

# Opportunity For Tax Savings: State and Local Pass-Through Entity Taxes Not Subject to the Federal Deduction Cap

November 12, 2020

Earlier this week, the Department of the Treasury and IRS announced that state and local taxes imposed at the entity level on pass-through entities are permitted as a federal tax deduction. Forthcoming proposed regulations will clarify that state and local income taxes imposed on and paid by a pass-through entity are allowed as a tax deduction by the pass-through entity in computing its taxable income. **Such tax payments are not subject to the \$10,000 state and local tax (SALT) deduction limitation on individual partners and shareholders who itemize deductions.**

Since the enactment of the Tax Cuts and Jobs Act (TCJA), the Treasury and IRS have issued detailed guidance regarding various techniques to give taxpayers a workaround to the \$10,000 SALT deduction cap. However, on the creation of entity level taxes on pass-through entities, a way for S corporation shareholders and LLC members and partners in partnerships to avoid the cap, the IRS and Treasury have remained silent, leaving many to question whether these deductions would be respected. These entity level taxes on pass-through entities often included offsetting state credits on the entity's partners' or shareholders' individual income tax returns in favor of avoiding the deduction limitation.

The workaround, first adopted by the state of Connecticut, took advantage of the fact that the TCJA only applied the SALT cap to individuals. The concept was that the entity level state tax is fully deductible by the pass-through at the federal level, while the distributive share of the income passed on to partners is reduced by a newly created state individual income tax credit. To date, seven states have adopted some variation of this entity level pass-through tax model.

Pass-through entities can rely on the upcoming regulations as of November 10, 2020. Furthermore, taxpayers can apply the upcoming rules to certain income taxes paid beginning with the 2018 tax year.

We are carefully monitoring this important tax item. If you have questions regarding the eligibility of your pass-through entity to deduct state and local taxes, please contact Alan Goldenberg, Leader of Anchin's State and Local Tax (SALT) group, or your Anchin Relationship Partner.