

## They're All Different and That's the Problem: State PTEs

by Steven N.J. Wlodychak



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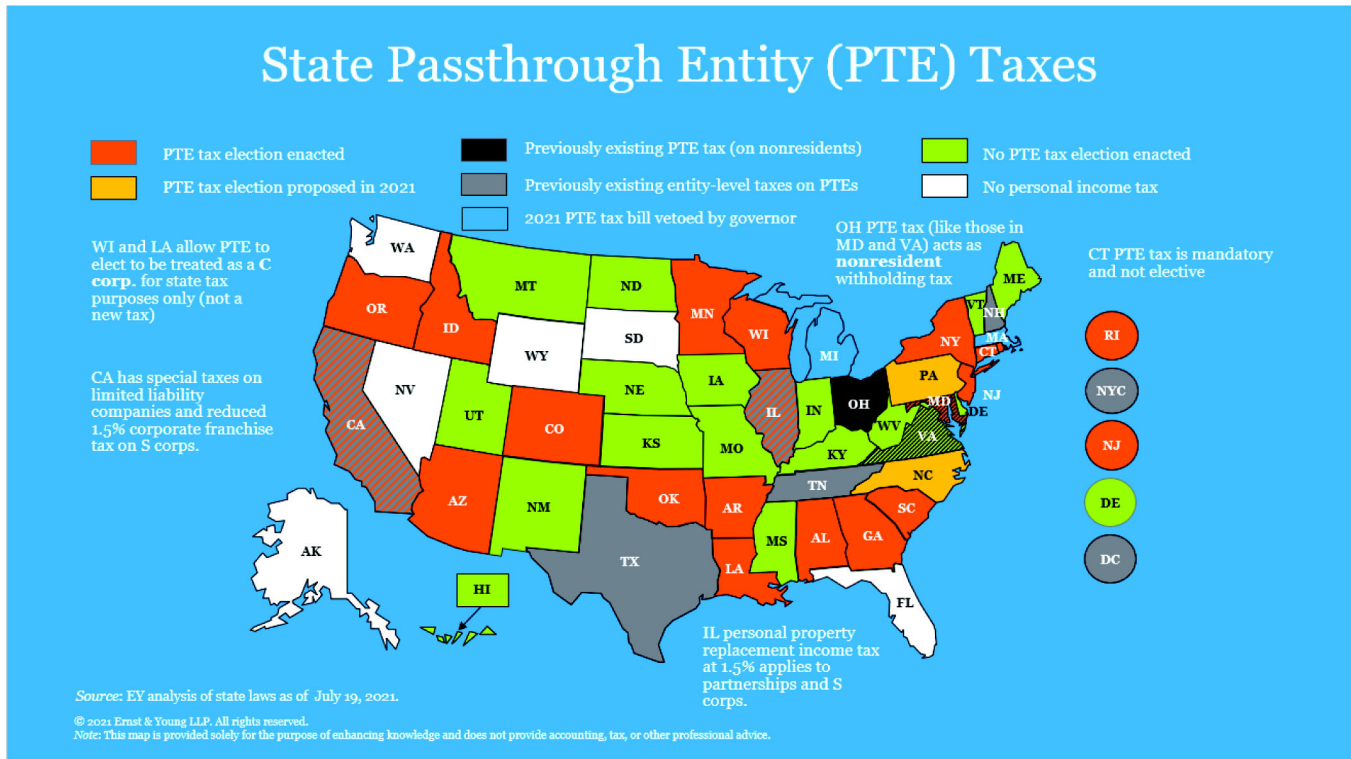
In this installment of *The Hissing Goose*, Wlodychak looks at recent state passthrough entity tax legislation.

In an article published in these pages in December 2020,<sup>1</sup> I predicted a flood of newly enacted state passthrough entity (PTE) taxes in response to the IRS's announcement in Notice 2020-75, 2020-49 IRB 1453 (Notice). The Notice was issued by the IRS shortly after the federal presidential election in early November 2020. In a surprise to many (including me), the IRS in the Notice essentially blessed the state PTE tax concept as a way to enable owners of PTEs (for example, partnerships, S corporations, and limited liability companies treated as partnerships or S corporations) to get around, and deduct in excess of, the \$10,000 annual state and local tax deduction limitation enacted as part of the Tax Cuts and Jobs Act (codified at IRC section 163(b)(6)) (SALT deduction limitation). The dam broke and the deluge has begun.

<sup>1</sup> Steven N.J. Wlodychak, "IRS Just Raised State Taxes for Multistate Passthrough Entity Owners," *Tax Notes State*, Dec. 14, 2020, p. 1159.

As the state legislative season began in earnest in late January, I started accumulating the various proposals and writing this article. I anticipated that it would be easy, that the states would follow a single model, and that writing this article would be a rather modest effort. Week after week, however, as I read the proposed legislation in the various states, it became readily apparent that was not to be. Instead, as the state legislative proposals were introduced and then amended through the legislative process, every single one of these state PTE taxes — every one — has differed from the other and many in material, significant ways.

This lack of uniformity among these new state PTE tax laws will make an already complex state PTE and individual tax compliance season even more difficult (as if the 2020 and 2021 tax return seasons weren't challenging enough) and will cause taxpayers and their advisers to have to make a bunch of tough choices. Not only will tax return preparers with clients with multistate activities have to navigate competing laws but they will also have to worry that the statutory language in one state is nowhere near the same as that in another. Even for PTEs and their owners who are subject to tax in a single state, the analysis of the PTE tax in one state won't necessarily be the same as in another. Moreover, as I cautioned in my previous article, nonresident owners of PTEs engaged in multistate activities and their tax advisers must be especially cautious because of the impact an election in a nonresident state will have in the owners' resident states (which may or may not have enacted a PTE tax) on their continued eligibility for a credit against their resident state income tax for their share of the PTE taxes paid to the other states.



Without more guidance, the tax authorities in resident states may deem the PTE taxes enacted in the other states as not “sufficiently similar” to their PTE taxes to qualify for the resident state tax credit. If so, I don’t know if the courts will provide any protections to affected taxpayers against potential double tax under the commerce or due process clauses of the U.S. Constitution. After all, we’re used to owners of C corporations being subject to a double tax at the entity and individual levels, and the courts may simply conclude that the legislatures intend the same thing for PTEs (more so when the taxpayers *elected* to be subject to that state’s PTE tax). Surely, the courts may conclude they had to know what they were getting into. Yes, be prepared for a wild ride (and for the lawyers out there, a new litigation opportunity).

When the state PTE tax concept first surfaced shortly after enactment of the SALT deduction limitation, in mid-2019 my colleagues Bruce Ely and Kelvin Lawrence published a great article in a competing

publication, highlighting the various proposed state PTE tax approaches.<sup>2</sup> At that time, one would have thought that every state legislature would have taken, for example, the model proposal of the Mainstreet Employer group<sup>3</sup> off the shelf and simply introduced and enacted it. That would have provided a uniform body of law that everyone from coast to coast could understand. Instead, one by one, states have enacted their own versions of a PTE tax, and while they have some similarities, every single one is different in marked ways from the other.

Following is a discussion of a few of these state PTE tax law variations. Also, I provide a state-by-state matrix of some of the key provisions of these newly enacted (as well as proposed) state PTE tax laws for reference, along with a map of the states (Figure 1) that attempts to differentiate among the various state PTE tax types and those that have and have not yet enacted a PTE tax.

<sup>2</sup> Bruce Ely and Kelvin Lawrence, “INSIGHT: A More Viable SALT Cap Workaround? Pass-Through Entity-Level Taxes,” *Bloomberg Law*, July 11, 2019.

<sup>3</sup> See Parity for Main Street Employers, Model Pass-Through Entity Tax (first proposed in 2018).

As I mentioned, I have been working on this article since late January but decided to delay completion until most state 2021 legislative sessions were over. No doubt, however, even some of the proposals may become law before this article is published (and in fact, some of the legislatures have already amended the PTE tax law statutes they just enacted). Moreover, this will continue to be a dynamic process as the remaining state legislatures address the PTE taxes and amend and modify the existing taxes, and, perhaps more importantly, as the state taxing authorities wrestle with and issue much-needed guidance.

### They Are All Different

The first thing to notice in comparing these state PTE tax laws is that the variations among them occur on so many different and overlapping levels. Let's start with an easy one — whether the state's PTE tax is mandatory or elective.

#### Elective or Mandatory?

The “good news” (well, the simple news) is that only one state's PTE tax is mandatory — Connecticut's. All the others are elective. Being the first of these laws, and preceding any IRS guidance on the issue, presumably Connecticut's PTE tax was made mandatory to strengthen the state's position that its tax would withstand an IRS challenge because it wasn't a substitute for a tax paid at the individual level.

