State Pass-Through Entity Taxes

North Carolina and Beyond

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Speaker

Dylan Stafford

Senior Manager – State and Local Tax

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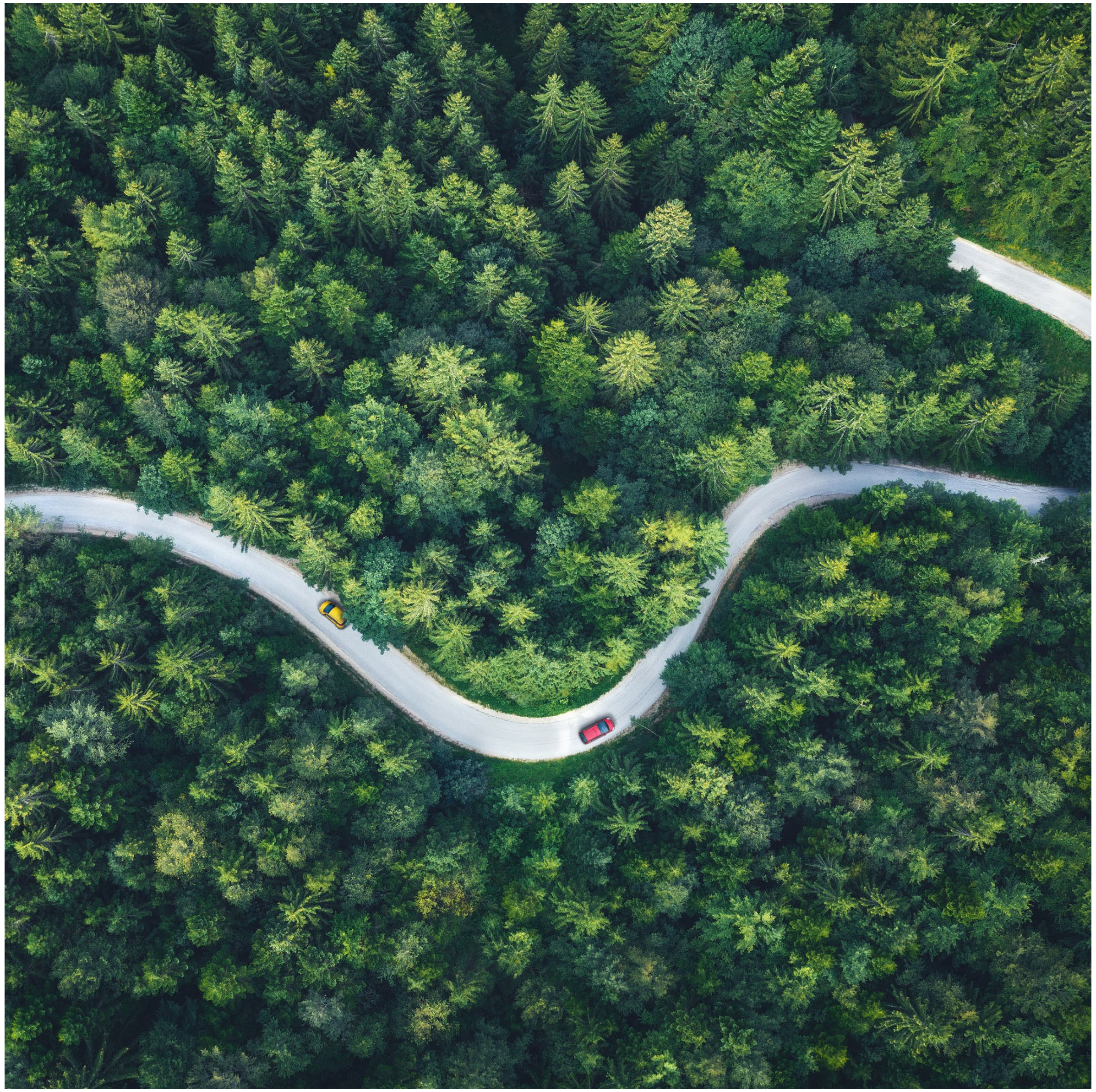
Agenda

1. Refresher on the current state of PTE Tax Elections
2. Considerations when making PTE Tax Elections
3. Common Issues
4. North Carolina’s Taxed Pass-Through Entity Election



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01

Current State of PTE Tax Elections

State Pass-Through Entity Taxes

Current State

What has happened so far?

- The Tax Cuts and Jobs Act created a cap on the State and Local Tax itemized deduction of $10,000 (married filing jointly) and $5,000 (married filing separately) for tax years beginning after 12/31/17 and before 1/1/2026.

- States began enacting legislation which allow pass-through entities to make an election to be subject to income tax at the pass-through entity level.

- Note that some states already imposed entity-level taxes on pass-through entities, such as Tennessee and Texas.

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State Pass-Through Entity Taxes

Current State

What has happened so far?

- IRS Notice 2020-75 indicates that the tax paid under a PTE Tax election will be treated as a deduction of the PTE Tax and is applicable to Specified Income Tax Payments made on or after November 9, 2020.

- Per IRS Notice 2020-75, PTE Tax payments are deducted on a cash basis regardless of the accounting method of the taxpayer.

  > "(2) Deductibility of Specified Income Tax Payments. If a partnership or an S corporation makes a Specified Income Tax Payment during a taxable year, the partnership or S corporation is <u>allowed a deduction</u> for the Specified Income Tax Payment in computing its taxable <u>income for the taxable year in which the payment is made</u>."

