# STATE PASS-THROUGH ENTITY-LEVEL TAX IMPLEMENTATION ISSUES

## BACKGROUND

One of the provisions of the 2017 federal tax reform (Pub. Law No. 115-97, commonly referred to as the *Tax Cuts and Jobs Act* (TCJA)) was a limit on the amount of state and local taxes an individual can deduct for regular federal income tax purposes. Congress amended section 164 by imposing a $10,000 limit for most individuals and married couples filing a joint return and a $5,000 limit on married individuals filing separately.[1] There were no changes to the provision in section 164 that allows for the deduction for taxes paid in connection with a trade or business that are imposed on the business directly.[2] There were also no additional limitations placed on the deductibility of charitable contributions under section 170, but section 170 was expanded.[3]

The TCJA legislative history,[4] as well as comments made by federal tax officials, indicate that the deduction for state and local income taxes paid by corporations was retained, but no similar deduction was retained for entities other than C corporations. The individual owners of pass-through entities (PTEs) report their proportionate share of business income on their individual income tax returns and are subject to the $10,000/$5,000 annual limit of section 164(b) for state and local income taxes paid. PTEs include entities taxed under subchapters K and S of the Internal Revenue Code. These PTEs include S-corporations, partnerships, limited partnerships, limited liability partnerships (LLPs), and limited liability companies (LLCs).

## ISSUE

In response to these new federal limitations, many state tax policy makers are proposing, and several state legislatures have enacted, various approaches to assist their taxpayers in mitigating this new limitation on the federal income tax deduction for state and local taxes.

One state legislative approach that several states have proposed, and one state already has enacted, is intended to **shift the tax on PTE income from the owner to the PTE**. Such an approach, its proponents believe, would allow the PTE to deduct the entity's state and local income taxes as a

[1] All section references in this document are to the Internal Revenue Code of 1986, as amended, (IRC) or the Treasury regulations promulgated thereunder, unless otherwise specified.
[2] TCJA, Sec. 11042(a) (amending IRC section 164(b).
[3] TCJA, Sec. 11023 increased the adjusted gross income (AGI) limitation for individual donors' cash contributions to operating charities from 50 percent to 60 percent. In addition, the Pease limitation, which phased out as much as 80 percent of the benefits of charitable and other itemized deductions for higher income taxpayers, was repealed. These changes will sunset after 2025.
[4] See section 164(a) ("…In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence [which lists the various taxes for which a deduction under section 164 is permitted] which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income)"). See e.g., House Rpt. 115-466, *Tax Cuts and Jobs Act: Conference Report to Accompany H.R. 1*, pg. 259 to 261.

tax on the business at the federal level, followed by a deduction for the PTE tax in the distributive share of the PTE owners' income. These state proposals also would provide that the owner is permitted to claim a credit on the owner's state income tax return for the amount of the owner's distributive share of the taxes paid by the PTE.

A PTE state-level tax was recently enacted in Connecticut,[5] and other states are considering similar proposals. As states consider enacting PTE-level taxes, states and state CPA societies should consider various perspectives and implementation issues regarding this approach.

The multitude of methodologies that states employ to impose tax on income and capital, the potential lack of guidance from state authorities, and the variety of taxpayer-specific fact patterns will likely result in added compliance complexities. In addition, it is uncertain whether federal tax officials will respect or challenge these approaches.

## IMPORTANCE TO CPAs

Given the number of PTEs and the novelty of the recently enacted federal limitations on the deductibility of state and local taxes for PTE owners, we anticipate some states will consider enacting an entity-level tax with a corresponding credit to the PTE owners. PTE-level taxes will have broad federal and state tax consequences. CPAs regularly assist PTEs and their owners with tax compliance and planning, and interact with state tax authorities on their behalf. In addition, many CPA firms are formed as PTEs.

CPAs are interested in working with state tax authorities and legislatures as they consider possible entity-level taxes on PTEs. Entity-level taxes have implications regarding both state tax revenues and state taxpayers, including PTEs and individual taxpayers.