#### A New Tax or Reliance Upon an Existing Tax?

Next in order of complexity, most states enacted a completely new entity-level tax on PTEs. Still, a few states (for example, Louisiana and Wisconsin) simply allow a PTE to elect to be subject to the state's existing tax on C corporations. A few jurisdictions already had a mandatory entity-level tax on PTEs. For example, New York City<sup>4</sup> and the District of

<sup>4</sup>New York City does not respect a federal or New York S corporation election. See N.Y.C. Department of Finance, “General Corporation Tax (GCT)” (“New York City does not recognize Federal or New York State ‘S Corporation’ elections. S Corporations are subject to this tax” (that is, the city's GCT)). Instead, any corporation, regardless of its federal or New York state S corporation (or qualified subchapter S subsidiary) election, is subject to the city's GCT. See N.Y.C. Admin. Code section 11-602.1. S corporations were excluded from the New York City corporate tax reform provisions enacted in 2015.

Columbia<sup>5</sup> both imposed their existing corporate income taxes on S corporations by disregarding the federal elections, and each imposes a direct tax based on net income on “unincorporated businesses” (known as an “unincorporated business tax”<sup>6</sup>). Virginia,<sup>7</sup> Maryland,<sup>8</sup> and Ohio<sup>9</sup> have long had “pass-through entity” taxes on PTEs, but they applied only to the aggregate distributive share of income attributed to nonresidents. Of these three states, only Maryland has expanded its PTE tax model to enable residents to benefit from these provisions<sup>10</sup> (although the author has heard that both Ohio and Virginia are considering following Maryland's lead).

One objective of the proponents of these PTE taxes was to allow the owners to qualify for the business entity exception to the federal SALT deduction limitation set forth in IRC section 164(b)(6) without raising (or, let's be honest, significantly raising) the state tax liability of the owners. In essence, these taxes were to be revenue neutral (or pretty close). To achieve that objective and to continue the single layer of tax on the PTE owner's distributive share of the PTE's income,

<sup>5</sup>See D.C. Code section 47-1801.04 (10)(B) (defining “corporation” for purposes of the District's income and franchise tax to include an “S corporation as defined in section 1361(a) of the Internal Revenue Code of 1986”); see also D.C. Office of Tax & Rev., 2020 D-20 District of Columbia (DC) Corporation Franchise Tax Forms and Instructions, at 4 (“For District tax purposes, an S corporation is a C corporation. Therefore, it must file Form D-20 and prepare all applicable schedules on the D-20. The fact that an S corporation does not have similar schedules on the federal form should not be considered as a relief for an S corporation from completing the schedules on the D-20.”).

<sup>6</sup>See D.C. Code sections 47-1808.01 to -1808.15 (“Tax on unincorporated businesses”); see also N.Y.C. Admin. Code, tit. 11, ch. 5 (“City unincorporated business income tax”) (sections 11-501 to -540).

<sup>7</sup>See Va. Code Ann. section 58.1-486.2(A) (“For the privilege of doing business in [Virginia], a pass-through entity [for example, partnership, S corporation, or LLC treated as a partnership or S corporation] that has taxable income for the taxable year derived from or connected with Virginia sources, any portion of which is allocable to a nonresident owner [excluding a corporation], shall pay a withholding tax under this section, except as provided in subsection C.”).

<sup>8</sup>See Md. Code Ann., Tax — Gen. section 10-102.1(b) (2019) (“In addition to any other tax imposed under this title, a tax is imposed on each pass-through entity that has: (1) any member who is a nonresident of [Maryland] or is a nonresident entity; and (2) any nonresident taxable income for the taxable year.”).

<sup>9</sup>Ohio Rev. Code Ann. sections 5733.40 to 5733.41, 5747.12, 5747.22, 5747.212, and 5747.231 (tax on qualifying PTEs); see also Ohio Department of Taxation, IT-2001-02 — Nexus Standards & Filing Safe Harbors for Pass-Through Entities (issued Sept. 2001, rev. Jan. 10, 2014, reissued Feb. 15, 2018).

<sup>10</sup>2020 Md. Laws ch. 641 (Md. S.B. 523) (amending the existing Maryland PTE tax to provide an election to apply the tax to Maryland residents at Md. Code Ann., Tax — Gen. section 10-102.1, among other provisions).



the first states enacting these PTE taxes provided a credit against the PTE owner's direct state tax liability (for example, Connecticut, New Jersey, and New York). Others, such as Alabama, Georgia, and South Carolina, took a different tact. Instead of providing a credit against the historic personal or corporate income state tax liability of the owners, these states chose to exclude the income subject to their PTE taxes from the owner's direct state income tax liability.

Thus, for example, if the owner's income was wholly derived from its distributive share of PTE income, it would have no income to report for purposes of the state's income tax. Instead of a credit, these states provide an outright exclusion of income subject to the state's PTE tax. In some cases (for example, Connecticut), the state PTE tax laws provide that if a nonresident PTE owner's income is exclusively derived from income from a PTE that is subject to the state's PTE tax, that nonresident owner doesn't have to file a state personal income tax return.<sup>11</sup>

Even which PTEs qualify to elect into the PTE regime differs among the states. A few state PTE tax laws impose no limitations whatsoever on the type of owners a PTE can have other than the usual restrictions that apply for other income tax purposes. For example, the state PTE law might not address the ownership of the PTEs, but of course, an S corporation can't be an S corporation for federal or state income tax purposes if it has a corporate owner and is thus ineligible for the state's PTE tax. On the other hand, no "regular tax" ownership restrictions apply to a partnership. A partnership can have owners with widely varying characteristics (for example, partners can be individuals, corporations, other partnerships, insurance companies, or nonprofit organizations).

Thus, unlike an S corporation, the characteristics of the owners of a partnership are highly flexible. In enacting their PTE taxes, however, a few states (for example, California) have chosen to strictly limit the PTE election to

those PTEs whose owners consist only of individuals, trusts, or other fiduciaries. In these states, ownership of an interest in the PTE by a single ineligible owner (no matter how small that interest may be) could disqualify the PTE from electing into that state's PTE regime.

One state (that is, Arizona (as originally proposed)) probably went too far in its original proposal by strictly limiting the PTE elective tax only to a PTE whose individual owners consist solely of Arizona residents.<sup>12</sup> Surely, that provision could not be constitutional, and it appears that the Arizona Senate picked up on that defect in its version of the bill.<sup>13</sup> Likewise, some states' laws limit PTEs that are engaged in a business that might be subject to a different state tax regime than as a flowthrough entity. In the current Michigan PTE tax proposal, for example (which was recently vetoed by Gov. Gretchen Whitmer (D)), while there appear to be no limitations on the nature of the owners of the PTE, a PTE that is subject to Michigan tax as a financial institution or is either a disregarded entity (DRE) or publicly traded partnership for U.S. federal income tax (U.S. FIT) purposes cannot make a Michigan PTE tax election.<sup>14</sup>

### PTE Tax Base

Even the income base upon which the PTE tax is based can vary. For purposes of constructing the state's PTE tax base, most states use the PTE's income reported for U.S. FIT purposes as the starting point, just as they had under their existing PTE information reporting or tax return filing regimes. One interesting PTE tax base approach worth mentioning — and incidentally, that is tangentially related to the character of the PTE's owners discussed in the previous paragraph —

<sup>12</sup> See Ariz. H.B. 2838, section 3 (introduced version) (2021) (adding Ariz. Rev. Stat. section 43-1014(c) ("Only partnerships, limited liability companies and S corporations whose partners, members or shareholders are all residents of this state may make the [PTE tax] election under this section.")).

<sup>13</sup> See Ariz. H.B. 2838, section 3 (Senate engrossed version) (2021) (adding Ariz. Rev. Stat. section 43-1014(a) (providing for the tax based on the PTE to be determined based upon the distributive share of income attributable to both resident and nonresident owners)).

<sup>14</sup> See Mich. H.B. 4288 (as passed by the House May 13, 2021) (adding Mich. Comp. Laws section 205.753(10) (defining "flow-through entity" as excluding a PTP, any DRE, or any person subject to the Michigan financial institutions tax)).

<sup>11</sup> Conn. Gen. Stat. section 12-699(e) ("A nonresident individual who is a member of an affected business entity shall not be required to file a [Connecticut personal] income tax return . . . if, for such taxable year, the only source of income derived from or connected with sources within this state for such member . . . is from one or more affected business entities.").

is New York's. Rather than using the taxable income of the PTE itself as the tax base, the New York PTE tax law establishes a special tax base defined as "pass-through entity taxable income" (PTETI).<sup>15</sup>

I must admit, the first time I saw this provision, I ran right past it like a stop sign hidden behind a tree, thinking that it was nothing other than the PTE's own taxable income. Don't make my mistake. Understanding this definition is crucial to recognizing how New York's PTE tax works and, in the author's opinion, an incredibly elegant legislative drafting solution to what seemed to be an almost insurmountable problem between PTE owners who want the tax and those who don't.

In the original proposal, the New York tax law would have prohibited any partnership that had any owner that wasn't an individual from

its PTE tax regime.<sup>16</sup> As enacted and as a compromise to those corporate taxpayers that opposed the PTE tax in the first place,<sup>17</sup> the New York PTETI tax base is basically the accumulation of only those distributive shares accruing to resident and nonresident taxpayers subject to New York's personal income tax. Thus, by the statute's silence, the New York PTETI tax base would exclude the distributive shares of the partnership's income that would be distributed to, for example, corporate owners or owners that are other partnerships, and would avoid subjecting the income of those owners to the state's PTE tax regime.