- Most states which impose an individual income tax have enacted legislation creating one of these elections.

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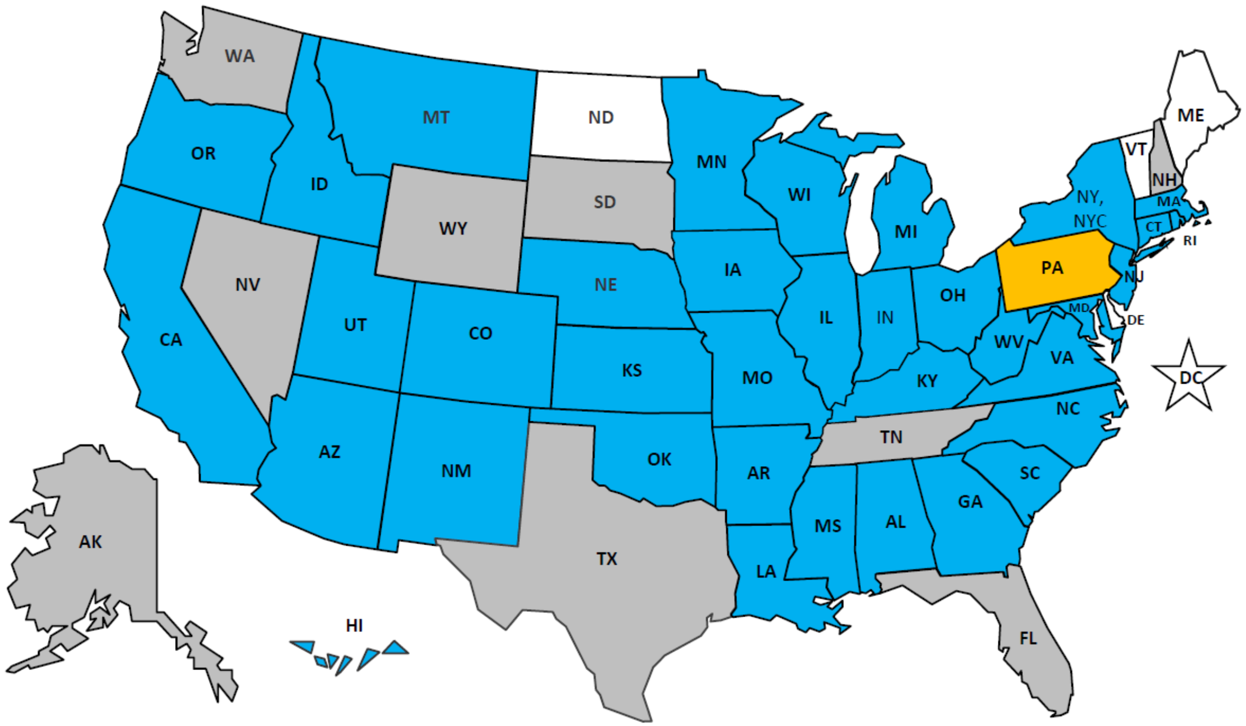
State Pass-Through Entity Taxes

Current State

States with Enacted or Proposed Pass-Through Entity (PTE) Level Tax

As of May 14, 2024



36 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:

AL, AR[1], AZ[1], CA, CO[3], CT[4], HI[2], GA[1], IA[1], ID, IL, IN[1], KS[1], KY[1] (& KY) ,LA, MA, MI, MD, MN, MO[1], MS[1], MT[2], NC[1], NE[3], NJ, NM[1], NY, OH[1], OK, OR[1], RI, SC, UT[1], VA, WI, WV[1], and NYC[1]

[1] Effective in 2022
[2] Effective in 2023 or later
[3] Retroactive to 2018
[4] Mandatory 2018-2023, elective starting 2024

1 state with active proposed PTE tax bills:
PA – SB 659 in Senate committee; HR 1584 in House committee

9 states with no owner-level personal income tax on PTE income:
AK, FL, NH, NV, SD, TN, TX, WA, WY

4 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes:
DC, DE, ME, and ND

AICPA

https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/56175896-pte-map.pdf

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02

Considerations when making PTE Tax Elections

Considerations when making PTE Tax Elections
Overview

Federal vs State Benefits

- States implemented these elections to give taxpayers a federal benefit through the additional deduction from federal income.

- There may or may not be a state benefit. It is not uncommon for more state tax to be paid on an owner's share of state income through a PTE Tax election compared to the owner filing individually.
    - Income may be subject to a higher tax rate.
    - Individuals may not be allowed deductions or exemptions they would be entitled to if they filed individually.

- Another important consideration is if owners are eligible for a credit for taxes paid to other states on tax paid by an electing PTE. In many states, once the election is made, the PTE pays the tax and individual owners are not required to file a state return.
    - Even if the individual owner is required to file a state return and claim a credit for tax paid by the PTE, their resident tax may only allow a credit on taxes paid net of credits.
    - In PTEs with significant multi-state operations, the lack of this credit can offset the federal benefit.

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Considerations when making PTE Tax Elections
Overview

Federal Issues

- Pass-through Entities will need to consider how they should handle special allocations which may occur as result of these elections.
    - An owner's share of state credit for taxes paid through a PTE Tax Election may not equal their ownership or income allocation %. The owner's credit may be greater than their normal share of the deduction.
    - A partnership or LLC agreement may need revision to allow the federal deduction to be specially allocated to match the state credit.
- Timing of the federal deduction may not align with the state benefit.
- Impact of the reduction in federal income should be evaluated.
    - Reduction may have detrimental impact to items like the 199A deduction.
    - Reduction may also have a beneficial impact, such as reduction in SE tax paid.