## RECENT STATE ACTIVITY

On May 31, 2018, the Governor of Connecticut signed into law Public Act 18-49 (Act) that contains a PTE-level tax. The Act imposes a 6.99% entity-level income tax on most PTEs in Connecticut. Owners of PTEs are entitled to a credit against their Connecticut personal income tax equal to 93.01% of the PTE owner's pro rata share of the PTE-level tax paid by their PTE. The state law grants a Connecticut resident owner of a PTE with a credit for any entity-level tax imposed by other states that the Connecticut Department of Revenue Services (CDRS) determines is similar to the Connecticut PTE-level tax.

The Act also provides that PTEs subject to the Connecticut PTE-level tax are required to make quarterly estimated tax payments. On June 6, 2018, the CDRS issued guidance regarding the Connecticut PTE-level tax and the estimated payment requirements thereunder.[6] In addition,

[5] See *Entity-Level Income Taxes on Pass-Through Businesses*, Connecticut General Assembly, Office of Legislative Research, Heather Poole, Associate Analyst, 2018-R-0090, March 8, 2018.

[6] SN 2018-4, issued June 6, 2018, provides guidance on estimate payment installments. Any owner and PTE may re-characterize their individual estimated payments to apply against the 2018 PTE estimated tax requirement.

CDRS issued additional guidance in OCG-6 (June 19, 2018) and OCG-7 (August 21, 2018).[7] The Act and the Connecticut PTE-level tax is applicable for taxable years beginning on or after January 1, 2018. Under the Connecticut PTE-level tax, however, the PTE may elect to carve out the pro rata share of PTE income allocated to corporate owners from the calculation of the Connecticut PTE-level tax. The Act does not affect the taxation of publicly-traded partnerships, sole proprietorships, or single-member limited liability companies (SMLLCs) that are treated as disregarded entities for federal income tax purposes.

Other states, such as New York, New Jersey and Arkansas, have announced that they are considering whether to enact their own PTE-level tax similar to Connecticut's. Specifically, the New York Department of Taxation and Finance released its own draft of a proposed Unincorporated Business Tax (UBT), which, similar to the Connecticut tax, would provide a credit for PTE owners against their corresponding New York state personal income tax liabilities.[8]

## AICPA POSITION

The AICPA encourages state CPA societies to advocate for fair, reasonable, and administrable tax rules that minimize the complexities and burdens to taxpayers and state tax authorities alike.

**The AICPA does not take any position on these state tax proposals, either as a concept or on any of the specific legislative drafts that some states have recently released.**

To assist state CPA societies, the AICPA identified the following list of issues for consideration in evaluating any proposed state PTE-level tax.[9] This list is not intended to support or oppose any proposal, but to provide a guide for discussion of any such proposal. Each state CPA society will need to make its own determination on whether such a regime will represent an overall benefit or detriment to their members, their members' clients, and the state's taxpayers in general. Each state CPA society should also consider whether such a regime represents overall good tax policy.

The AICPA does not express any opinion on the relative importance of the items identified below nor is the order in which the issues are listed below any indication of the AICPA's view of the significance of these issues.

[7] The guidance addresses various details, including the calculations for: how a PTE distributes and reports the credit to owners, what happens if the credit exceeds an owner's tax liability, how tiered PTEs report and distribute the credit, how combined groups of corporations that own a PTE can distribute the credit, how trusts report and distribute the credit, and whether nonresident individuals who receive a credit must otherwise file a Connecticut personal income tax return.

[8] See the New York Department of Taxation and Finance discussion draft and summary for a state PTE level tax.

[9] In addition to the AICPA State Pass-Through Entity-Level Tax Task Force, the AICPA State and Local Tax, Partnership, and S Corporation Tax Technical Resource Panels, as well as the AICPA Tax Executive Committee approved this paper.

**Potential Benefits**

Simplified Nexus for All PTEs, Including Multi-Tiered Entities, Which will Also Have Reduced Administrative Burdens

1. Determination of nexus is simplified by requiring testing solely at the PTE–level (and not at the individual owner level).

2. Compliance costs for multi-tiered PTEs are reduced because state income tax nexus is limited to the entity level, and nexus determinations do not apply at upper tiers of a multi-tiered PTE (i.e., including hedge funds).