Related to the eligible ownership issue discussed above, the purpose for this income exclusion, of course, is to allow any partnership, even one with a "blended ownership" (that is, partnerships that include not only individual owners but also corporate and other owners that aren't interested in the benefits (and burdens) of the PTE tax), to elect into the New York PTE tax regime. By doing so, New York's PTE tax appears to satisfy the delicate objective of providing U.S. FIT deduction benefits to those owners who want them without adversely affecting those who don't. The lesson learned from a careful reading of the New York PTE tax law applicable to all these new state PTE taxes is that one cannot assume that the tax bases are the same.

### State PTE Tax Rates

The first of these new PTE taxes, Connecticut's, imposed a flat, stated rate of 6.99

<sup>15</sup> N.Y. Tax Law section 860(h) (defining "pass-through entity taxable income"). For clarity, the entire provision follows (and I caution, read it slowly (and perhaps several times) to let it sink in): "(h) . . . Pass-through entity taxable income means: (1) In the case of an electing partnership, the sum of (i) all items of income, gain, loss, or deduction derived from or connected with New York sources to the extent they are included in the taxable income of a nonresident partner subject to tax under article twenty-two [that is, New York's personal income tax law] under [N.Y. Tax Law section 632(a)]; and (ii) all items of income, gain, loss, or deduction to the extent they are included in the taxable income of a resident partner subject to tax under article twenty-two [that is, New York's personal income tax law] (2) In the case of an electing S corporation, the sum of (i) all items of income, gain, loss, or deduction derived from or connected with New York sources to the extent they would be included under [N.Y. Tax Law section 632(a)(2)] in the taxable income of a shareholder subject to tax under article twenty-two of this chapter." The astute reader will recognize that for a resident individual, there is a difference in the way the PTETI derived from the distributive share of income from a partnership is computed compared with the way it is determined for shareholders of an S corporation. A resident individual would of course include 100 percent of her distributive share of income from a partnership in computing PTE tax liability, but if she were a shareholder of an S corporation, she could report only the apportioned share of S corporation income (even though New York would have full authority to impose its personal income tax on 100 percent of that resident individual's share of S corporation income (subject to a resident state tax credit for the taxes paid on that income to other states)). That provision was changed for some inexplicable reason in the final version of the legislation. Compare 2021 N.Y. Laws ch. 59, Part C (N.Y. A.B. 3009-C/S.B. 2009-C) (adding N.Y. Tax Law section 860(h) (defining "pass-through entity taxable income")) with 2021 N.Y. A.B. A3009-B, Part C (that would have added N.Y. Tax Law section 860 paragraphs (g) (defining "pass-through adjusted net income (not less than zero)"), (h) (defining "partnership taxable income"), and (i) (defining "S corporation taxable income")).

<sup>16</sup> See N.Y. S.B. S2509 (original), Part C (which would have added N.Y. Tax Law section 860(a) and defined "eligible partnership" as "any partnership as provided for in [IRC section 7701(a)(2)] that consists solely of partners who are individuals" (emphasis added)).

<sup>17</sup> The concern of corporate owners was very understandable. Corporations often use PTEs for liability purposes in their organizational structure. Sometimes, interests in partnerships were acquired over time, and for legal reasons it was far more beneficial to keep the partnerships around instead of liquidating them into the corporate owners. Corporate owners legitimately raised the possibility that by imposing a PTE tax on them, they would be subject to another layer of tax and another layer of costly administrative compliance managing entities that had historically not been directly subject to an entity-level tax. Moreover, with the advent of combined reporting in New York, there was a reasonable fear that these entities could be included directly in the New York combined unitary returns, creating even further complications from a tax compliance perspective.

percent, which is equivalent to the highest marginal tax rate under Connecticut's personal income tax law.<sup>18</sup> For Connecticut taxpayers, the personal income tax rate brackets are relatively compressed with a tax rate of 5.5 percent applying to income of \$50,000 for unmarried individuals filing separately. The incremental rate differential between the highest bracket and that midrange bracket is only 1.49 percent. Perhaps the rate differential under the fixed rate PTE tax and the personal income tax compared with the perceived federal tax benefit of being able to deduct the tax for federal income tax purposes, along with the fact that any difference is fully refundable,<sup>19</sup> mitigates any PTE owner's concern that she would be paying more estimated state taxes under the PTE regime than if the PTE did not make the election and she had to file tax returns under the state's personal income tax.

Following the same method, states with broader income tax rate differentials faced resistance when they sought to follow Connecticut's lead and simply apply the state's highest marginal personal income tax rate to the PTE tax. In New York, for example, after recent amendments, the top marginal tax rate for 2021 is 10.9 percent (for income in excess of \$25 million), while for taxpayers earning more than \$43,000 but not more than \$161,550, that rate is 5.97 percent, or nearly half the highest marginal New York personal income tax rate.<sup>20</sup>

Obviously, if New York followed Connecticut's lead and used the highest marginal

tax rate, New York PTE owners would have seen a substantial increase in their estimated taxes even though the difference between the PTE tax and the personal income tax liability would be fully refundable.<sup>21</sup> New York legislators, thus, had to take a slightly different tact and imposed the same rate brackets as under the personal income tax but based upon only the PTETI of the PTE (not of the individual taxpayers).<sup>22</sup> The problem, of course, is that the PTETI is an aggregate of all the distributive shares of the individual owners of the PTE. Thus, it should be obvious that owners of a PTE with many owners will be subject to PTE tax at a much higher rate than owners of PTEs with few owners with the same average amount of PTE distributive shares. Again, that the estimated taxes are fully refundable and the owners obtain a federal tax benefit they otherwise would not have gotten probably mitigates the concerns of the higher rate brackets on these PTE owners.

In fact, this issue might have been so complex for California legislators (whose state has a broad series of personal income tax brackets) that they left the rate blank (literally, a series of underscores) in the original introduced version of the PTE tax legislation.<sup>23</sup>

On the other hand, at least one state, Alabama, in enacting its PTE tax provided corporate taxpayers with the possibility of using PTEs to reduce their state tax rate by up to 20 percent if they restructure their Alabama business income into a partnership. Unlike some states' PTE laws,

<sup>18</sup> Compare Conn. Gen. Stat. section 12-699(c)(2) (stating that the Connecticut PTE tax equals the PTE tax base multiplied by 6.99 percent) with Conn. Gen. Stat. section 12-700(a)(9)(A)(i) ("For taxable years commencing on or after January 1, 2015, in accordance with the following schedule: . . . For any person who files a return under the federal income tax for such taxable year as an unmarried individual," the tax rate for Connecticut taxable income over \$500,000 is "\$31,550, plus 6.99% of the excess over \$500,000.").

<sup>19</sup> See Conn. Gen. Stat. section 12-699(g)(1). In its original 2018 enactment, the PTE credit percentage was a revenue-neutral 93.01 percent (equivalent to 100 percent minus the 6.99 percent tax rate). See Conn. Pub. Acts 18-49, section 1 (adding Conn. Gen. Stat. section 12-699(g)(1)). Less than one year later, the Connecticut legislature reduced the credit percentage from 93.01 percent to 87.5 percent. (See Conn. Pub. Acts 19-117, section 333, amending Conn. Gen. Stat. section 12-699(g)(1)). That reduction in the credit percentage resulted in an effective tax rate increase on owners of PTEs. In effect, this PTE tax credit mechanism provides the legislature with a surreptitious way to increase taxes on PTE owners through a "rate reduction."

<sup>20</sup> See, e.g., N.Y. Tax Law section 601(a)(iv) (as amended by 2021 N.Y. Laws ch. 59, Part A, section 1).

<sup>21</sup> N.Y. Tax Law sections 863 (added by 2021 N.Y. Laws ch. 59, Part C, section 1) (authorizing the PTE credit) and 606(kkk) (as amended by 2021 N.Y. Laws ch. 59, Part A, section 2) (allowing for the PTE tax credit under the New York personal income tax law).

<sup>22</sup> See N.Y. Tax Law section 862 (as added by 2021 N.Y. Laws ch. 59, Part C, section 1).

<sup>23</sup> See Cal. S.B. 104, section 2 (Jan. 5, 2021) (adding Cal. Rev. & Tax Code section 19900(a) (A "qualified taxpayer . . . may elect to pay an elective tax . . . measured by its net income computed at the rate of \_\_\_ percent upon the basis of its net income." (blank in original))). The current version of Cal. S.B. 104 (as of Apr. 12, 2021) inserted a single rate of 9.3 percent, equivalent to a relatively "common" rate bracket paid by taxpayers in the state for 2020, topping out at income above \$299,508 (single). See Cal. Rev. & Tax Code section 17041, and Cal. Franchise Tax Board, 2020 California Tax Rate Schedules. With its 1 percent mental health tax on income exceeding \$1 million (Cal. Rev. & Tax Code section 17043), the top California personal income tax rate bracket is 13.3 percent. On May 20, 2021, S.B. 104 was placed on the suspension list. Subsequently, the PTE tax described in S.B. 104 was included with a "budget trailer" bill as section 15 of S.B. 150, which is awaiting final approval.