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Considerations when making PTE Tax Elections

Overview

State Issues

- The importance of the impact to an owner's resident state tax credit cannot be overstated. If PTE Tax elections in non-resident states will eliminate this credit for an owner, the cash tax they pay to their resident state will increase.
  - Impact to cash tax payments in non-resident states would vary based on non-resident withholding and composite return filing requirements.

- Logistical issues related to making the election or complying with filing requirements.

- Owners will be impacted differently. One may get the federal benefit of the deduction with no state drawbacks and another may be impacted by the loss of their resident state tax credit or inability to utilize carryforward losses. Other potential downsides include loss of other credits now utilized at the PTE level, inability to use credit carryforwards, or offsetting current year income against losses from other activities.

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Considerations when making PTE Tax Elections
Overview

Election Evaluation

- A thorough analysis should be performed to determine the benefit or drawback of making PTE Tax elections.

- A complete analysis requires gathering sufficient information on all the owners to understand their tax situation.
  - Resident state, other sources of state income, carryover attributes, etc.
  - This information may not always be available

- The determinations may change year to year. Any analysis should be reviewed annually for any changes in facts or state law/regulations for the PTE Taxes.

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Considerations when making PTE Tax Elections
State PTE Tax Elections

State-by-State Nuances

- The exact implementation of PTE Taxes differs for each state, but there are common considerations.
- When is the election effective?
- What is the deadline to make the election?
  - By the end of the tax year, within 3 months and 15 days of end of tax year, by extended due date of return?
- Is it annual, revocable, irrevocable, etc.?
  - Effective until revoked (ex. AL, OK)
  - Binding for 3 years (ex. MI)
  - Annual election but binding for that tax year once made (ex. CO, GA)

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Considerations when making PTE Tax Elections
State PTE Tax Elections

State-by-State Nuances

- What is the compliance burden of the election?
  - PTE Tax filings may replace existing state returns or may be in addition to them.
  - Some states may require substantial documentation to make the election.

- What entity types are eligible?
  - Generally, entities classified as Partnerships and S Corporations. What about Single-Member LLCs?

- Who is an eligible owner participant?
  - Typically, individuals, trusts, and estates are eligible owners. Others vary by state.

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Considerations when making PTE Tax Elections
State PTE Tax Elections

State-by-State Nuances

- How are tiered structures treated?
    - Owners which are PTEs may be excluded from calculations or may disqualify the entity from making an election.
    - Some states include other PTEs and pass up a credit.
- Must all owners participate?
    - Owners may be allowed to elect out of inclusion in election.
    - Some states may require that owners elect to be included (ex. CA).
- How are estimated tax payments treated, especially for the first year of the election?
- Do the owners still file a personal return in the state?

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Considerations when making PTE Tax Elections
State PTE Tax Elections

State-by-State Nuances

- How are net operating losses treated?

- How is the income of a resident owner calculated?
    - Pre- or Post-Apportionment?

- What adjustments are made in the calculation of income?
    - Are separately stated items included? Tax base can differ from withholding or composite tax calculations.

- Can the PTE file a composite return and claim a credit for PTE Tax paid?

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Considerations when making PTE Tax Elections

State PTE Tax Elections

State-by-State Nuances

- The most commons scenarios are:
    - Owners of PTE reduce their adjusted gross income by their income from the PTE that was taxed at the entity level. This may or may not require the PTE owner to file a state return.
    - PTE owners report income from the taxed PTE in their adjusted gross income, but are allowed to take a credit for their share of the entity-level tax paid.
    - In certain cases, a non-resident return is not required to be filed by the PTE owner if their only income in that state was from the electing PTE.

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Considerations when making PTE Tax Elections
State PTE Tax Elections

Applicability to Tiered Partnership Structures

- State treatment depends on the details of the specific state's election.
- Certain states may only allow the PTE Tax election to be made if all owners are individuals, trusts, or estates. This prevents the election from being made by a lower-tier entity in a tiered partnership structure.
- If states do allow entities which have other pass-through entities as owners to make the election, then treatment is divided.
  - Excluded – State does <u>not</u> include the income of a partner which is another pass-through entity in the PTE Tax calculation.
  - Included – State includes the income of all partners, includes partners which are pass-through entities, in the PTE Tax calculation.

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Considerations when making PTE Tax Elections
State PTE Tax Elections

Applicability to Tiered Partnership Structures

- In tiered partnerships, some states exclude income subject to PTE Tax at lower tier from upper tier's return. Any allowed PTE Tax credit will pass through the upper tier(s) to be reported by the ultimate owner.

- Other states will allow the upper tier claim a credit for PTE Tax paid by the lower tier if the upper tier entity also makes a PTE Tax election.

- A general recommendation is to make PTE Tax elections at the highest tier of the structure where K-1s will be issued to the ultimate taxpayers. This conclusion may change depending on a taxpayer's specific facts and circumstances.

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Considerations when making PTE Tax Elections

Sunset of TCJA Limitation

What happens when the SALT cap goes away after 2025?

