MN HOUSE RESEARCH

Bill Summary

H.F. 1909

As amended by H1909A1

Subject	**Pass-through entity tax**
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Overview

H.F. 1909 would allow a pass-through entity (i.e. a partnership, LLC, or S corporation) to elect to file and pay the proposed pass-through entity tax (PTE tax). Each owner of a pass-through would then receive a pro rata refundable credit for the amount of PTE tax paid when the owner files their individual income tax return. The PTE tax would be equal to the sum of each owner's tax liability, which would be calculated by multiplying each owner's income (as defined and used for the filing of composite returns) by the highest individual income tax rate of 9.85%.

A PTE tax and credit would allow each owner of a pass-through entity to deduct their share of the PTE tax under the federal state and local tax (SALT) deduction, for federal income tax purposes. In 2017, the Tax Cuts and Jobs Act limited this deduction to $10,000. Recently however, the Treasury Department released a notice stating their intention to propose rules allowing states to create workarounds to the cap such as what is proposed in H.F. 1909.

Summary

Section	Description
1	**Pass-through entity tax.** **Overview**. This section would allow a partnership to elect to pay a pass-through entity tax. The tax would be computed similar to the manner in which tax is computed for nonresident composite return filers, except that the tax would be imposed directly on the pass-through entity and resident partners would be able to participate. Each owner of a pass-through entity would still be required to file an individual income tax return and pay any tax due, but would receive a refundable credit for the amount of PTE tax paid. **Paragraph (a)** establishes the definitions to be used in the subdivision creating the PTE tax.

Section	Description
	"Income" is defined by reference to the definition of income in the composite return subdivision which aligns the tax base for the PTE tax to the base that is used for composite returns. In addition, this definition requires that a resident partner's income is apportioned to the state (which is also the case for nonresident partner business income). "Qualifying owner" is defined as an individual partner, member or shareholder of a qualifying entity. "Qualifying entity" is defined as a partnership, LLC, or S corporation that does not have a partnership, LLC, or S corporation as an owner. **Paragraph (b)** allows a qualifying entity to file and pay the PTE tax if the owners holding more than a 50% ownership in the entity elect to do so. The election would be binding on all owners of the entity. **Paragraph (c)** imposes the PTE tax on a qualifying entity. The amount of tax is equal to the amount of tax liability of each owner. **Paragraph (d)** requires the tax liability of each owner to be calculated by applying the highest rate of 9.85% under the individual income tax to each owner's share of the qualifying entity's income. As is the case for the composite return filing rules, no nonbusiness deductions would be allowed. In addition, only those deductions and credits allowed to an individual owner are allowed in calculating the owner's tax liability. **Paragraph (e)** requires that the same deductions used to calculate an owner's tax liability for the PTE tax must also be used to calculate the owner's liability under the individual income tax. **Paragraph (f)** imposes the estimated tax requirements on owners paying the PTE tax, in the same manner as required for composite return filers. **Paragraph (g)** clarifies that an owner's adjusted basis in the partnership is determined as if the election to pay the PTE tax was not made. **Paragraph (h)** treats a PTE return and a qualifying entity like a composite return and composite filer for administrative purposes. **Paragraph (i)** allows the commissioner of revenue to prescribe the content, format and manner of PTE returns and other documents. **Paragraph (j)** allows PTE filers to also pay the composite tax.

Section	Description
	Effective date: Tax years beginning in 2021.
2	**Credit for pass-through entity tax.** Allows a credit under the individual income tax equal to the amount of a qualifying owner's tax liability that was used to calculate the PTE tax. Effective date: Tax years beginning in 2021.
3	**Withholding by partnerships.** Provides an exception from the withholding rules for partnerships that elect to pay the PTE tax. Effective date: Tax years beginning in 2021.
4	**Withholding by S corporations.** Provides an exception from the withholding rules for S corporations that elect to pay the PTE tax. Effective date: Tax years beginning in 2021.