year*
- Election and PTET filing must be done on NYS online account
- PTE eligible owners: individuals, trusts and estates
- PTE itself is eligible even if it has ineligible owners
- Owner receives tax credit on individual return



Highlights of Other States

California

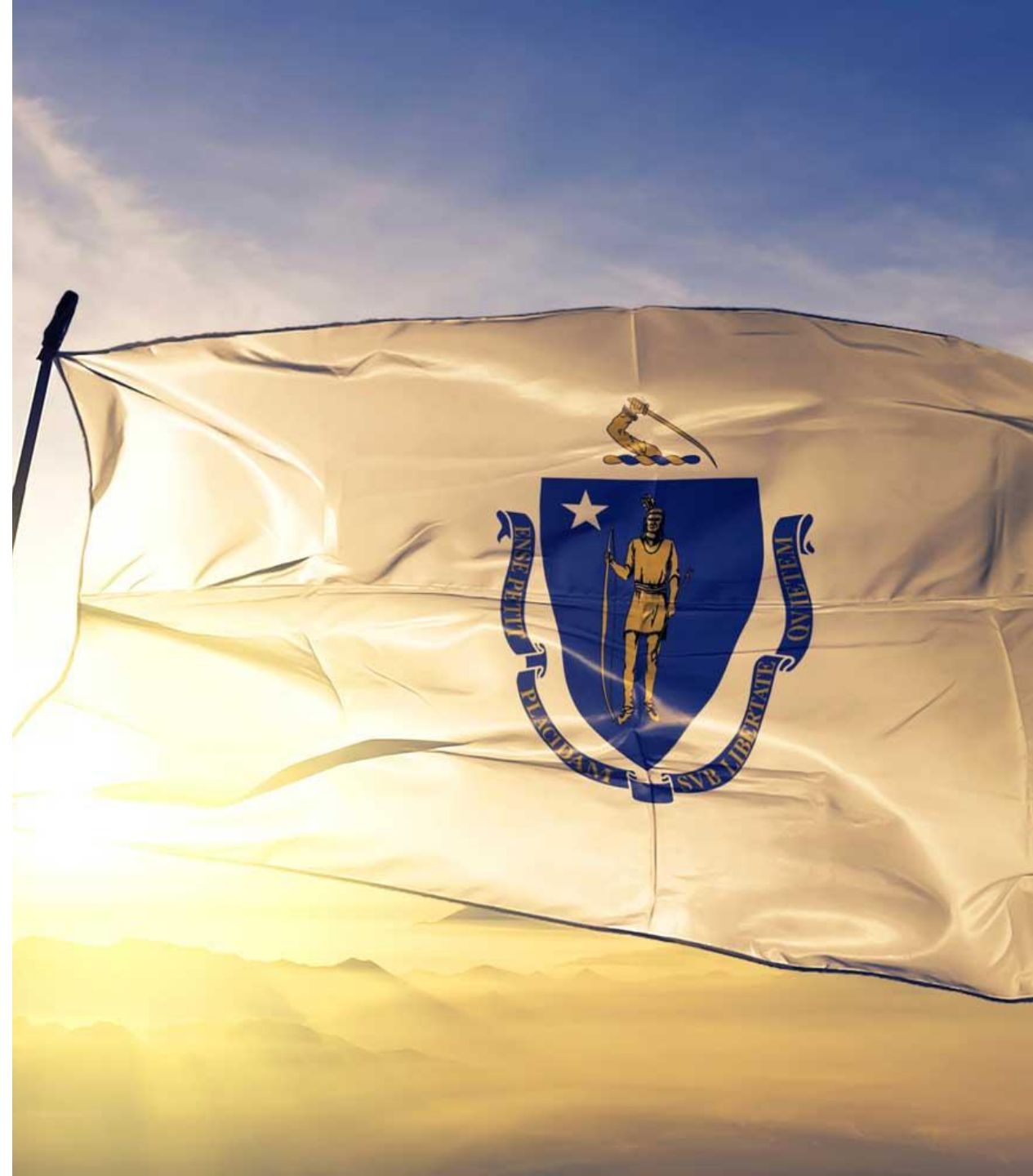
- Election made on timely filed return.
- BUT payment *must* be made by 6/15 of tax year
- Owners can elect in separately from one another
- PTET rate is 9.3%
- Owners receive a tax credit – which is *nonrefundable* and can be carried forward for five years
- Nonresident withholding is still required, unless a waiver is granted



Highlights of Other States

Massachusetts

- Eligible entities include S Corporations, Partnerships, and Trusts
- Owners receive a credit on their individual return: 90% of their pro rata share of the tax paid by the PTE



Highlights of Other States

Louisiana

- Election is made in a separate filing by April 15 of the year after the tax year
- By making the election, the PTE agrees to be taxed as a C Corporation



Highlights of Other States

Colorado

- Initially enacted in 2021 for 2022
- Amended in May 2022 and made retroactive to 2018
- Amended law also changed Colorado from a deduction state (like NC) to a credit state (like VA and MD)



Important Considerations:

- Will owners indeed benefit from PTET election?
- Consider:
 - Ability to take credit for tax paid, deduction of income taxed
 - Can differences in taxed income vs. allocations to owners be resolved satisfactorily?
 - Cost-effective?



Potential Strategies to Increase Eligibility to Participate

- SMLLC's, single owner activities:
 - Elect S-Corp treatment?
 - Form partnership by adding spouse, family members?
- Multi-level partnerships:
 - Could additional tier partnerships be eliminated such that qualified individuals/ trusts represent ownership?
- Cautions:
 - Need to consider “all angles” before making changes
 - Confer w/ legal counsel as appropriate
 - Most PTET regimes set to expire in 2026, or likely upon removal of SALT Cap

Questions



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Thank You

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