- Depends on the state's legislation.
  - Some state enacted legislation which only allowed the election for a specific period of time. Generally, tax years ending before 2026.
  - Some states tied the election to the federal SALT limitation. The election only applies in a tax year where the federal limitation is in effect.
  - Other states are silent on the issue. The election is not tied to the federal SALT limitation and does not expire after a specific period of time.
- States can always enact new legislation to change the expiration date, or lack thereof.
- Key Takeaway – Taxpayers will need to evaluate the continued use of the PTE Tax elections, if available, once the federal SALT limitation sunsets. The cost of compliance and additional filings required may eliminate any remaining benefit. Some taxpayers may still benefit from the reduction in SE tax.

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03

Common Issues

Common Issues with PTE Tax Elections
State PTE Tax Elections

What gets missed?

- Election due dates are missed.
    - Some states may allow late elections.
    - Others strictly follow their statutory due date (ex. CA and NY).

- Estimated tax payment requirements are not followed.
    - Many states provided penalty relief for the first year in which that state’s election was in effect, but this relief only applied to that year.
    - Taxpayers may qualify for penalty relief under a state’s normal provisions for estimated tax payments.

- Ineligible owners are included in the calculations of income subject to PTE Tax.
    - An amended return may be required to correct the filing.

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Common Issues with PTE Tax Elections
State PTE Tax Elections

What gets missed?

- State-specific Requirements. Return preparers may not be aware of all the compliance requirements related to the elections.
- Some examples:
  - CA – A estimated tax payment equal to the greater of 50% of the prior year's PTE Tax or $1,000 must be made by June 15th of the tax year for the election to be valid. CA will disallow the election if this requirement is not met.
  - MO – An executed Form 2827 Power of Attorney designating the electing PTE's representative for the tax year must be attached to the PTE Tax return, if it has not been separately filed. MO will disallow the election if this requirement is not met.
  - LA – An electing PTE must attach a copy of Form R-6981 for each owner and Form R-6982 to its return. These forms report each owner's share of income taxed at the entity-level and the LA income tax which would have been paid by the owners if the PTE election was not made.

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04

North Carolina’s Taxed Pass-Through Entity Election

North Carolina's Taxed Pass-Through Entity Election
Election Process

Partnerships

- Partnerships may make the taxed pass-through entity election on a timely filed return.
- This is an annual election.
- The election is irrevocable for the tax year once the return is filed.
- Publicly traded partnerships described in I.R.C. § 7704(c) are not allowed to make the election.

N.C. Gen. Stat. § 105-154.1(a)

"Taxed Partnership Election. - A partnership may **elect, on its timely filed return** … to have the tax under this Article imposed on the partnership **for any taxable period covered by the return**. A partnership **may not make or revoke the election after the return is filed**."

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North Carolina's Taxed Pass-Through Entity Election
Election Process

S Corporations

- S Corporations may make the taxed pass-through entity election on a timely filed return.
- This is an annual election.
- The election is irrevocable for the tax year once the return is filed.

N.C. Gen. Stat. § 105-131A(a)

"Taxed S Corporation Election. - An S Corporation may **elect, on its timely filed return** … to have the tax under this Article imposed on the S Corporation **for any taxable period covered by the return**. An S Corporation **may not make or revoke after the return is filed**."

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North Carolina's Taxed Pass-Through Entity Election
Eligible Owners

Partnerships

Partnerships may only make the election if all of its partners are one of the following:

1. An individual
2. An estate
3. A trust which
   a. is eligible to be an S Corporation shareholder; or
   b. does not have a beneficiary other than an individual, an estate, a trust, or an exempt organization eligible to be an S Corporation shareholder
4. An exempt organization eligible to be an S Corporation shareholder
5. Entities classified as either a partnership or corporation for federal income tax purposes

S Corporations

No restrictions on S Corporation shareholders.

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North Carolina's Taxed Pass-Through Entity Election
Taxable Income

Partnerships - N.C. Gen. Stat. § 105-154.1(b)

- Taxable income is the post-apportionment distributive share of income or loss for partners **other than entities classified as either a partnership or corporation for federal income tax purposes**.
  - Post-apportionment for both resident and non-resident partners.
- Distributive share of income or loss includes adjustments required under N.C.G.S. § 105-153.5 and § 105-153.6.
  - State income taxes, bonus depreciation, etc.
- Separately stated items of deduction are **not** included in calculating the distributive share of income or loss.
  - This includes IRC § 179 deductions

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North Carolina's Taxed Pass-Through Entity Election
Taxable Income

S Corporations - N.C. Gen. Stat. § 105-131.1A(b)

- Taxable income is the total of each shareholder's post-apportionment pro rata share of income or loss.
  - Post-apportionment for both resident and non-resident shareholders.
- Pro rata share of income or loss includes adjustments required under N.C.G.S. § 105-153.5 and § 105-153.6.
  - State income taxes, bonus depreciation, etc.
- Separately stated items of deduction are **not** included in calculating the distributive share of income or loss.
  - This includes IRC § 179 deductions

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North Carolina's Taxed Pass-Through Entity Election
Notable Adjustments

N.C. Gen. Stat. § 105-153.5 and § 105-153.6

- Addition required for income taxes, including PTE taxes, paid to NC and other states.
- Addition required for 85% of bonus depreciation claimed on the federal return.
- Deduction for prior bonus depreciation additions is allowed in taxable income calculation. Per DOR guidance, the allowable deduction must be based on the additions made by an owner included in the Taxed PTE filing in a prior year. If an owner reported an addition in a prior year, but is no longer an owner in the year of the deduction, then the Taxed PTE may not report a deduction related to their share of the prior year addition.
    - See NC DOR's Personal Taxes Bulletin
- Other adjustments may apply based on a taxpayer's specific facts and circumstances.

