D. H. SCOTT & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS
A LIMITED LIABILITY PARTNERSHIP

California's Gov. Gavin Newsom recently signed Assembly Bill 150 ("AB150"), which created a workaround for the current $10,000 limitation on the deduction for state and local taxes paid for individuals. AB150 creates an elective tax that allows the taxes on pass-through income to be paid at the entity level. This means owners of partnerships and S Corporations will be able to bypass the cap's limitation that could otherwise be applicable.

For tax years beginning on or after Jan. 1, 2021, and before Jan. 1, 2026, qualified entities can make an irrevocable election annually on an original, timely filed return to pay the tax on a qualified owner's share of net income of the qualified entity. Qualified entities include partnerships, limited liability companies with multiple members treated as a partnership, and S corporations.

Qualified owners must consent to the qualified entity making the election to pay the elective tax at a rate of 9.3% on the qualified owner's share of net income. Each qualified owner separately elects to be subject to the pass-through entity ("PTE") tax; if one elects to not be included, the qualifying entity can still elect to pay the PTE tax for others.

The qualified entity pays the elective tax on the sum of the qualified net income for the taxable year of each qualified taxpayer. "Electing qualified owners will receive a *nonrefundable* credit against their California income tax liability. If the allowable credit exceeds the qualified owner's California tax liability, the excess can be carried over for up to five years.

The election would be available for tax years beginning on Jan. 1, 2021, and ending before Jan. 1, 2026, when the federal state tax limit is set to expire, or if the state and local tax deduction cap is repealed before the expiration – whichever comes first.

For tax years beginning between Jan. 1, 2021, and Jan. 1, 2022, the elective tax is due and payable on or before the due date of the tax return without regard to any extension of time to file. For calendar year filers, the due date is March 15, 2022.

For taxable years beginning after 2021, the elective tax is due and payable in two installments. The first installment is due by June 15 of the current tax year and is the greater of $1,000 or 50% of the elective tax paid in the prior year. The second installment is due on or before the due date of the tax return without regard to any extension of time to file.

It is critical that the elective tax is paid in a timely manner. The election may be deemed invalid if the payments are not made based on the above requirements. The procedure for how a qualified owner makes the payment and provides consent has not been addressed by the Franchise Tax Board. Until guidance is released, we recommend the qualified entity and qualified owner both sign a written consent.

Most importantly, at this time, the Internal Revenue Service has not determined if it will recognize the deductibility of these payments at the pass-through entity level. We will be monitoring these items as legislation is passed and keep you informed.