3. Administrative burdens are reduced because multiple tiers will not have a requirement for state purposes to separately calculate combined apportionment factors at each tier of a multiple tier PTE structure.

Other Administrative Simplification and Burden Reduction

4. Elimination of composite returns and filing requirements for non-resident owners of PTEs provides administrative simplification.

5. Administrative simplification for corporate partners and other partnership owners of a PTE is promoted if there is no requirement for upper-tiered owners to file state tax returns.

6. A PTE-level tax could reduce the administrative burden on states as the states may not have to expend resources to collect from non-residents with state source income (and can thus focus their collection efforts only on the PTE).

7. There is the possibility that non-residents with income from multiple PTEs would no longer need to file a separate individual income tax return in the non-resident state that has a PTE-level tax.

**Potential Challenges and Complexities**

Double Taxation Potential and Individual Level State Credits for Taxes Paid

1. PTE-level taxes present a potential for double taxation or an unintended increase in individual income taxes. States may levy a second layer of income tax if all the individual-level state income tax credits are not equal to all of the entity-level state income tax paid. To avoid double taxation, all states would need to provide a full credit to their residents for all states' PTE-level taxes.

    a. Each state may or may not provide a full credit against the owner's resident state income tax for the owner's share of PTE-level taxes paid in a non-resident state.

        i. The state may or may not provide a PTE owner-level credit that is fully refundable.

ii. If the credit is not fully refundable, the state may or may not allow a carryforward of the balance of the credit, or the taxpayer might not have the ability to utilize a carryforward.

b. The individual-level tax credit treatment is relevant to both residents and non-residents and may involve both the Commerce Clause and Due Process Clause of the U.S. Constitution as well as potential state constitution or statutory counterparts.

i. Regarding resident owners, the state imposing the entity-level tax will need to permit its residents to apply credit for income taxes paid to another state by the entity. It is possible that resident owners may not continue to claim a credit for taxes paid to other states. Because a resident individual is not personally paying the PTE-level tax (and residents receive a credit from the resident state to offset the PTE-level tax), it is possible that residents may lose their credits for taxes paid to other states.

ii. Regarding non-resident owners, other states will need to determine whether, and how, they will permit their residents to receive credit for the non-resident PTE-level tax imposed on pass-through income in another state.[10] A possible result is different treatment for non-residents in different states, involving the U.S. Constitution and recent U.S. Supreme Court cases.[11]

Determination of Tax or Credits to Owners

c. Details are needed regarding the determination of the tax or credit for:

i. Separately-stated income of a partnership or S corporation.

ii. Special allocations of income reported by a partnership to specific partners.

iii. Guaranteed payments made to specific partners, particularly non-residents.

d. Because there are different methods for calculating a partner's ownership percentage of partnership capital or profits, etc., a particular method that is used to allocate the tax paid or credit available may create unexpected or disparate results. Substantial economic effect rules could come into play.

[10] The failure to provide a state tax credit would result in the taxpayer subject to double taxation, a result that the Supreme Court precedent historically appears to avoid. However, states have differentiated between a tax at the entity level and a tax at the individual level. For example, California only provides a credit for other state taxes paid at the individual level. California does not provide a credit for the Texas margins tax. The state would have to distinguish the Texas margins tax from the Connecticut PTE tax to provide a credit for the Connecticut PTE tax and other similar PTE-level taxes.

[11] See *Comptroller of the Treasury of Maryland v. Wynne et. ux.*, Dkt. No. 13-485 (May 18, 2015), 575 U.S. _(2015), 135 S.Ct. 1787.

Treatment of Credits Otherwise Creditable to Owners

e. It is possible a state may not provide for the treatment of state tax credits, such as research and development credits, that are otherwise creditable to PTE owners. States will need to consider whether the credit is allowed against the PTE-level tax.

Treatment of PTE Credits for Taxes Paid to Non-Resident States by the Entity

f. The state in which the PTE files returns and pays PTE-level taxes may not allow the PTE to claim a credit for other states' PTE-level taxes paid by the PTE to a non-resident state.