Alabama's PTE tax law allows any "Subchapter K Entity as defined by [Ala. Code] Section 40-18-1[(35)]<sup>24</sup> . . . to pay Alabama income tax at the rate prescribed by [2021 Ala. Acts 1, section 10] subsection (e)."<sup>25</sup>

The definition of a subchapter K entity in the Alabama tax law does not appear to impose any additional restriction on the nature of the owners of those entities other than those imposed for federal income tax law purposes (along with an express exclusion of a DRE from the definition). Subsection (e) of Alabama's PTE tax law instructs that electing PTEs "shall pay a tax at the highest marginal rate provided in [Ala. Code] Section 40-18-5."<sup>26</sup> The Alabama Code section in that clause is a reference to the Alabama personal income tax law, under which the highest rate imposed is 5 percent.<sup>27</sup> In contrast, Alabama corporate income tax is imposed at the rate of 6.5 percent.<sup>28</sup> Rather than provide its taxpayers with a credit against their own tax liability for tax paid at the PTE level, Alabama, like neighboring Georgia and South Carolina, allows PTE owners to exclude any of their income subject to tax at the PTE level from the determination of their own Alabama tax liability.<sup>29</sup> Thus, by creating a partnership and having all their tax liability taxed at the PTE level, a corporation in effect could reduce its Alabama

tax rate by 1.5 percentage points or, effectively, reduce its effective tax rate by 23 percent.

### Resident or Other State Tax Credits for Similar PTE Taxes

Generally (and appropriately), for PTEs engaged in multistate activities, most states extend the PTE tax only to the PTE's income that is apportioned or allocated to the state. Resident taxpayers may find this confusing since under their state's personal income tax, most states require that the resident taxpayer pay tax on 100 percent of income from whatever source derived while the state's PTE tax will be based on only the PTE's income apportioned to the state based on the PTE's own apportionment factors. To obtain the full benefit of the offset to the federal SALT deduction limitation, the PTE owner will have to expect first, that every state in which the PTE operates provides for a PTE tax (together with an offsetting tax credit, exclusion, or exemption from the state's personal or corporate income tax, as the case may be) and second, perhaps even more importantly, that the owner's resident state recognizes the amounts paid at the PTE level in other states as a creditable tax against their own resident state personal income tax liability.

In the states that use a credit mechanism, that may not be so clear. New York's new PTE tax law also modified the state's existing resident tax credit rule under its personal income tax law (contained in N.Y. Tax Law section 620)<sup>30</sup> and added a new subsection (b), which reads:

#### (b) Pass-through entity taxes.

(1) A resident shall be allowed a credit against the tax otherwise due pursuant to this article for any pass-through entity tax *substantially similar* to the tax imposed pursuant to article twenty-four-A of this chapter [i.e., New York's elective PTE tax law] imposed on the income of a partnership or S corporation of which the resident is a partner, member or shareholder for the taxable year by another state of the

<sup>24</sup> Ala. Code 40-18-1(35) ("For purposes of this chapter [Alabama's income tax law], the following terms shall have the respective meanings ascribed in this section: . . . (35) Subchapter [sic] K entity. — A partnership, including a limited partnership or limited liability partnership, limited liability company, or any other entity subject to subchapter K of the Internal Revenue Code, 26 U.S.C.S. [sections] 701 to 761, for federal income tax purposes, not including a single member limited liability company.").

<sup>25</sup> See 2021 Ala. Acts 1, section 10(b)(1).

<sup>26</sup> *Id.*, section 10(e).

<sup>27</sup> See, e.g., Ala. Code section 40-18-5(1) ("The tax levied and imposed by Section 40-18-2 shall be computed as follows: (1) For a single person, head of family, or married persons filing separate returns: . . . c. Five percent of taxable income in excess of three thousand dollars (\$3,000).").

<sup>28</sup> Ala. Code section 40-18-31(a) ("A corporation subject to the tax imposed by [Ala. Code] Section 40-18-2 shall pay a tax equal to six and one-half percent of the taxable income of the corporation.").

<sup>29</sup> 2021 Ala. Acts 1, section 10(f) ("The owners, members, partners, or shareholders shall not be liable for the tax otherwise imposed by Chapters 16 and 18 of Title 40, Code of Alabama 1975, on their pro rata or distributive shares of the Electing Pass-Through Entity's income."). "Chapter 18" referred to in the Alabama PTE tax law (Ala. Code sections 40-18-1 to -446) is the Alabama income tax law generally applicable to both individuals and corporations, while "Chapter 16" (Ala. Code sections 40-16-1 to -11) is a reference to the Alabama tax law imposing a tax on the net income of financial institutions, such as banks and credit card companies, likewise at a rate of 6.5 percent. Ala. Code section 40-16-4(a).

<sup>30</sup> 2021 N.Y. Laws ch. 59, Part C (N.Y. A.B. 3009-C/S.B. 2009-C), section 4 (amending subsection (b) of N.Y. Tax Law section 620).

United States, a political subdivision of such state, or the District of Columbia upon income both derived therefrom and subject to tax under this article.

(2) Such credit shall be equal to the taxpayer's direct share of the pass-through entity tax paid by the electing partnership or electing S corporation to such other state, political subdivision of such other state or the District of Columbia.

(3) However, *such credit will be allowed on [New York personal income] tax paid only if:*

(A) the state of the United States, political subdivision of such state, or the District of Columbia imposing such tax also imposes an income tax substantially similar to the tax imposed under this article [that is, article 22 of the New York Tax Law (New York's personal income tax)]; and

(B) in the case of taxes paid by an S corporation, such S corporation was treated as a New York S corporation. [Emphasis added.]

In effect, the statute says that first, the PTE tax in the other state must be "substantially similar" to New York's, and more importantly, clause (b)(3)(A) is clear that the other state must impose a personal income tax substantially similar to New York's personal income tax. Thus, as should be obvious, New York resident taxpayers who own interests in a PTE that pays tax at the entity level in states that don't have a personal income tax (such as New Hampshire, Tennessee, and Texas) can't claim a credit for the taxes paid to those states. Likewise, one questions whether the existing PTE taxes that are imposed by states such as California and Illinois (that is, the 1.5 percent California corporate franchise tax on S corporations<sup>31</sup> and the 1.5 percent "personal

property tax replacement income tax" imposed by Illinois on partnerships, LLCs, and S corporations<sup>32</sup>) are substantially similar to New York's tax regime to qualify for the tax credit.

Last but not least (the greatest uncertainty of all), and as should be obvious from the discussion above, since none of these state PTE taxes is exactly the same as the other, how can the tax authority determine that the PTE tax paid to another state is eligible for the New York resident tax credit? Moreover, what's going to happen when the only avenue open to a PTE tax in the other state is the election to be treated as a C corporation for state tax purposes, such as those provided by Louisiana and Wisconsin? Is New York going to view that tax as substantially similar to its own? If so, why isn't Texas's margins tax or the Tennessee franchise or excise tax, both applicable to S corporations, LLCs, and partnerships, substantially similar to New York's new PTE tax? Considering New York's recent adventures during the COVID-19 crisis (and even from many years before) regarding its "convenience of the employer" test on the treatment of nonresidents working hundreds, if not thousands, of miles away from New York — and not even taking into consideration New York's aggressive stance asserting residency for "statutory residents" — one wonders how "reasonable" the New York Department of Taxation and Finance is going to be in allowing these resident state tax credits for the PTE taxes paid to other states.

This is not just to pick on New York. Some states, such as Alabama, Georgia, and South Carolina, which followed the income exclusion route as opposed to the tax credit route in avoiding the double tax at the individual and entity level, didn't even provide an amendment to their existing resident state tax credit laws to reflect the potential existence of a claim for a resident state tax credit against personal income tax for residents engaged in a multistate business who paid a PTE tax to another state. As indicated above, those taxpayers might not even have to file a personal income tax return (let alone join in a

<sup>31</sup> Cal. Rev. & Tax Code section 23802(b)(1) ("(b) Corporations that are 'S' corporations . . . shall continue to be subject to the [California corporate franchise tax] (commencing with Section 23101) . . . except as follows: (1) The tax imposed under Section 23151 . . . shall be imposed at a rate of 1-1/2 percent rather than the rate specified in those sections.").

<sup>32</sup> 35 Ill. Comp. Stat. 5/201(c) and (d) (imposing the 1.5 percent rate on partnerships, trusts, and S corporations after Jan. 1, 1981).



composite return) to evidence the state personal income tax on their share of income.

Again, because of the wide variations in the state approaches to these PTE taxes, the greatest fear taxpayers should have must be the administrative denial of the resident or other state tax credit because of a state PTE tax election. That denial would mean that the taxpayer agreeing to a state PTE election potentially turned a 39-cent U.S. FIT benefit into a dollar-for-dollar increase in state taxes.

