



Current Federal Tax Developments

August 23, 2021

Kaplan Financial Education



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This Week's Topics

A look at §1244 stock - an issue not often seen and on which a taxpayer lost this week

Comprehensive look at the design of SALT entity level workarounds that more and more states are enacting-what are they, why do we see them passing with bipartisan support and what issues do they create?



Stock Was Not §1244 Stock, No Ordinary Loss Allowed



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- *Ushio v. Commissioner*, TC Summary Opinion 2021-27, 8/16/21
 - Taxpayer invested \$50,000 in corporation
 - Company agreed to invest in LLC that was dealing with alternative energy process
 - Ultimately never had gross receipts
 - Court found both not operating and failed to show was a small business

State Level Entity Level Passthrough Taxes



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- A number of states have enacted some sort of passthrough entity income taxes to date
- Interest grew dramatically after Notice 2020-75 issued last November
 - IRS indicated they will issue regulations to allow
 - Limited to S corporations and partnerships
 - Not matter if voluntary or tax credit given

Example - Why It's Wanted

	ELIT	No ELIT
State income tax (other income)	7,000	7,000
Real estate tax (personal)	5,000	5,000
State income tax on passthrough income	9,000	9,000
Passthrough income	200,000	200,000

Example - Why It's Wanted

	ELIT	No ELIT
Elect Entity Level Passthrough Income Tax		
Income before state tax	200,000	200,000
Passthrough tax at 4.5%	(9,000)	0
Federal Schedule E Income	191,000	200,000
Federal tax rate	37%	37%
Federal tax on passthrough income	70,670	74,000
Savings	3,330	

Example - Why It's Wanted

	ELIT	No ELIT
State income taxes (personal)		
Tax before credits	16,000	16,000
Credit for ELIT	(9,000)	0
State tax paid (direct)	7,000	16,000
State tax paid (indirect via entity)	9,000	0

Example - Why It's Wanted

	ELIT	No ELIT
Schedule A State & Local Tax		
State tax (assume pay all in current year)	7,000	16,000
Real Estate Taxes	5,000	5,000
Total Taxes	12,000	21,000
Deductible - Limit to SALT Cap	10,000	10,000

State Level Entity Level Passthrough Taxes



- No two states laws are exactly the same
- Key differences
 - Elective vs. mandatory (only CT is mandatory)
 - Credit vs. exclusion (most are credits, but a few are exclusions)
 - Refundable vs. carryover credit (most are refundable, but some have limited carryovers)

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State Level Entity Level Passthrough Taxes



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- Key differences
 - Covers all equity holders vs. limited
 - Some exclude all but individuals, trusts and estates
 - Issue of passthrough members
 - Now have some that allow individual equity holders to opt out

State Level Entity Level Passthrough Taxes



- Elections generally have to be made by due date (including extensions) of passthrough entity return
- Covers partnerships and S corporations, but not proprietorships

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State Level Entity Level Passthrough Taxes



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- Credit for taxes paid to other states
 - Potential problem for out of state equity holders - may lose credit
 - Covered by existing statutes? Revenue departments have to rule
 - A few states have added provisions to explicitly grant credit for “similar” taxes paid for other states
 - Need to understand impact on all equity holders

State Level Entity Level Passthrough Taxes



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- Remember that the IRS told us that we'd have regulations eventually
- States have gotten somewhat more creative since the Notice came out
- Will the IRS allow these changes (iike member opt-out) or not? What are the limits (or are there any)?



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