Tax Rate Disparity

g. A disparity (and greater tax payment) potentially exists between a flat-rate PTE-level tax versus the typical graduated tax rates imposed by states on individuals, including the possible exemption from taxation of specific categories of income (i.e., investment income, capital gains, etc.).

Sourcing Rules, Determination of In-state Source Income, and Treatment of Investment Partnerships

h. Differences may exist between the sourcing rules applied to determine the PTE-level tax and the sourcing rules applied at the owner level. Such differences may create taxpayer confusion and could result in significant differences (potential increases and decreases) in the amount of tax imposed by the state on the PTE, as well as its owners.

i. Details are needed regarding the determination of in-state source income at the entity-level. The legislation may provide for the use of:

    i. Corporate-type apportionment and allocation rules.

    ii. Individual taxpayer residency type rules, clarifying whether the rules are based on the PTE's organizational or corporate domicile.

    iii. "Special allocation" rules for specific types of income, such as investment income. Most states source certain specified types of income entirely based upon the taxpayer's residence. The state may treat all investment income for an in-state PTE as sourced to the resident state of its partners, members or shareholders and might treat such income as in-state income of the PTE based upon its business situs or corporate domicile, regardless of owner residency.

    iv. It is possible that a state may consider the mere formation or registration of a PTE as minimal contact with a state for a PTE-level tax. It is possible that the PTE-level tax may apply to all PTEs, including investment partnerships. For investment partnerships, states will need to clarify how to determine which state's PTE-level tax applies for purposes of deducting the tax.

De Minimis Exception

j. Details are needed regarding whether there is a *de minimis* exception.

Mandatory or Elective Tax

k. Details are needed regarding whether the PTE-level tax is mandatory or elective. If it is elective, details are needed regarding whether the election is required only once or annually on a timely filed return, with extensions, who makes the election (the PTE or its owners), and if the election is irrevocable once it is made.

Separately Stated Form 1040 Schedule K-1 Items

l. Details are needed regarding the PTE-level tax and state individual income tax treatment of separately stated Form 1040 Schedule K items. Below are a few examples needing guidance.

    i. Whether charitable donations made by the PTE are deductible by the PTE. If charitable donations are deductible, what limitations apply.

    ii. Whether the insolvency exception for cancellation of debt income applies at the individual level or PTE-level.

Basis Step-Up Adjustments

m. Details are needed regarding the treatment of any basis adjustments (i.e., whether depreciation from basis step-up adjustments is deductible at the entity level, reducing the PTE-level tax).

Net Operating Loss Treatment

n. Details are needed on the treatment of net operating losses (NOLs) to address whether losses are carried forward at the PTE level.

SMLLCs and Other Disregarded Entities

o. The PTE level assessment may cover SMLLCs and other disregarded entities.

    i. If the legislation covers SMLLCs, the legislation should clarify the process for collecting from the entity and granting credit to the owner.

    ii. The legislation should include a clear definition whether an owner who is itself a SMLLC or grantor trust is considered a natural person if owned by a natural person.

    iii. The legislation should clarify whether all in-state SMLLCs are subject to the PTE-level tax, or if there are exceptions (e.g., investment SMLLCs).

p. Disparate tax treatment of business income generated through a partnership or S corporation is possible compared to business income generated through a disregarded entity (such as a SMLLC or qualified subchapter S subsidiary (Q-sub)) or a sole proprietor (who files a Form 1040 Schedule C). The form of an entity should not result in different state tax treatment.

Unreimbursed Business Expenses

q. Whether and how unreimbursed business expenses deducted by a shareholder owner on the owner's individual return (Form 1040 Schedule E) may affect the state tax credit allowed.

Treatment of Pass-Through Income from Other PTEs and Treatment of Compensation

r. The treatment of pass-through income from other PTEs and how that income received by a PTE is treated in determining the PTE-level tax will create complexities. Specific, detailed guidelines on how to handle these calculations are a necessary element of any proposal.

s. An incentive may exist for the active shareholders of S corporations to further reduce their salary income and instead increase distributions from the business to reduce state tax paid by the owner. The reduced salary could create an IRS challenge as not enough for reasonable compensation.

