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ALERT

Governor Newsom Signs New Business Recovery Bill

On July 16, 2021, in an effort to provide tax relief to small businesses facing unprecedented economic hurdles due to COVID-19, Governor Gavin Newsom signed California Assembly Bill 150 establishing a new elective pass-through entity level tax. The new law allows California taxpayers to work around the $10,000 state and local tax limitation imposed by the Tax Cuts and Jobs Act ("TCJA").

In 2018, the TCJA went into effect, limiting an individual's deduction for the aggregate amount of state and local taxes paid during the calendar year to $10,000. This was a big hit for California taxpayers because prior to TCJA, the state and local tax deduction was unlimited and most likely the California taxpayer's largest itemized deduction.

Now, thankfully, there is a workaround to this limitation effective as of January 1, 2021. California taxpayers who own qualified pass-through entities can now receive a credit for their share of the pass-through level state and local taxes deducted by partnerships and S-Corporations, allowing them to indirectly exceed the $10,000 state and local tax deduction limitation on their federal taxes.

Here is how it works. The qualified pass-through entity makes the election. The entity pays state and local taxes at the individual rate. The entity deducts the additional state and local taxes paid, lowering the adjusted business income. The owners report their share of the adjusted business income on their individual federal tax return. The owner additionally obtains a credit for the amount of tax paid on their distributive share on their individual state tax return.

Qualified pass-through entities include:
· Partnerships (General, Limited and Limited Liability Partnerships)
· Limited Liability Companies
· S-Corporations

Note, the following entities are excluded as "qualified entities":
· Trusts (unless taxed as a partnership)
· Publicly Traded Partnerships
· Sole Proprietorships
· Single Member LLCs
· Entities permitted or required to be part of a combined reporting group
· Entities with pass-through owners like a partnership or LLC

Qualified pass-through entity owners include:
· Individuals
· Trusts
· Estates
· C-Corporations

If you are a business owner that owes more than $10,000 in state and local taxes, you should contact the business and tax attorneys at our Walnut Creek office to discuss taking advantage of this tax election.

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