### Conclusion

It was a no-brainer for state legislators to enact these elective state PTE taxes. In the weeks and months ahead, it's easy to foresee every state enacting one of these taxes. Legislators quickly realized there is no economic cost to the state (and likely a possible increase in state tax revenue), and it directly helps small business, PTE owners, who likely are the legislators' greatest financial supporters of their campaigns. What could go wrong?

The "good news" is that if you own a dental practice in Poughkeepsie, New York, a car dealership in Tustin, California, or a personal injury practice in Atlanta, Georgia, you are a resident of those same states, and you only have sales solely sourced to that state, you're in luck: These state PTE taxes are a welcome relief from the federal SALT deduction limitation. Even so, significant risks remain, foremost of which is whether the Biden administration is going to follow through with one of the last promises made by the Trump administration — the issuance of proposed regulations promised by Notice 2020-75 that these state PTE taxes do what they say they do and qualify for the business tax exception to the SALT deduction limitation.

On a similar vein, there's been much talk, mostly coming from leaders of President Biden's own party, about potentially repealing the SALT deduction limitation entirely, which would make these PTE taxes and the associated elections irrelevant. On the other hand, none of Biden's recent budget proposals suggest any relief from the SALT deduction limitation, and considering how much revenue the elimination of the SALT deduction limitation would cost, it

seems unlikely that Congress will actually go through anything other than posturing to repeal the provision (which expires on its own for tax years beginning in 2026). Congress and the Biden administration could go in an entirely different direction and impose (or in some cases reimpose) limitations on the deductibility of SALT taxes under a modified alternative minimum tax or a new targeted limitation on the total amount of itemized deductions (including the SALT deduction) depending upon the income level of the taxpayer.

At the state level itself, the number one focus must be on ensuring that for multistate taxpayers, the PTE taxes paid to other states will be taken into account and reduce the taxes imposed by the owner's resident state, regardless of whether the resident state enacts its own PTE tax. That could come in the form of a modification of the resident state's already existing other state tax credit or by otherwise excluding or exempting income taxed by the other state from the resident state tax.

Another concern would be the manipulation of the percentage for computing the "in-state credit" for the PTE tax paid against the owner's direct tax liability for the state. As mentioned above, Connecticut legislators quickly figured out they could raise revenue from PTE owners by reducing the PTE tax credit percentage used to compute the tax credit for the direct tax liability. In the future, an even greater concern would be whether these PTE taxes become permanent features of the state's tax law, with legislators deciding to make them mandatory as opposed to elective and perhaps even remove the in-state credits for PTE tax paid as a way to impose a "double layer" of tax similar to that imposed on C corporations and use them as a way to raise revenue.

As noted at the beginning, these state PTE taxes, as simple as they seem to be, are anything but. Taxpayers and their advisers will have to carefully consider each state's PTE tax and their own tax situations, and somehow predict the future before making any election into a state's PTE tax regime.

Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/ Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
Alabama	Feb. 11, 2021.	2021 Ala. Acts 1, section 10 (2021 Ala. H.B. 170) (enrolled).	Not yet codified.	New PTE tax.	Tax years beginning on or after Jan. 1, 2021.	Elective (subject to revocation by PTE).	One-time election by greater than 50% of the voting control of the PTE.	S corporations, partnerships, and LLCs treated as partnerships (but not DRES for U.S. FIT purposes).	No restrictions.
Arizona	June 29, 2021.	2021 Ariz. H.B. 2838 (Senate engrossed version) (May 26, 2021).	Ariz. Rev. Stat. sections 43-1014, 43-1075.	New PTE tax.	Tax years beginning after Dec. 31, 2021.	Elective.	Annual election by individual, estate, or trust PTE owners who consent to tax at PTE level.	S corporations, partnerships, and LLCs treated as partnerships.	PTE tax election does not apply to PTE owners that are not individuals, estates, or trusts or that have not elected for the PTE tax to apply.
Arkansas	Mar. 15, 2021.	2021 Ark. Acts 362 (2021 Ark. H.B. 1209).	Ark. Code Ann. sections 26-65-101 to -108 (new chapter 65).	New PTE tax.	Tax years beginning on or after Jan. 1, 2022.	Elective.	Annual election by greater than 50% of the voting control of the PTE.	General partnerships, limited partnerships, LLCs, and S corporations for U.S. FIT purposes.	No limitations.
California	July 16, 2021.	2021 Cal. Stat. Ch. 82 (2021 Cal. A.B. 150), section 15 (Small Business Relief Act).	Cal. Rev. & Tax Code sections 19900-19906, 17052.10, 17055.	New PTE tax.	Tax years beginning on or after Jan. 1, 2021.	Elective.	Annual election by the PTE.	Entities taxed as a partnership or S corporation (which includes LLCs taxed as either but excludes general partnerships, which are not subject to tax).	Only individuals, estates, and trusts. Partnerships cannot be eligible PTE owners.

Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
Colorado	Proposed.	2021 Colo. H.B. 21-1327 (revised June 1, 2021).	Colo. Rev. Stat. 39-22-340 to -346.	New PTE tax.	Tax years beginning on or after Jan. 1, 2022.	Elective.	Annual election by the PTE.	Entities taxed as a partnership or S corporation (which includes LLCs taxed as either).	No limitations.
Connecticut	May 31, 2018.	2018 Conn. Pub. Acts 18-49, section 1; 2019 Conn. Pub. Acts 19-117, section 333; 2019 Conn. Pub. Acts 19-186, section 1.	Conn. Gen. Stat. sections 12-699 to -699a.	New PTE tax.	Tax years beginning on or after Jan. 1, 2019.	Mandatory.	NA	U.S. FIT partnerships and S corporations, except PTPs.	No limitations.
District of Columbia	Preceded enactment of TCJA.	Not relevant.	UBT — D.C. Code section 47-1808.01 to -1808.15 (unincorporated business tax); S corporation — D.C. Code section 47-1807.01 to 1807.15 (S corporation treated as C corporation).	Existing UBT to partnerships and corporation tax applied to S corporations.	Existing.	Mandatory.	NA	UBT — Partnerships and LLCs treated as partnerships. Corporation tax — S corporations.	No restrictions (S corporations and partnerships may be required to join in combined reports with related members).
Georgia	May 4, 2021.	2021 Ga. Acts ch. 164 (2021 Ga. H.B. 149).	Ga. Code Ann. sections 48-7-21(b)(7)(C) (S corporations), 48-7-23 (partnerships).	New PTE tax.	Tax years beginning on or after Jan. 1, 2022.	Elective.	Annual election by the PTE.	S corporations and partnerships (including LLCs treated as S corporations or partnerships for U.S. FIT purposes).	No restrictions.



Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
Idaho	Apr. 15, 2021.	2021 Idaho Sess. Laws, ch. 239 (2021 Idaho H. 317) (enrolled).	Idaho Code section 63-3026B.	New PTE tax.	Tax years beginning on or after Jan. 1, 2021.	Elective.	Annual election by PTE signed by each member at time of election or by an officer of PTE who has authority to make the election.	S corporations and partnerships (including LLCs treated as S corporations or partnerships for U.S. FIT purposes).	No restrictions.
Illinois	Sent to governor June 28, 2021.	2021 Ill. S.B. 2531 (engrossed Apr. 28, 2021) (approved by both houses May 30, 2021).	35 ILCS 5/201(p).	New PTE tax.	Tax years ending on or after Dec. 31, 2021, and beginning before Jan. 1, 2026.	Elective.	Annual election by PTE.	Partnerships (other than PTPs) and S corporations.	No restrictions.
Louisiana	June 22, 2019.	2019 La. Acts 442; see also La. Dep't of Rev. RIB 19-019, "Guidance on the Pass-through Entity Election" (2020).	La. Rev. Stat. sections 287.732, 287.732.2, 293, and 297.14.	PTE election to be treated as C corporation for state tax purposes.	Tax years beginning on or after Jan. 1, 2019.	Elective (subject to revocation by PTE).	One-time election by PTE.	Any S corporation or entity taxed as a partnership for U.S. FIT purposes.	State's PTE tax law appears to provide PTE tax income exclusion only to PTE owners that are individuals. State DOR guidance affirms that PTE owners that are corporations, estates, or trusts are not eligible for exclusion of income subject to PTE tax.

Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/ Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
Maryland	May 8, 2020.	2020 Md. Laws, ch. 641.	Md. Code Ann., Tax — Gen. sections 10-102.1, 10-402, 10-701.1, and 10-703.	New PTE tax (supplementing state's existing PTE tax on distributions to nonresidents).	For PTE owners that are residents of the state — tax years beginning after Dec. 31, 2019. For PTE owners that are nonresidents of the state — already existing.	Elective (for distributive share of PTE income of PTE owners that are residents of the state); mandatory (for distributive share of PTE income of PTE owners that are nonresidents of the state).	PTE makes election for resident owners (PTE tax remains mandatory for distributive shares of nonresident owners).	S corporations, partnerships, LLCs, business trusts, and statutory trusts not taxed as corporations under state law.	No restrictions.
Massachusetts	Enrolled July 9, 2021 (governor conditional veto July 16, 2021).	2021 Mass. H. 4002, section 39 (2022 Budget (July 9, 2021) (conditional veto July 16, 2021) (adding new Mass. Gen. Laws ch. 63D)).	Mass. Gen. Laws ch. 63D, sections 1 to 7.	New PTE tax.	Tax years beginning on or after Jan. 1, 2021.	Elective.	Annual election by PTE.	S corporations and partnerships (including LLCs treated as S corporations or partnerships for U.S. FIT purposes).	No restrictions (although PTE tax base is determined solely based on cumulative amount of distributive share paid to S corporation shareholders or, for partnerships, partners who are natural persons).

Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
Michigan	Vetoed by governor July 13, 2021.	2021 Mich. H.B. 4288, (as enrolled and presented to the governor on June 30, 2021) (vetoed by governor July 13, 2021).	MCL 206.751 to 206.797 (also known as "Part 4").	New PTE tax.	Tax years beginning on or after Jan. 1, 2021.	Elective (irrevocable for current and two subsequent years).	One-time election by PTE (subject to renewal).	U.S. FIT partnerships and S corporations. But no PTPs, DREs, or financial institutions subject to the Michigan financial institution franchise tax can elect into the PTE tax.	No limitations.
Minnesota	July 1, 2021.	2021 Minn. H.F. 9, article 3 (2nd Engrossment).	Minn. Stat. section 289A.08, subdiv. 7a.	New PTE tax.	Tax years beginning after Dec. 31, 2020.	Elective (annually).	PTE and qualifying owners who hold more than 50% ownership interest in the PTE.	S corporations, partnerships, and LLCs, except ones that have a partnership, LLC, or corporation as a partner, member, or shareholder.	No PTE owner can be a partnership, LLC (other than one that is a DRE), or corporation.
New Jersey	Jan. 13, 2020.	N.J. P.L. 2019, c. 320.	N.J.S.A. 54A:12-1 et seq.	New PTE tax.	Tax years beginning on or after Jan. 1, 2020.	Elective (annually).	PTE and each PTE owner (or officer, manager, or member authorized to make election) consent to state's PTE tax.	Partnerships, S corporations, and LLCs with at least one member liable for state's PIT.	At least one member of PTE must be subject to state's PIT.
New York	Apr. 19, 2021.	2021 N.Y. Laws ch. 59, Part C (2021 N.Y. S2509-C, 2021 N.Y. A3009-C).	N.Y. Tax Law sections 860-867 (Art. 24-A).	New PTE tax.	Tax years beginning on or after Jan. 1, 2021.	Elective (annually).	PTE officer authorized to make election.	Partnerships, New York S corporations, and LLCs treated as partnerships or New York S corporations.	No limitations.



Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/ Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
New York City	Preceded enactment of TCJA.	Not relevant.	UBT – N.Y.C. Admin. Code 11-501 to -540. S corporation – N.Y.C. Admin. Code 11-60-610 (general corporation tax).	Existing UBT (partnerships) and corporation tax (S corporations).	Existing.	Mandatory.	NA	UBT – Partnerships and LLCs treated as partnerships. Corporation tax – S corporations.	No restrictions.
North Carolina	Proposed.	2021 N.C. S.B. 583, section 4(a)-(e) (S corps), 4(f)-(m) (partnerships).	N.C. Gen. Stat. sections 105-131.1A (S corporations), 105.153.3 (partnerships).	New PTE tax.	Tax years beginning on or after Jan. 1, 2021.	Elective.	Annual election by PTE.	S corporations and partnerships (except PTPs or partnerships that have a member during the year that is not an individual, estate, S corporation trust, or qualified pension plan or 501(c)(3) organization) including LLCs treated as S corporations or partnerships.	All PTE owners must be (1) an individual, (2) an estate, (3) a qualified S corporation trust, or (4) a qualified pension, profit-sharing, or stock bonus plan or 501(c)(3) organization.

Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/ Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
Ohio	Preceded enactment of TCJA.	Not relevant.	Ohio Rev. Code Ann. sections 5747.01(K) to 5733.04(O) (defining PTE); 5733.40 to 5733.41 (operating provisions); 5747.41 (withholding tax — individuals); 5733.41 (withholding tax — other than individuals).	Existing PTE tax on distributions to nonresidents.	Preceded enactment of TCJA.	Mandatory.	NA	S corporations and partnerships, LLCs of any other person, other than an individual, trust, or estate not classified as a corporation for U.S. FIT purposes.	No restrictions (although PTE tax generally applies only to PTE distributions to state nonresident individuals — numerous statutory exemptions to “investor” (for example, exempt organizations, C corporations, resident individuals)).
Oklahoma	Apr. 29, 2019.	2019 Okla. Laws ch. 201, 2019 Okla. H.B. 2665 (enrolled); 2021 Okla. Laws 514 (H.B. 2961) (amended rates).	Okla. Stat. tit. 68, sections 2355.1P-1 to 2355.1P-4.	New PTE tax.	Tax years beginning on or after Jan. 1, 2019.	Elective.	One-time election by PTE (effective until revoked).	S corporations, partnerships, and LLCs treated as S corporations or partnerships for U.S. FIT purposes.	No restrictions (although different tax rates apply to net income attributable to different PTE owners).
Oregon	Enrolled (June 26, 2021).	2021 Or. S.B. 727 (enrolled).	314 Or. Rev. Stat. (sections to be determined).	New PTE tax.	Tax years beginning on or after Jan. 1, 2022, and before Jan. 1, 2024.	Elective.	Annual election by PTE.	S corporation, partnerships, or LLCs treated as S corporations or partnerships for U.S. FIT purposes.	All owners must be either (1) individuals subject to the state’s PIT or (2) PTEs owned entirely by individuals subject to the state’s PIT.

Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
Pennsylvania	Proposed.	2021 Pa. H.B. 1709.	72 Pa. Stat. section 7306.2(f), 7307.8(f).	New PTE tax (grafted onto existing Pennsylvania PIT PTE underreporting rules).	Effective date is 60 days from enactment, no specific provision.	Elective.	Annual election by PTE.	S corporation or partnership (except a PTP or a partnership that has a member during the year that is not an individual, estate, S corporation trust or qualified pension plan, or 501(c)(3) organization), including LLCs treated as an S corporation or partnership.	No specific restrictions.
Rhode Island	July 5, 2019.	2019 R.I. Pub. Laws, ch. 88, article 5, see section 8.	R.I. Gen. Laws sections 44-11-2.2. and -2.3.	New PTE tax.	Tax years beginning on or after Jan. 1, 2019.	Elective.	Annual election by PTE.	S corporations, partnerships, LLCs, and unincorporated sole proprietorships that are not taxed as corporations for U.S. FIT purposes.	An individual who is a shareholder of an S corporation; a partner in a GP, LP, or LLP; a member of an LLC; a beneficiary of a trust; or a sole proprietor.



Table 1. Summary of Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Enactment Date	Session Law Citation	Key Statutory Codification	Type	First Year PTE Tax Available	Elective/Mandatory	Requirements for PTE Tax Election	Eligible PTE Entities	Character of Members*
South Carolina	May 17, 2021.	2021 S.C. Acts 61 (ver. May 12, 2021).	S.C. Code Ann. section 12-6-545(G).	New PTE tax.	Tax years beginning after 2020.	Elective.	Annual election by PTE.	Partnerships and S corporations (including LLCs taxed as partnerships or S corporations), when all owners are "qualified owners" or partnerships, and when those partnerships are owned directly or through other partnerships by "qualified owners."	All PTE owners must be (1) an individual, (2) an estate, (3) a trust, or (4) any other entity other than those taxed as corporations or exempt organizations (see S.C. Code Ann. sections 12-6-530 and 12-6-540 through 550).
Virginia	Preceded enactment of TCJA.	Not relevant.	Va. Code Ann. section 58.1-486.2.	Mandatory (for distributive shares of PTE income of nonresident PTE owners).	Existing.	Mandatory.	NA	Any entity, including partnerships, LLCs, business trusts, and S corporations, that is recognized as a separate entity for U.S. FIT purposes.	Applies to distributive shares paid to nonresidents only. Does not apply to income of nonresident owners exempt from state tax.
Wisconsin	Dec. 14, 2018.	2017 Wisc. Act. 368, sections 1 through 12.	Wis. Stat. sections 71.04 to 71.775 (various sections were amended).	PTE election to be C corp.	Tax years beginning on or after Jan. 1, 2019.	Elective.	Annual election by PTE but must have consent of persons who hold 50% of the capital and profits of a partnership.	Partnerships, S corporations, and LLCs treated as partnerships or S corporations.	No restrictions.

Abbreviations:  
DRE — Disregarded entity.  
PIT — Personal or individual income tax.  
PTE — Passthrough entity (for example, a partnership, S corporation, or LLC treated as a partnership or S corporation).  
PTP — Publicly traded partnerships.  
U.S. FIT — U.S. federal income tax.

\*For purposes of the limitations on the owners of a PTE, it should be understood that in no state can an S corporation (which is eligible for a state's PTE tax) that has disqualified owners for U.S. FIT purposes (for example, a corporate owner) be an S corporation that can elect into the state's PTE tax.

