



Oregon Pass-Through Entity – Elective Tax

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Background and Problem: Deduction for State and Local Taxes is Limited to \$10,000

As you may be aware, the tax laws changed back in 2018 limiting your federal personal State and Local Tax (SALT) deduction to \$10,000 per year. This change (i.e., lost deduction) was widely covered in the media and is now commonly known as the “SALT Cap”.

With limited exceptions, the SALT Cap limits your personal federal income tax deduction to \$10,000 with respect to state and local taxes from all jurisdictions and for all types of taxes such as state income, county property, and local and municipal income taxes. Many taxpayers (especially in a high-tax state like Oregon) pay much more than \$10,000 in SALT tax each year.

Since 2018, many states, including Oregon, have been considering this issue and have been drafting legislative solutions to the SALT Cap problem. A key legislative strategy has emerged for business formed as a pass-through entity (S-corporations, LLCs taxed as partnerships, and partnerships under state law).

The pass-through entity (PTE) strategy allows for the business (S-corp or partnership) to “elect” to pay state income taxes at the entity level. This elected tax is deducted at the entity level and generally results in a personal tax credit to be claimed on your Oregon individual return. Effectively, the business entity pays the Oregon income tax on behalf of its owners and the business entity takes a business level deduction for the taxes. The business deduction will bypass the SALT Cap altogether and thus reduce the taxpayer’s distributive share of taxable income for the year.

New Opportunities and Solutions: IRS Notice 2020-75 and Oregon SB 727

IRS Notice 2020-75

In response to the strategies imposed by several states, the IRS issued a taxpayer favorable procedure notice (2020-75). The notice acknowledges and allows for the pass-through tax strategy and provides a rough framework to ensure tax deductibility. The notice also reserves space for future guidance and regulations to be provided by the IRS.

Oregon SB 727

The Oregon legislature passed SB 727 last year, which allows for a pass-through entity to make an affirmative election to pay Oregon income tax at the entity level. SB 727 creates a work-around for the SALT Cap imposed on Oregon business owners doing business through a pass-through entity. This new tax structure is called the Pass-Through Entity – Elective Tax (PTE-E).

For tax years beginning on or after January 1, 2022, entities taxed as S corporations and partnerships may elect annually to be subject to the PTE-E tax at a rate of 9% tax on the first \$250,000 of distributive proceeds (per owner) and 9.9% tax on any amount exceeding \$250,000. The law will expire if the federal SALT Cap expires or is repealed. Qualifying members of an electing PTE are eligible for a refundable credit equal to 100% of the member's distributive share of the PTE-E tax paid.

Summary

The new PTE-E tax will likely be beneficial to many pass-through entity business owners by creating additional tax deductions (that’s a good thing!). However, there are several traps and pitfalls for the unwary that should be considered. Please contact your tax adviser at Kernutt Stokes to discuss how your unique situation may benefit from the law change. You can also review the State of Oregon’s [PTE-E Tax FAQ](#).