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North Carolina's Taxed Pass-Through Entity Election
Tax Rate

Partnerships - N.C. Gen. Stat. § 105-154.1(b), (f)
S Corporations - N.C. Gen. Stat. § 105-131.1A(b), (g)

- Taxed Partnerships and S Corporations both pay tax at the applicable rate for individuals per N.C.G.S. § 105-153.7.

2023	4.75%
2024	4.50%
2025	4.25%
After 2025	3.99%

- Quarterly estimated tax payments are required if estimated tax is > $500. Payments must equal 90% of current year tax or 100% of prior year tax.

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North Carolina's Taxed Pass-Through Entity Election
Impact on Owners

Partnerships

- Both resident and non-resident owners are **allowed** a deduction for their share of apportioned distributive income from a Taxed Partnership to the extent the income was included in the owner's AGI, subject to the adjustments required by N.C.G.S. § 105-153.5 and § 105-153.6 apportioned to NC.

- Both resident and non-resident owners are **must** add their share of apportioned distributive loss from a Taxed Partnership to the extent the loss was included in the owner's AGI, subject to the adjustments required by N.C.G.S. § 105-153.5 and § 105-153.6 apportioned to NC.

N.C. Gen. Stat. § 105-154.1

"(d) Deduction Allowed for Partners of a Taxed Partnership. - The partners of a taxed partnership **are allowed a deduction as specified in G.S. 105-153.5(c3)(3)**…

(e) Addition Required for Partners of a Taxed Partnership. - The partners of a taxed partnership **must make an addition as provided in G.S. 105-153.5(c3)(4)**. "

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North Carolina’s Taxed Pass-Through Entity Election
Impact on Owners

Partnerships

- The allowable deduction and required addition should equal the amounts reported to the owner on their NC K-1.

C. Taxed Partnerships Only *(To be completed by all Taxed Partnerships for each partner for which the partnership is required to pay tax at the entity level.)*

Partner’s Pro Rata Share Items	Amount	Individuals Filing Form D-400 Enter Amount on:
10. Share of Loss Attributable to North Carolina *(From Form D-403, Part 4, Line 24, if the amount of Line 24 is less than zero)*		Form D-400 Schedule S, Part A *(all partners)* and Form D-400 Schedule PN-1, Column B, Part A *(nonresidents only)*
11. Share of Income Attributable to North Carolina *(From Form D-403, Part 4, Line 24, if the amount of Line 24 is zero or greater)*		Form D-400 Schedule S, Part B *(all partners)* and Form D-400 Schedule PN-1, Column B, Part B *(nonresidents only)*

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North Carolina's Taxed Pass-Through Entity Election
Impact on Owners

Partnerships

- Resident owners are also allowed a deduction for their share of distributive income from a Taxed Partnership which was included in the Partnership's taxable income in another state or the District of Columbia and was subject to an entity-level tax.
  - See N.C.G.S. § 105-153.5(c3)(3a).

  "A partnership is taxable in another state or the District of Columbia if the partnership's business activity in that state or the District of Columbia subjects the partnership to a net income tax or a tax measured by net income."

- Similar to the Taxed PTE deduction, this is allowed to the extent the income was included in the owner's AGI, subject to the adjustments required by N.C.G.S. § 105-153.5 and § 105-153.6.

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North Carolina's Taxed Pass-Through Entity Election
Impact on Owners

S Corporations

- Both resident and non-resident shareholders are **allowed** a deduction for their pro rata share of apportioned distributive income from a Taxed S Corporation to the extent the income was included in the owner's AGI, subject to the adjustments required by N.C.G.S. § 105-153.5 and § 105-153.6 apportioned to NC.

- Both resident and non-resident shareholders are **must** add their pro rata share of apportioned distributive loss from a Taxed S Corporation to the extent the loss was included in the owner's AGI, subject to the adjustments required by N.C.G.S. § 105-153.5 and § 105-153.6 apportioned to NC.

N.C. Gen. Stat. § 105-131.1A

"(e) Deduction Allowed for Shareholders of a Taxed S Corporation. – The shareholders of a taxed S Corporation **are allowed a deduction as specified in G.S. 105-153.5(c3)(1)….**

(e) Addition Required for Shareholders of a Taxed S Corporation. – The shareholders of a taxed S Corporation **must make an addition as provided in G.S. 105-153.5(c3)(2)**."

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North Carolina's Taxed Pass-Through Entity Election
Impact on Owners

S Corporations

- The allowable deduction and required addition should equal the amounts reported to the owner on their NC K-1.

Part 3. Shareholder's Pro Rata Share Items	Amount	Individuals Filing Form D-400 Enter Amount on:
Taxed S Corporations Only		
9. Share of Loss Attributable to North Carolina *(From Form CD-401S, Schedule K, Line 14)*		Form D-400 Schedule S, Part A *(all shareholders)* and Form D-400 Schedule PN-1, Column B, Part A *(nonresidents only)*
10. Share of Income Attributable to North Carolina *(From Form CD-401S, Schedule K, Line 15)*		Form D-400 Schedule S, Part B *(all shareholders)* and Form D-400 Schedule PN-1, Column B, Part B *(nonresidents only)*

N.C. Gen. Stat. § 105-131.1A

"(e) Deduction Allowed for Shareholders of a Taxed S Corporation. – The shareholders of a taxed S Corporation **are allowed a deduction as specified in G.S. 105-153.5(c3)(1)….**

(e) Addition Required for Shareholders of a Taxed S Corporation. – The shareholders of a taxed S Corporation **must make an addition as provided in G.S. 105-153.5(c3)(2)**."