Capital Accounts

t. An incentive may exist to skew section 704(b) capital accounts, particularly if corporate or tax-exempt partners exist. If corporate partners are not receiving a payment on their behalf, it may affect their share of the proceeds on the liquidation of their partnership.

Tax-Exempt and Foreign Partners and Shareholders

u. States may not provide appropriate treatment of a PTE-level tax imposed on the income allocated to tax-exempt and foreign partners and shareholders.

Corporate Partners

v. Corporate partners may not receive credit for their share of the PTE-level taxes paid by the PTE to another state.

w. The state may subject C corporations doing business in the state to additional liability solely due to their ownership of interests in PTEs and the state applying the tax to entities owned either directly or indirectly by C corporations.

Administrative Burdens of Tracking, Reporting, and Payments Increased

2. New administrative burdens could apply with respect to the tracking and reporting of state tax payments.

    a. All owners of a PTE paying a PTE-level tax will need to track their respective share of PTE-level taxes paid, the amount of credits provided by the resident state, and the credit for taxes paid to other (non-resident) states.

    b. Taxpayers and state revenue departments may have different sourcing rules to determine the PTE-level tax and at the owner level.

    c. The PTE will have direct liability for paying estimated tax payments. Some PTEs might face cash-flow issues that would require cash infusions from their owners as either capital contributions or loans.

    d. The states will need to consider how a PTE-level tax system will interact with or need to change regarding:

        i. Existing non-resident owner composite and withholding filing, reporting and payment systems.

        ii. Existing filing, reporting, and payment procedures for unitary corporate partners.

        iii. State unitary combined filings and whether such filings will include PTEs.

    e. Tiered PTE structures present the possibility of even more complex, additional administrative tracking and reporting issues because tax payments and associated credits are flowed through multiple layers.

    f. If the proposal affects Publicly Traded Partnerships, they may face new and complex additional administrative burdens and securities law issues.

Different Federal and State Tax Treatment and Potential Impact on Federal Calculations

3. A PTE-level tax would not follow the traditional pass-through treatment of partnerships and S corporations under the Internal Revenue Code (notably, IRC Subchapters K and S).

    a. Thus, the federal and state tax systems in effect would apply different tax treatment of the same entity. The federal tax system would not treat a partnership or S corporation as a taxable entity, but the state would treat the entity as taxable.

    b. Non-resident owners would no longer have the ability to offset income and losses from investments held in different legal entities for state tax purposes. Individuals may lose the ability to use losses from one PTE to offset income from another PTE, particularly for section 469 passive activities.

c. The state's implementation of a PTE-level tax could affect the amount of income eligible for the new federal 20% deduction for qualified business income (QBI) of PTEs under section 199A. A state PTE-level tax that is deducted by the PTE for federal income tax purposes will reduce the owner's distributive share of QBI and, therefore, result in a smaller federal deduction than if there was no PTE-level tax.

d. A reduction in owners' self-employment income may occur, thereby resulting in a possible reduction in their credited earnings for Social Security purposes.

Federal Deductibility of Individual State Income Taxes

4. Deductibility of such PTE-level taxes for federal income tax purposes remains an open issue and partners, members and shareholders of PTEs could face challenges from the IRS as to the deductibility of overall income passed through to them from the PTE.

   a. Treasury and IRS officials have publicly stated that the IRS will apply "substance over form" principles in interpreting the $10,000 state and local tax deduction limitation.[12]

      i. Texas views the margin tax paid by a PTE as imposed only on the income of the "trade or business" for federal income tax purposes because it only applies to business income and the state does not impose a personal income tax.

      ii. The Connecticut PTE-level tax is similarly imposed on the income at the PTE level, but by contrast, each partner, member or shareholder receives a full tax credit against the owner's state tax liability for a state income tax that the owner would otherwise owe on the owner's distributive or pro rata share of the PTE's income.

      iii. The Connecticut PTE-level tax law allows an election to carve out the distributive share of the PTE's income allocated to corporate partners in computing the PTE-level tax that results in the PTE only paying tax on income allocated to owners who are natural persons. The mere existence of this election may provide credence to a challenge that the new PTE-level tax is, and the federal government should treat as, similar to a withholding regime.