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSIC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
Alabama	2021 Ala. Acts 1, section 10 (2021 Ala. H.B. 170) (enrolled).	PTE's own taxable income apportioned or allocated to Alabama.	5% (Highest marginal PIT rate.)	Exclusion of distributive share of PTE income from direct PIT liability of owner.	NA	None.	Same as applicable to corporations.	No special provision.	
Arizona	2021 Ariz. Sess. Laws ch. 425 (2021 H.B. 2838).	PTE's own taxable income: (1) the portion of its income attributable to resident owners and (2) the portion of its taxable income attributable to nonresident owners derived from sources in Arizona. Income to owners that are not individuals, estates, or trusts is excluded.	4.5%	Credit for share of PTE tax paid.	Credit with five-year carryforward.	Resident credit for any tax that is "substantially similar" to the state's PTE tax.	Same as applicable to individuals, provided the PTE's taxable income exceeds \$150,000.	PTE, but the AZ DOR can under the new law specifically collect from electing PTE owners for their proportionate share of PTE tax not paid.	
Arkansas	2021 Ark. Acts 362 (2021 Ark. H.B. 1209).	PTE's own net taxable income.	5.9%	Exemption.	NA	Exclusion of income subject to a PTE tax in another state that is "substantially similar" to Arkansas's.	Required in equal quarterly installments based on the PTE's tax year.	PTE and individual owners (based on pro rata share) of the PTE.	

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSTC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
California	2021 Cal. Stat. ch. 82 (2021 Cal. A.B. 150), Sec. 15 (Small Business Relief Act).	Total of the resident owners' share of the PTE's net income from all sources and the total of the nonresident owners' share of the PTE's income apportioned or allocated to California.	9.3%	94.9% of 9.3% of the pro rata share or distributive share of income subject to PTE tax.	Three-year carryover of any excess.	Not addressed by bill. See generally Cal. Rev. & Tax Code sections 18001 to 18006 (PIT OSTC provisions).	Not addressed. Rely on existing estimated tax rules.	No special provision.	Law expires Dec. 1, 2026. Not applicable to years beginning on or after Jan. 1, 2026.
Colorado	2021 Colo. H.B. 21-1327 (revised June 1, 2021).	Each owner's pro rata or distributive share of the PTE's income attributable to Colorado and each Colorado resident owner's pro rata or distributive share of the PTE's income <i>not</i> attributable to Colorado.	4.55%	Exclusion of owner's share of PTE income subject to PTE tax.	NA	PTE is entitled to credit for taxes paid to another state whether the other state taxes were paid by the PTE or by the owners.	Same as if the PTE were treated as a corporation.	PTE is treated as the taxpayer.	PTE tax election allowed only in a year in which the federal SALT deduction limitation applies.
Connecticut	2018 Conn. Pub. Acts 18-49, section 1; 2019 Conn. Pub. Acts 19-117, section 333; 2019 Conn. Pub. Acts 19-186, section 1.	Default — PTE's own net taxable income. Alternative Tax Base — PTE income attributable only to individual owners of the PTE.	6.99%	87.5% of distributive share of owner's PTE tax.	Refundable credit.	PTE owners entitled to credit for PTE taxes paid to another state that are "substantially similar" to this state's PTE tax.	Regardless of PTE's fiscal year, estimated taxes are due at fixed dates for calendar-year periods set forth in the law.	No provision.	Nonresident owners electing PTEs are not obligated to file state PIT returns if their shares of income are derived from PTEs subject to state's PTE tax.



Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSTC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
District of Columbia	Preceded enactment of TCJA.	UBT – PTE taxable income.	UBT – 8.25%; corporations – 8.25%	UBT – PIT and CIT payers qualify for credit for UBT paid. S corporations – no credit.	NA	NA (Both taxes apportioned; no OSTC provided.)	Quarterly payments.	PTE only.	
Georgia	2021 Ga. Acts ch. 164 (2021 Ga. H.B. 149).	PTE's own allocated and apportioned income to the state.	5.75%	Exclusion of distributive share of PTE income from direct PIT liability of owner.	NA	None.	PTE treated as a corporation for purposes of estimated payments.	PTE only.	Nonresident owners of electing PTE are not obligated to file state PIT returns if their shares of income are reported on PTE's return.
Idaho	2021 Idaho Sess. Laws, ch. 239 (2021 Idaho H. 317) (enrolled).	PTE's own income.	6.925% (The then-effective state corporate income tax rate.)	Credit for share of PTE tax paid.	Individual and corporate PTE owners entitled to fully refundable credit to the extent that share of PTE tax exceeds PIT or CIT liability.	PTE owners entitled to credit for PTE taxes paid to another state that are "substantially similar" to this state's PTE tax.	No special provision.	No special provision.	Nonresident owners of electing PTE are not obligated to file state PIT returns if their shares of income are reported on PTE return.

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSIC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
Illinois	2021 Ill. S.B. 2531 (enrolled Apr. 28, 2021) (approved by both houses (May 30, 2021)).	PTE's own net income — modifications to standard state definition of net income. Partnerships of other PTEs (tiered partnerships) must also deduct distributive share of PTE income already taxed.	4.95% (Note: PTE tax is separate from, but in addition to, existing 1.5% personal property tax replacement income tax for total rate of 6.45%.)	Credit equal to 4.95% of distributive share of PTE income subject to PTE tax.	Any excess credit not used treated as overpayment of PTE owner's tax.	PTE owners entitled to credit for PTE taxes paid to another state that are "substantially similar" to this state's PTE tax.	Reference to and reliance upon existing state's income tax law on estimated tax payment requirements. PTE owner withholding suspended.	PTE is primarily liable for PTE tax, but if not paid, PTE owners are liable based upon a ratio of each PTE owner's share of the net income of the PTE over total PTE net income.	(1) Nonresident owners of electing PTEs are not obligated to file state PIT returns if their shares of income are derived from PTEs subject to state's PTE tax. (2) PTE tax election allowed only in a year in which the federal SALT deduction limitation applies.
Louisiana	2019 La. Acts 442.	PTE's own income as if the entity had been required to file an income tax return with the IRS as a C corporation.	Progressive rates for electing PTE: 2% (<\$25K), 4% (>\$25K but <\$100K), 6% (>=\$100K).	Exclusion of distributive share of PTE income from direct PIT liability of owner.	NA	None.	PTE subject to same estimated tax requirements applicable to other, state taxpayers.	No special provision.	PTE entitled to state tax deduction of U.S. FIT it would have paid if it had filed with IRS as a C corporation.

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSIC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
Maryland	2020 Md. Laws, ch. 641.	PTE's income under IRC that is derived from or reasonably attributable to the PTE's trade or business in the state.	Sum of (1) state's corporate tax rate (8.25%); and (2) (a) applicable county rate (for resident PTE owners) or (b) statewide county rate (for nonresident PTE owners).	Credit against member's own state tax liability equal to proportionate share of state PTE tax paid by PTE.	No provision.	State resident PTE owners eligible for credit for PTE tax paid to other state if other state provides a credit for tax paid to this state.	PTE subject to same estimated tax requirements applicable to other state taxpayers.	If partnership does not pay PTE tax, partners are liable for PTE tax only to extent of their distributions from the partnership (unless state demonstrates intention of partner to defeat imposition of PTE tax).	State PTE tax does not apply to distributive share or pro rata share of a member that is (1) a real estate investment trust (for U.S. FIT purposes) or (2) an entity exempt from taxation under IRC section 501 (that is, a nonprofit). Publicly traded PTE can apply with state to exclude itself from PTE tax if entity files information report regarding its nonresident PTE owners with state.

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSTC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
Massachusetts	2021 Mass. H. 4002, section 39 (2022 Budget (July 9, 2021) (conditional veto July 16, 2021).	Qualified income taxable in Massachusetts defined to be PTE's income determined under state's PIT law and allocable to S corporation shareholders or partners in a partnership that are natural persons.	5%	Credit for proportionate share of PTE tax times 0.9 and applicable against PIT of PTE owner. (governor conditional veto recommends 100% credit).	No provision.	No provision.	PTE must make estimated payments under same terms and conditions applicable to other taxpayers under Mass. Gen. Laws ch. 62B.	No provision.	PTE tax election allowed only in a year in which the federal SALT deduction limitation applies. Requires state DOR to develop administrative regulations on PTE tax to trusts and other provisions to "ensure that the electing [PTE] and its . . . members pay an aggregate amount of tax under [PTE tax and PIT] generally equivalent to the amount that would have been paid" absent PTE tax election.