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North Carolina's Taxed Pass-Through Entity Election

Impact on Owners

S Corporations

- Resident shareholders are also allowed a deduction for their pro rata share of distributive income from a Taxed S Corporation which was included in the Partnership's taxable income in another state or the District of Columbia and was just to an entity-level tax.
    - See N.C.G.S. § 105-153.5(c3)(1a).

    "An S Corporation is taxable in another state or the District of Columbia if the S Corporation's business activity in that state or the District of Columbia subjects the S Corporation to a net income tax or a tax measured by net income."

- Similar as the Taxed PTE deduction, this is allowed to the extent the income was included in the owner's AGI, subject to the adjustments required by N.C.G.S. § 105-153.5 and § 105-153.6.

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North Carolina's Taxed Pass-Through Entity Election
Tax Credits

Credit for Income Taxes Paid to Other States - N.C. Gen. Stat. § 105-153.9(f)

- Resident individuals may not claim a credit for taxes paid to other states or the District of Columbia on income which is eligible for the deductions for entity-level taxes paid under N.C.G.S. § 105-153.5(c3).

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North Carolina’s Taxed Pass-Through Entity Election
Other Tax Credits

Partnerships - N.C. Gen. Stat. § 105-154.1(c)
S Corporations - N.C. Gen. Stat. § 105-131.1A(c)

- Both Partnerships and S Corporations that qualify for a tax credit may apply each owner’s share of the credit against that owner’s share of the Taxed PTE’s income tax.
- If the credit is taken in installments and the Taxed PTE election was not in place for the initial year of the credit, then the credit must be passed out to the owners.
- Any credits generated during a tax year in which the Taxed PTE election is in place may not be passed out to owners. The Taxed PTE will carryforward any unused portion of the credit and will claim any subsequent installments.

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North Carolina's Taxed Pass-Through Entity Election
Non-resident Tax Payments

Partnerships – N.C. Gen. Stat. § 105-154(d)

- If the Taxed Partnership election is made, then withholding is only required on partners which are classified as a partnership or corporation for federal income tax purposes.

- These owners may still elect out of withholding with Form NC-NPA.

S Corporations - N.C. Gen. Stat. § 105-131.7(g)

- If the Taxed S Corporation election is made, then the S Corporation is no longer permitted to file a composite return and is no longer required to remit estimated tax payments on behalf of any non-resident shareholder for whom Form NC-NA has not been filed.

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North Carolina's Taxed Pass-Through Entity Election

How does NC compare to other regional states?

Georgia

- Annual election made on return.
- Election and tax reported on existing GA forms for Partnerships and S Corporations.
- No restrictions on ownership per statute.
  Note: Regulations were not updated when statute was updated. Per Regulation, all owners must be eligible to be S Corporation shareholders for both Partnerships and S Corporations.
- Tax calculated on owners' distributive shares of income apportioned to GA.
- Post-apportionment income is used for resident owners.
- Owners exclude their share of income taxed at PTE level.
- Quarterly estimates required if **income** > $25,000.

Alabama

- For tax years beginning before 1/1/25: Online election due by 3/15 following year end.

  For tax years beginning on/after 1/1/25: Election made on return.
  Election binding until revoked.
- Form EPT replaces existing composite tax filing.
- No restrictions on ownership.
- Tax calculated on owners' distributive shares of income apportioned to AL.
- Post-apportionment income is used for resident owners.
- Owners receive credit for their share of tax paid.
- Quarterly estimates required if **tax** > $500.

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North Carolina's Taxed Pass-Through Entity Election
How does NC compare to other regional states?

South Carolina

- Annual election made on return.
- Form I-435 is attached to existing SC forms for Partnerships and S Corporations to calculate income subject to PTE Tax.
- Eligible owners limited to individuals, estates, trusts, and certain entities (including Partnerships owned by eligible owners). S Corporations are not an eligible owner.
- Tax is calculated on "Active Trade or Business Income" apportioned to SC.
- Post-apportionment income is used for resident owners.
- Owners exclude their share of income taxed at PTE level.
- Quarterly estimates required if **tax** > $100.

Virginia

- Annual election made by filing Form 502PTET.
- Form 502PTET replaces existing form for Partnerships and S Corporations.
- No restrictions on owners, but only income flowing to individuals, estates, and trusts is included in calculations.
- Tax calculated on owners' distributive shares of income apportioned to VA. Only income flowing to individuals, estates, and trusts is included.
- Pre-apportionment income is used for resident owners.
- Owners receive credit for their share of tax paid.
- Quarterly estimates required if **tax** > $1,000.
- Separately stated deductions **are** included, subject to same limitations as a C Corporation