      iv. Treasury Secretary Mnuchin, then-Acting IRS Commissioner Kautter, as well as members of Congress instrumental in enacting the limitation on the federal deduction for state and local taxes have stated that the IRS may challenge state or local government provisions enacted to avoid the federal limitation on the deduction for state and local taxes. As of now, no state has provided for financial indemnification for any such challenge by the IRS. The IRS could apply a *quid pro quo* challenge to the PTE-level tax approach, similar to that which it has made in proposed regulations

[12] IRS Notice 2018-54 (5/23/18).

challenging the state tax credits for charitable contributions in Prop. Reg. §1.170A-1.[13] Further, some commentators have suggested that if the IRS continues to challenge approaches to address the limitations on the state tax deduction, IRS may consider challenging the economic substance or substance over form of a transaction. It is possible that the IRS could name any reliance on such state law tax provision enacted to avoid the federal limitation on the deduction for state and local taxes as a "listed transaction" that will require the taxpayer to disclose such transactions on the federal income tax returns. Preparers of tax returns claiming such deductions may have independent tax preparer reporting obligations.

5. Additional considerations and concerns with adopting a state PTE-level tax include:

   a. The TCJA section 11042 that imposes the state and local tax deduction limitation is scheduled to sunset after 2025. The adoption of a PTE-level tax, however, may remain a permanent transformation of a state's business tax system.

   b. After the enactment of a PTE-level tax, the state may modify or curtail the individual-level credits. This situation could result in a double taxing regime on PTEs that formerly never existed.

   c. Some taxpayers may not realize the minimal impact of the state and local tax deduction limitation for high income taxpayers in many states. Prior to the TCJA, the state and local tax deduction was limited for many middle and high income individuals because it was disallowed (and the tax rules continue to disallow it) under the federal alternative minimum tax (AMT). The TCJA limitation may not affect the state and local tax deduction for these high income individuals. While the TCJA increased the AMT exemption and threshold amount, decreasing the number of taxpayers subject to the AMT, taxpayers in the higher earning brackets could have expected continuing liability for AMT. This AMT result would negate any limitation imposed under the regular income tax for the state and local tax deduction.

**PRESENT LAW**

For federal purposes, Subchapter K and Subchapter S of the Internal Revenue Code are considered pass-through tax regimes. Income is calculated and reported at the entity level, but the income tax is imposed on the owners based on their allocable share of the entity's income.

[13] The IRS issued proposed regulations (REG-112176-18), effective on August 27, 2018, limiting charitable contributions in exchange for state or local tax credits. The proposed regulations apply the *quid pro quo* principle to limit the charitable deduction generally to the net contribution after subtracting the value of state tax credits the taxpayer receives or expects to receive. On September 5, 2018, the IRS clarified in an information release (IR-2018-178) that taxpayers who make business-related payments to charities or government entities in exchange for state or local tax credits can generally deduct the payments as business expenses as long as the payment qualifies as an ordinary and necessary business expense. This general deductibility rule is unaffected by the recent proposed regulations (REG-112176-18) that require taxpayers to reduce their charitable contribution deduction by the amount of any state or local tax credit they receive.

For the most part, states have adopted the same tax regime as the federal tax regime for these types of PTEs. As detailed in the chart below, a few state and local taxing jurisdictions, notably New York City (NYC) and the District of Columbia (DC), impose tax on income earned at both at the entity and the owner level with minimal offsetting credits allowed. However, in NYC and DC, residents are provided a credit for the entity-level tax against their personal income tax.

Most entity-level taxes currently imposed by states on PTEs are considered gross receipts or business activity taxes, as contrasted with income taxes. Roughly half of the states that impose such taxes are notable for having no individual income tax regime.

