



IRS Issues Welcome Guidance Regarding SALT Workaround for Pass-Through Entities

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The Tax Cuts and Jobs Act limited an individual's state and local tax ("SALT") deduction to \$10,000 (\$5,000 in the case of married filing separately) for tax years starting after December 31, 2017, and before January 1, 2026. State and local taxes subject to this limit include real and personal property taxes, income taxes, and sales taxes. Many states, including New Jersey, considered and enacted various attempted workarounds to the SALT deduction limit.

One popular workaround was to credit against real property taxes certain "charitable contributions" made to certain state and local entities or affiliated nonprofit entities by individual taxpayers. The thought was that the charitable donation would provide a federal income tax deduction in lieu of tax payments that would be limited by the SALT deduction cap. However, the IRS quickly issued guidance disallowing this workaround as a result of the contributions lacking donative intent, since the individual received a corresponding benefit in the form of a tax credit.

Another workaround involved the imposition of an entity-level tax on the income of partnerships and S corporations, in lieu of taxing the partners and shareholders of such entities on this income. The thinking was that a tax paid by an entity would reduce its income for federal tax purposes, which would in turn reduce the amount of income passing through to partners and shareholders. Since entities are not subject to the SALT deduction cap, this would effectively allow partners and shareholders to benefit from the payment of state and local income taxes for federal income tax purposes despite the SALT deduction cap. A number of states adopted variations of a pass-through entity tax, including New Jersey, where the Pass-Through Business Alternative Income Tax Act ("BAIT") was signed into law by Governor Phil Murphy on January 13, 2020.

Until now, the IRS has not weighed in on whether it would permit a pass-through entity tax workaround to the

SALT deduction cap. However, the IRS recently issued Notice 2020-75, providing welcome guidance that it plans to issue regulations that would generally allow the pass-through entity tax workarounds to the SALT deduction cap. The following key points were addressed in Notice 2020-75 (and will be addressed in forthcoming proposed regulations):

- Amounts paid by a partnership or S corporation to a state or political subdivision of a state to satisfy income taxes imposed on the partnership or S corporation are deductible in computing its income or loss in the year the payment is made.
- Such deduction would be allowed without regard to whether the imposition of and liability for the tax on the entity is elected by the entity or is mandatory.
- Such deduction would be allowed without regard to whether partners or shareholders of the entity receive a partial or full credit, deduction or other tax benefit based on their share of the amount paid by the entity to satisfy its state or local tax liability, thereby reducing the individual's state or local income tax liability.
- Such payments by the pass-through entity are not taken into account in applying the SALT deduction cap to its partners or shareholders.

Based on Notice 2020-75, it appears that BAIT will be respected by the IRS, and partners and shareholders electing to have their entities pay BAIT will not be subject to the SALT deduction cap on the federal income tax benefit they receive from doing so.

If you have any questions about the recent IRS notice or BAIT, or if you would like assistance with regard to BAIT, please contact [Robert C. Daleo](#), [Jason D. Navarino](#), [Hannah J. Greendyk](#) or any member of Riker Danzig's [Tax](#) and [Corporate](#) Departments.

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