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSIC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
Michigan	2021 Mich. H.B. 4288, (as enrolled and presented to the governor on June 30, 2021) (vetoed by governor July 13, 2021).	Federal taxable income as if the PTE were treated as a C corporation with tax due on only the tax base allocable to those members who are individuals, flow-through entities, estates, or trusts. Business income of the PTE allocable to members that are corporations, insurance companies, or financial institutions must be excluded.	4.25% (Same as under MCL 206.51.)	Credit against PIT.	Any PTE tax in excess of PIT credit is fully refundable.	No provision.	PTE subject to same estimated tax requirements applicable to other state taxpayers (MCL 206.301).	No provision.	
Minnesota	2021 Minn. H.F. 9, article 3 (2nd Engrossment).	Sum of the tax liability of each qualifying owner of the PTE based on the PTE's income.	9.85% (Highest marginal state PIT rate.)	Subtraction of qualifying owner's income subject to state's PTE tax from that owner's state PIT.	Any PTE tax in excess of PIT credit is fully refundable.	Tax paid for PTE owner as part of PTE tax is treated as payment of the tax by the PTE owner and (similar provision for corporate owner of PTE subject to PTE tax).	PTE must make estimated payments under same terms and conditions applicable to other taxpayers under Minn. Stat. section 289A.25.	No special provision.	Only allowable in a year in which federal SALT deduction limitation applies. Nonresident PTE owner does not have to file state PIT return if PTE income is only state source income.



Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSIC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
New Jersey	N.J. P.L. 2019, c. 320.	Sum of distributable shares of income to PTE owners consenting to PTE tax election.	Progressive rates based on PTE tax base: 5.675% (<\$250K), 6.52% (≥\$250K but <\$1M), 9.12% (≥\$1M but <\$5M), 10.9% (≥\$5M).	Credit (refundable) against PTE owner's PIT liability.	NA	Resident PTE owners entitled to credit for PTE taxes paid to another state that are "substantially similar" to this state's PTE tax. (Different statutes provide for credit under state's PIT and CIT laws.)	Quarterly on or before 15th day of fourth, sixth, and ninth month of current year and first month of succeeding year.	PTE owners jointly and severally liable for PTE tax (except that a person admitted as a partner is not personally liable for any obligation before the person's admission as a partner).	
New York	2021 N.Y. Laws ch. 59, Part C (2021 N.Y. S2509-C, 2021 N.Y. A3009-C).	Generally, the aggregate of the distributive share of direct, individual owners of the PTE.	Progressive rates based on PTE tax base: 6.86% (<\$2M), 9.65% (≥\$2M but <\$5M), 10.3% (≥\$5M but <\$25M), 10.9% (≥\$25M).	Credit (refundable) against PTE owner's PIT liability.	None.	Resident PTE owners entitled to credit for PTE taxes paid to another state that are "substantially similar" to this state's PTE tax, but the other state must also impose a PIT similar to this state's PIT and, in the case of taxes paid by an S corporation, the S corporation was treated as a New York S corporation.	Regardless of PTE's fiscal year, estimated taxes are due Mar. 15, June 15, Sept. 15, and Dec. 15 of the calendar year.	Several liability for PTE tax not to exceed distributive share of PTE tax liability to PTE owner.	

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSTC for PIT or PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
New York City	Preceded enactment of TCJA.	UBT – PTE taxable income. S corporations – as if treated as C corporations.	UBT – 4% S corporations – 8.85% (see also alternative bases).	UBT – PIT (which applies only to NYC residents) and CIT taxpayers qualify for credit for UBT paid. S corporations – no credit.	NA	NA (Both taxes apportioned; no OSTC provided.)	Quarterly payments.	PTE only.	UBT – real estate and investment companies excluded from UBT. S corporations – 2015 city tax reform did not apply to S corporations, but still subject to general corporation tax.
North Carolina	2021 N.C. S.B. 583, sections 4(a)-(e) (S corps), 4(f)-(m) (partnerships).	Equal to the sum of the distributive shares of the income of the PTE of all members allocated or apportioned to the state; plus, the distributive share of the resident PTE owner's income not attributable to N.C.	5.25% (Rate imposed under N.C. Gen. Stat. section 105-153.7.)	Deduction of income subject to PTE tax.	NA	Credits for taxes paid to other states are creditable to the PTE, not the owners, but statute provides that the owner's share of the PTE's income is treated as the income of the PTE owner subject to the OSTC and treated as imposed on the PTE owner for purposes of the state's PIT.	Same as applicable to corporations.	No provision.	

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSIC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
Ohio	Not relevant.	"Adjusted qualifying amount" — generally, distributive share of "qualifying investor" state income from PTE.	5% (PTE tax base to nonresident individual investors.) 5% (PTE tax base to nonresident beneficiaries.) 8.5% (PTE tax base to investors other than nonresident individuals.)	NA (Does not apply to resident PTE owners.)	NA (Does not apply to resident PTE owners.)	Same as applicable to corporations and individuals (depending on nature of qualifying investor).	Qualifying investors can be held liable for PTE tax not paid.		
Oklahoma	2019 Okla. Laws ch. 201, 2019 Okla. H.B. 2665 (enrolled); 2021 Okla. Laws 514 (H.B. 2961) (amended rates) (enrolled).	Oklahoma net entity income (or loss) — sum of electing PTE's items of income, gain, loss, and deduction.	4.75% (If PTE owner is an individual, trust, or estate (highest marginal state PIT rate)). 4% (If PTE owner is corporation, PTE, or financial institution).	Subtraction from PTE owner's income of distributive or allocated share of income subject to PTE tax.	NA	No special provision.	For tax years beginning on or after Jan. 1, 2020, electing PTE must pay estimated taxes under same schedule applicable to other taxpayers.	If PTE tax not paid, state tax commission can revoke the election (causing general PTE liability rules to apply).	Nonresident individual PTE owners do not have to file state income tax returns if their only source of state income is from one or more electing PTE taxpayers.

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSIC for PIT for PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
Oregon	2021 Or. S.B. 727 (enrolled).	Sum of the PTE's "distributable proceeds" (i.e., income derived or connected with sources within Oregon) to each member of the PTE.	Progressive rates based on PTE tax base: 9% (≤\$250k) 9.9% (>\$250k).	Credit against PTE owner's PIT liability.	Any PTE tax in excess of PIT credit is fully refundable.	No provision.	No provisions (although PTE owners are still required to make their own estimated tax payments, which are creditable against their share of the PTE tax liability).	No provision (presumably PTE itself).	Only allowable in a year in which federal SALT deduction limitation applies.
Pennsylvania	2021 Pa. H.B. 1709.	All the PTE's income allocable to resident partners or members and the portion of the PTE's income from sources within Pennsylvania allocable to nonresident partners or members.	3.07% (applicable Pennsylvania PIT rate).	Credit against PTE owner's PIT liability.	Credit against PTE owner's PIT liability.	Credit allowed at the electing PTE level. No credit allowed to individual PTE owners.	Estimated taxes required of an electing PTE as if it were treated as a corporation.	No provision.	
Rhode Island	2019 R.I. Pub. Laws, ch. 88, art. 5, section 8.	"Net income" reported on federal tax form schedules C and E but does not include specially allocated investment income.	5.99%	Credit against PTE owner's PIT liability.	No provision.	A similar type of tax imposed by another state on the owners' income paid at the state entity level shall be deemed allowed as a credit for taxes paid to another jurisdiction under existing OSIC rule.	Same as applicable to corporations (as PTE tax codified under business corporation tax law).	No provision (presumably PTE itself).	

Table 2. Additional Key Features of State PTE Taxes (as of July 20, 2021) (Continued)

State	Session Law Citation	PTE Tax Base	PTE Tax Rate	Owner Income Tax Offset	Nature of Credit or Carryover	Eligibility of State Resident Owners for OSTC for PIT or PTE Tax Paid to Other State	Estimated Taxes	Liability for PTE Tax	Other
South Carolina	2021 S.C. Acts 61 (ver. May 12, 2021).	Active trade or business income or loss as if the PTE were an individual — excludes passive investment income, capital gain, payments for services.	3% (Reference to statutory rate schedule for taxpayers that are not corporations.)	PTE owners exclude income subject to PTE tax from their income.	NA	None.	Required for tax years after 2021. Cross-reference existing S.C. estimated payment rules applicable to corporations with quarterly dates for calendar- and fiscal-year taxpayers.	PTE but if PTE does not pay, direct and indirect PTE owners are liable on their proportionate shares of the PTE income.	Active trade or business income or loss of PTE must be apportioned and none can be treated as income from personal services that is allocated.
Virginia	Preceded enactment of TCJA.	Accumulated shares of PTE income from state sources of all nonresident PTE owners.	5%	Credit for nonresident PTE owners for income subject to PTE tax.	NA	NA (Applies only to nonresidents.)	Nonresident owners still liable for own estimated payments.	PTE.	
Wisconsin	2017 Wisc. Act. 368, sections 1 through 12.	PTE income as if it were a C corporation.	7.9%	PTE owners exclude income subject to PTE tax from their income.	NA	None.	PTE subject to same estimated tax requirements applicable to other state taxpayers.	PTE but if PTE does not pay, PTE owners are liable on their proportionate shares of the PTE tax.	

Abbreviations:

- CIT — Corporate income tax.
- PIT — Personal or individual income tax.
- PTE — Passthrough entity (for example, a partnership, S corporation, or LLC treated as a partnership or S corporation).
- OSTC — Other state tax credit (or resident state tax credit). The PIT credit some states provide to resident taxpayers for the state taxes paid to other states.
- U.S. FIT — U.S. federal income tax.