Specifically, as detailed in the chart below, at least eleven states, plus NYC and DC, impose an entity-level income tax on PTEs. Five of these states do not levy an individual income tax (i.e., Nevada, New Hampshire, Tennessee, Texas, and Washington) and three states (i.e., Connecticut, Kentucky, and Ohio) and DC and NYC provide some type of partial offsetting personal income tax credit or deduction. Other states impose annual fees or flat taxes on PTEs, such as annual filing fees or partnership fees.[14]

Currently, the below thirteen states or jurisdictions have some form of a state PTE-level tax.

| | State or Jurisdiction | Type of Tax | Legislation | Details of the Tax |
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| 1 | Alabama | Business privilege tax | Ala. Code §40-14A-22 | The tax applies to corporations, limited liability entities, and entities considered disregarded for federal tax purposes. In general, the rate is: $0.25 per $1,000 for taxable incomes less than $1, $1 per $1,000 for incomes of at least $1 but less than $200,000, $1.25 per $1,000 for incomes of at least $200,000 but less than $500,000, $1.50 per $1000 for incomes of at least $500,000 but less than $2,500,000, and $1.75 per $1000 for incomes of $2,500,000 or higher. In general, the minimum tax is $100, and the maximum tax is $15,000. No offsetting credit or deduction is provided. |
| 2 | California | Franchise tax on S corporations | RTC §23802(b) | A 1.5% franchise tax (or $800 minimum if greater) is imposed on the net income of S corporations. No credit is provided to owners. It is an entity-level tax allowable above-the-line. It is deducted on the Form 1040 Schedule E and is not subject to the $10,000 limit for the shareholders. Each shareholder is responsible for paying taxes on their pro rata share of the S corporation's items of income, deductions, and credits. S corporations are subject to the annual $800 minimum franchise tax. |
| 3 | Connecticut | Pass-through entity tax | CT Public Act 18-49 | The tax is imposed at a rate of 6.99% on entity-level income of most PTEs in Connecticut. Owners of PTEs are entitled to a credit against their Connecticut personal income tax equal to 93.01% of the PTE owner's pro rata share of the PTE-level tax paid by their PTE. Connecticut resident owners of a PTE may claim a |

[14] See *An Update on State Tax Treatment of LLCs and LLPs*, State Tax Notes, Bruce P. Ely, Christopher R. Grissom, and William T. Thistle II, January 8, 2018, p. 155.

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| | | | | credit for any entity-level tax imposed by other states that is similar to the Connecticut PTE-level tax. PTEs subject to the Connecticut PTE-level tax are required to make quarterly estimated tax payments. The Connecticut PTE-level tax is applicable for taxable years beginning on or after January 1, 2018. A PTE may elect to carve out the pro rata share of PTE income allocated to corporate owners from the calculation of the Connecticut PTE-level tax. The tax does not affect the taxation of publicly-traded partnerships, sole proprietorships, or single-member limited liability companies (SMLLCs) that are treated as disregarded entities for federal income tax purposes. |
| 4 | District of Columbia | Unincorporated business franchise tax | DC ST §47-1808.03 | Business income is taxed at the entity level, but it is subtracted from income of resident-owners for personal income tax purposes. The District is prohibited by an act of Congress from imposing a direct tax on the income of non-residents. S corporations are treated as C corporations for purposes of their corporate income taxes, and thus, an S corporation is not respected for DC tax purposes. The tax generally applies to any trade or business conducted by an individual or entity, other than a corporation; exempt businesses include professional firms (1) with gross income which is at least 80% derived from personal services rendered by members of the entity, and (2) for which capital is not a material income-producing factor. The rate is 8.25% of taxable income. The minimum tax is (1) $250 if DC gross receipts are $1 million or less, and (2) $1,000 if DC gross receipts are greater than $1 million. |
| 5 | Illinois | Personal property replacement tax | 35 ILCS 5/201 | The tax applies to corporations, partnerships, trusts, S corporations, and public utilities. The rate is 1.5% of net income for partnerships and S corporations. There is no minimum tax. No offsetting credit or deduction is provided. |
| 6 | Kentucky | Limited liability entity tax | KRS § 141.0401 | Owners are generally allowed a personal income tax credit or corporate income tax credit for limited liability entity taxes paid. The tax applies to corporations and limited liability PTEs (e.g., LLCs and LLPs) with gross receipts or gross profits greater than $3 million. In general, the tax is the lesser of (1) $0.095 per $100 of Kentucky gross receipts or (2) $0.75 per $100 of Kentucky gross profits; taxpayers with gross receipts or gross profits between $3 million and $ 6 million may reduce their taxes by a specified formula. The minimum tax is $175. |
| 7 | Nevada | Commerce tax | N.R.S. 363C | The tax generally applies to all business entities with at least $4 million in annual gross revenue apportioned to the state. The rate varies from 0.051% to 0.331% of gross revenue, depending on industry. There is no minimum tax, and there is no individual income tax. |
| 8 | New Hampshire | Business enterprise tax; business profits tax; and interest | N.H. Rev. Stat. § 77-E:2; N.H. Rev. Stat. § 77-A:2; (N.H. | The New Hampshire business enterprise tax applies to all business entities (including disregarded entities, such as sole proprietors and SMLLCs) with more than $208,000 in gross receipts or an enterprise value tax base greater than $104,000. The rate is 0.675% of the |