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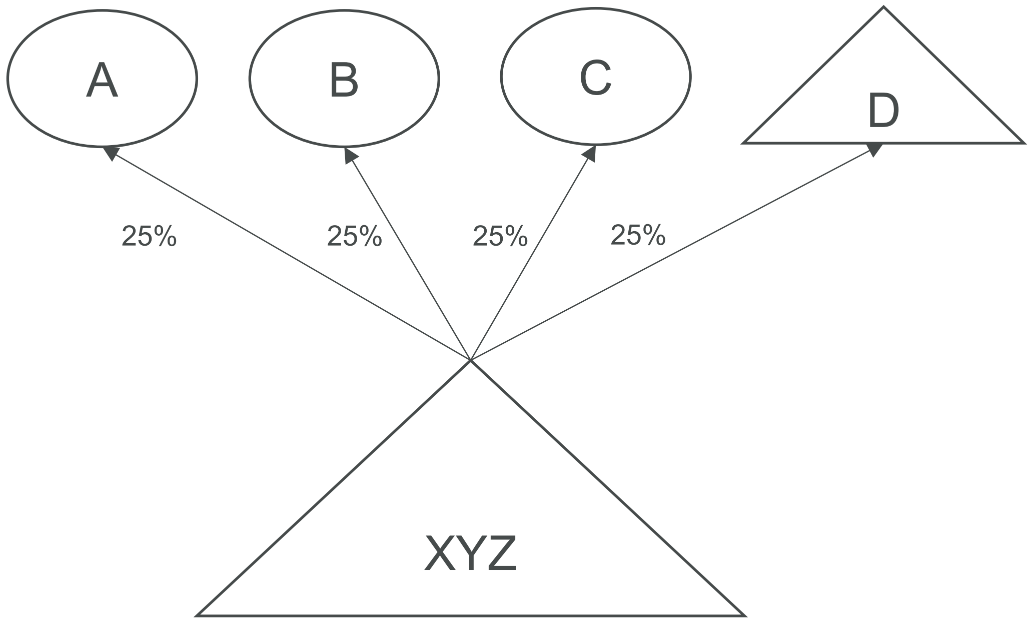
North Carolina's Taxed Pass-Through Entity Election
Example



- Partnership XYZ is owned by Individuals A, B, C and Partnership D. Each owner holds a 25% interest.
- XYZ makes the NC PTE Tax Election on its 2023 NC Return.
- XYZ's total federal income is $500,000. This amount includes a deduction for $100,000 of bonus depreciation and a deduction of $7,500 for NC PTE estimate payments made in 2023.
- NC apportionment for 2023 is 50%
- D provides Form NC-NPA to the partnership so no non-resident withholding is due.

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North Carolina's Taxed Pass-Through Entity Election
Example

2023

	XYZ	A	B	C	D
	100%	25%	25%	25%	25%
Federal Income	500,000	125,000	125,000	125,000	125,000
State Taxes	7,500	1,875	1,875	1,875	1,875
Bonus Depreciation Addback (85%)	85,000	21,250	21,250	21,250	21,250
NC Adjusted Income	592,500	148,125	148,125	148,125	148,125
NC Apportionment	50%	50%	50%	50%	50%
Apportioned to NC	296,250	74,063	74,063	74,063	74,063
PTE Tax Rate		4.75%	4.75%	4.75%	
PTE Tax	10,554	3,518	3,518	3,518	
Estimates paid in '23	(7,500)				
Balance due paid in '24	3,054				

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North Carolina's Taxed Pass-Through Entity Election
Example

2023

	XYZ	A	B	C	D
	100%	25%	25%	25%	25%
Federal Income	500,000	125,000	125,000	125,000	125,000
State Taxes	7,500	1,875	1,875	1,875	1,875
Bonus Depreciation Addback (85%)	85,000	21,250	21,250	21,250	21,250
NC Adjusted Income	592,500	148,125	148,125	148,125	148,125
NC Apportionment	50%	50%	50%	50%	50%
Apportioned to NC	296,250	74,063	74,063	74,063	74,063
PTE Tax Rate		4.75%	4.75%	4.75%	
PTE Tax	10,554	3,518	3,518	3,518	
Estimates paid in '23	(7,500)				
Balance due paid in '24	3,054				

- No PTE Tax is due for D since D is a partnership.
- A, B, and C's income is included in the calculation since they are all individuals. No opt out is available.
- XYZ must report addition modifications for the bonus depreciation and state income taxes deducted on the federal return.

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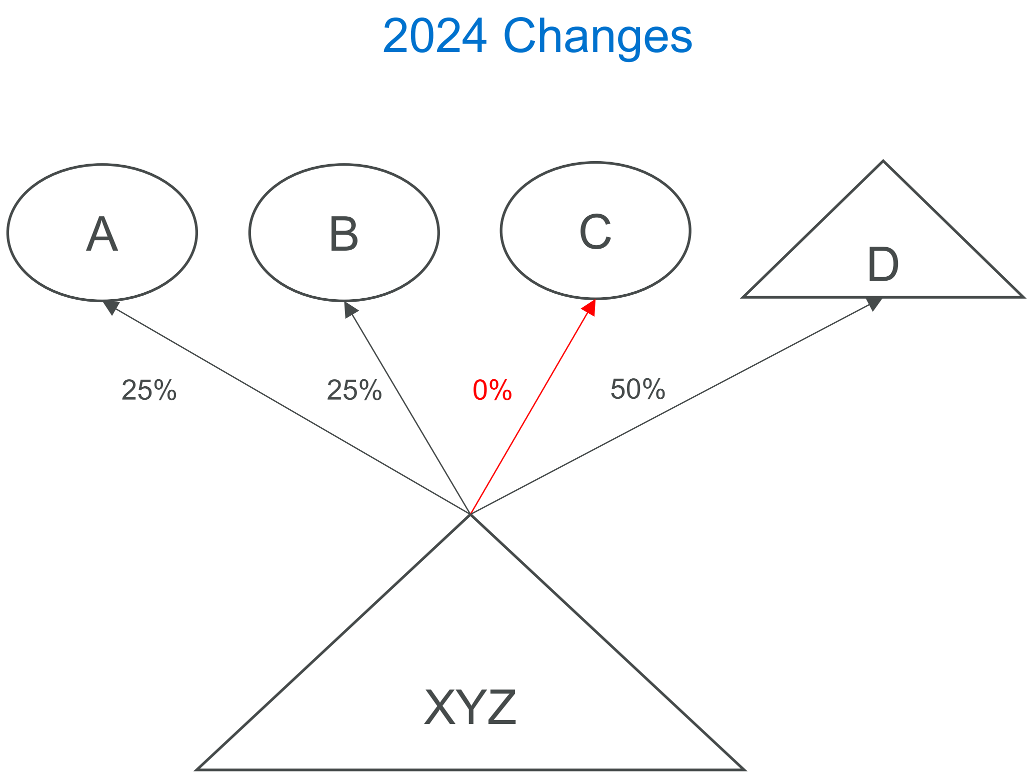
North Carolina's Taxed Pass-Through Entity Election
Example



