

Arrow Point Tax Services

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- **California State and Local Tax (SALT) \$10,000 Cap**

Workaround for Business Owners – Benefit; allows businesses structured as S Corps or Partnerships (Non-Single Owner LLC also) would be allowed to elect to pay a tax credit on passthrough profit distributions which would be a work around of the \$10,000 SALT cap

- This still has not passed, but is looking very good to pass; Follow SB 104 for more updated information
- On the back of IRS Rev Ruling 2020-75 which opened this opportunity for states, California is the tenth state to work to enact legislation that would create a SALT limit workaround for business owners
- The proposed change will only benefit business owners, and will only be allowed for net income or profit distributions from a Partnership or S Corp
 - Wages paid to owner-employee will not qualify effectively eliminating Sole Proprietorships
- California will allow business owners to “elect” to pay an elective tax at the beginning of the year tied to distributions
 - The tax rate is 9.3%
 - *DK Comment: Businesses should do a net benefit calculation to determine what the election would mean in tax savings*
- For California taxes, the “election” would receive a credit for 94.9% of the amount paid, essentially meaning, California would allow all passthrough income distributions to be ~95% offset at the entity level
 - For example, if the business has \$1,000 of profit income, they would first pay \$93 dollars in quarterlies as an elective tax and then receive a tax credit on the “elected tax” they in the amount of \$88.26 (\$93 x 94.9%), the business owner would have \$4.74 that would not be offset. Therefore the business would have \$911.74 of income that would passthrough to the business owner
- Under IRC Section 164(a), certain state taxes are allowed as a federal deduction
 - IRS Rev Ruling 2020-75 confirms that the “elective” tax paid by the business owner would then be allowed as a deductible expense at the entity level for federal taxes. Thus the net income of the business would be reduced by that

- amount paying for that portion of “income” and getting a full deduction on the federal return
- Same example as above, \$1,000 on profit income, on the federal return the \$93 of elective credit paid to California would become a deductible expense prior to distributions. Therefore the business would have \$907 of income that would passthrough to the business owner
 - Text currently reads that this could be an election made by each shareholder or partner individually and attached to their quarterly payment and pro rata distribution
 - This could change if they amend the document again
 - Would have to make this election by March 15th and the election would be irrevocable for the year
 - Each year after it would be an optional for the business owner to choice to pay the elective tax or not
 - *DK Comment: From a tax planning standpoint this will work very well for passthrough businesses that have some wages and relatively high distributions. The wages paid would still owe income tax and could be used to be counted for the SALT tax. This would be the best use, as a home office plan for partnerships or S-Corps would allow to offset real estate taxes pro-rata to home office. So would want to make election, then choose to use income from wages to be allocated toward SALT (Assuming at or above \$10,000) leaving out real estate taxes, this would then allow for max deduction using the pro rata method for home office deduction to be used*