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| | | and dividends tax | Rev. Stat. § 77:4) | enterprise value tax base (i.e., the sum of all compensation paid or accrued, interest paid or accrued, and dividends paid by the enterprise, after adjustments and apportionment). There is no minimum tax. The New Hampshire business profits tax applies to all business entities organized for gain or profit with at least $50,000 in gross receipts. The rate is 7.9% of taxable business profits; there is no minimum tax. The New Hampshire interest and dividends tax applies to New Hampshire residents, fiduciaries, LLCs, partnerships, and associations with non-transferable shares whose gross interest and dividend income exceeds $2,400. The rate is 5% of interest and dividend income; there is no minimum tax. There is no broad-based individual income tax (state taxes interest and dividend income). |
| 9 | New York City (NYC) | Unincorporated business tax (UBT) | NYC Admin. Code 11-501 – 11-540 | Individual city residents may claim a credit against their NYC personal income tax for a portion of UBT payments made. New York state law prohibits NYC from imposing a direct income tax on non-resident individuals. S corporations are treated as C corporations for purposes of their corporate income taxes, and thus, an S corporation is not respected for NYC tax purposes. The UBT generally applies to individuals and unincorporated entities engaged in any trade, profession, or business; exceptions include performing services as an employee. The rate is 4% of taxable income allocated to New York City; there is no minimum tax. Businesses with liabilities less than $5,400 may receive a full or partial UBT tax credit. |
| 10 | Ohio | Commercial activity tax | Ohio Rev Code § 5751.03 | The first $250,000 (joint filers) or $125,000 (single filers) of business income is deductible for personal income tax purposes. The Ohio commercial activity tax generally applies to all business entities with gross receipts greater than $150,000. The rate equals (1) an annual minimum tax of $150 to $26,000, depending on gross receipts plus (2) 0.26% of gross receipts in excess of $1 million. |
| 11 | Tennessee | Franchise and excise tax; and interest and dividends tax | Tenn. Code Ann. § 67-4-2007; Tenn. Code Ann. § 67-2-102 | The Tennessee franchise and excise tax applies to any individual or entity doing business in the state. The franchise tax rate is $0.25 per $100 of net worth (i.e., the difference between total assets and total liabilities); minimum tax is $100. The excise tax rate equals 6.5% of net earnings. The Tennessee interest and dividend taxes applies to individuals and partnerships whose taxable interest and dividend income exceeds $1,250. The tax equals 5% of dividend and interest income. There is no broad based individual income tax (tax on interest and dividend income only). |
| 12 | Texas | Franchise and margin tax | T.C.A., Tax Code § 171.001 | The Texas franchise tax generally applies to any business entity formed in or doing business in Texas; exceptions include sole proprietors and general partnerships owned entirely by natural persons. The base is the lesser of (1) 70% of total revenue, (2) total revenue minus the costs of goods sold, (3) total revenue minus total compensation, or (4) total revenue minus $1 |

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| | | | | million. The tax rate is 0.375% for retailers or wholesalers and 0.75% for other types of businesses. There is no minimum tax, and there is no individual income tax. |
| 13 | Washington | Business and occupation tax | RCWA 82.04.220 | The tax applies to any individual or entity engaged in business. The rate is 0.138% to 3.3% of gross receipts, depending on industry. There is no individual income tax. |

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