- Effective 1/1/2024, D buys out C's interest.
- XYZ makes the NC PTE Tax Election on its 2024 NC Return.
- XYZ's total federal income is $400,000. This amount includes a deduction for $50,000 of bonus depreciation and a deduction of $7,554 for NC PTE payments made in 2024. This includes the $3,054 balance due paid with the 2023 return and $4,500 of 2024 estimates paid in 2024.
- NC apportionment for 2024 is 50%.
- D provides Form NC-NPA to the partnership so no non-resident withholding is due.

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North Carolina’s Taxed Pass-Through Entity Election
Example

2024

	XYZ	A	B	C	D
	100%	25%	25%	0%	50%
Federal Income	400,000	100,000	100,000		200,000
State Taxes	7,554	1,888	1,888		3,777
Bonus Depreciation Addback (85%)	42,500	10,625	10,625		21,250
Bonus Depreciation Subtraction	(17,000)	(4,250)	(4,250)	(4,250)	(4,250)
NC Adjusted Income	433,054	108,263	108,263		220,777
NC Apportionment	50%	50%	50%		50%
Apportioned to NC	216,527	54,132	54,132		110,388
PTE Tax Rate		4.50%	4.50%		
PTE Tax	4,872	2,436	2,436		
Estimates paid in ’24	(4,500)				
Balance due paid in ‘25	372				

- Effective 1/1/2024, D buys out C’s interest.
- XYZ makes the NC PTE Tax Election on its 2024 NC Return.
- XYZ’s total federal income is $400,000. This amount includes a deduction for $50,000 of bonus depreciation and a deduction of $7,554 for NC PTE payments made in 2024. This includes the $3,054 balance due paid with the 2023 return and $4,500 of 2024 estimates paid in 2024.
- NC apportionment for 2024 is 50%.
- D provides Form NC-NPA to the partnership so no non-resident withholding is due.

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North Carolina’s Taxed Pass-Through Entity Election
Example

2024

	XYZ	A	B	C	D
	100%	25%	25%	0%	50%
Federal Income	400,000	100,000	100,000		200,000
State Taxes	7,554	1,888	1,888		3,777
Bonus Depreciation Addback (85%)	42,500	10,625	10,625		21,250
Bonus Depreciation Subtraction	(17,000)	(4,250)	(4,250)	(4,250)	(4,250)
NC Adjusted Income	433,054	108,263	108,263		220,777
NC Apportionment	50%	50%	50%		50%
Apportioned to NC	216,527	54,132	54,132		110,388
PTE Tax Rate		4.50%	4.50%		
PTE Tax	4,872	2,436	2,436		
Estimates paid in ’24	(4,500)				
Balance due paid in ‘25	372				

- No PTE Tax is due for D since D is a partnership.
- A and B’s income is included in the calculation since they are individuals. No opt out is available.
- XYZ must report addition modifications for the bonus depreciation and state income taxes deducted on the federal return.
- C will report a subtraction modification for the bonus depreciation addition they reported in 2023 on their individual return.
- Only A and B’s depreciation subtractions are included in the PTE Tax calculation

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North Carolina's Taxed Pass-Through Entity Election
Example

2023 – A's Individual Return

	With PTE Election	Without PTE Election
XYZ Federal Income	125,000	126,875
Other Income	50,000	50,000
Federal AGI	175,000	176,875
On Schedule S		
Addition for State Taxes	1,875	
Addition for Bonus Depreciation	21,250	21,250
Total Additions	23,125	21,250
Taxed Pass-Through Entity Income	(74,063)	
Total Subtractions	(74,063)	
NC Taxable Income	124,063	198,125
Tax Rate	4.75%	4.75%
NC Tax	5,893	9,411
Plus: Share of PTE Paid	3,518	
Total NC Tax Paid	9,411	9,411
A's Federal Tax Savings (24% * State Tax Deduction)	450	

- This is a simplified example of the individual tax calculation for A. It does not consider standard or itemized deductions.
- A has $50,000 of income from sources other than the XYZ partnership.
- The "Without PTE Election" column assumes no addition for states income tax is required.
- The estimated federal benefit for A assumes a 24% tax rate.

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Contact

Forvis Mazars

Dylan Stafford
Senior Manager – State and Local Tax
P: 404.575.8876
dylan.stafford@us.forvismazars.com

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