

1 S.45

2 Introduced by Senators Chittenden, Baruth, Brock, Clarkson and Ram

3 Hinsdale

4 Referred to Committee on Finance

5 Date: February 27, 2023

6 Subject: Taxation; income tax; pass-through entity tax and credit

7 Statement of purpose of bill as introduced: This bill proposes to create an
8 elective, entity-level income tax on pass-through businesses, such as S
9 corporations and partnerships, that do business or have income derived from or
10 connected with sources in Vermont. The pass-through businesses would be
11 able to deduct the full amount of Vermont tax paid from the pass-throughs'
12 federal taxable income under the federal deduction for state and local taxes
13 paid. This bill would provide an offsetting Vermont income tax credit to the
14 individual taxpayer-member of the pass-through business, in the amount of 90
15 percent of the entity-level Vermont tax paid by the pass-through. Furthermore,
16 this bill would allow a credit against the tax paid to another state that imposes
17 a pass-through entity income tax that is substantially similar to the Vermont
18 tax.

19 An act relating to an elective pass-through entity income tax and credit

1 It is hereby enacted by the General Assembly of the State of Vermont:

2 Sec. 1. FINDINGS AND PURPOSE; STATE AND LOCAL TAX

3 DEDUCTION; LIMIT; WORKAROUND

4 (a) The purpose of this act is to create a Vermont taxation structure for
5 pass-through entities that conforms to the criteria approved by the IRS in
6 Notice 2020-75 to allow the pass-through entity to claim a federal deduction
7 for state and local taxes (SALT) paid. The federal SALT deduction under 26
8 U.S.C. § 164 allows taxpayers to reduce their federal taxable income by the
9 amount of certain SALT paid by the taxpayer during the taxable year. Under
10 federal law prior to 2018, there was no dollar limit to the deduction that
11 individual taxpayers could claim for taxes, including state personal income
12 taxes and property taxes paid. Under the federal Tax Cuts and Jobs Act, Pub.
13 L. No. 115-97, § 11042, for the 2018 through 2025 taxable years, the
14 deduction is limited to \$10,000.00 (or \$5,000.00 for married taxpayers filing
15 separately) for SALT taxes paid or accrued in the taxable year by individual
16 taxpayers. Businesses, irrespective of their business structure, are still allowed
17 under 26 U.S.C. § 164 to claim a deduction with no dollar limit for SALT
18 paid, including state income and property taxes.

19 (b) As of January 1, 2023, 29 states have enacted state taxation structures
20 for pass-through entities that conform to the criteria approved by the IRS in
21 Notice 2020-75. These structures typically involve imposing an elective state

1 income tax on the pass-through entity, which allows the entity to claim a
2 federal deduction for SALT paid, thus reducing the entity's federal tax liability
3 and ultimately the share of any tax paid by the pass-through members.

4 Additionally, these state structures provide an offsetting income tax benefit to
5 the individual taxpayer, such as a full or partial credit, deduction, or exclusion
6 for the individual's share of the tax paid by the pass-through entity.

7 Sec. 2. 32 V.S.A. chapter 151, subchapter 10C is added to read:

8 Subchapter 10C. Elective Pass-Through Entity Income Tax

9 § 5921a. DEFINITIONS

10 As used in this subchapter:

11 (1) "Distributive proceeds" means the net income, dividends, royalties,
12 interest, rents, guaranteed payments, and gains of a pass-through entity derived
13 from or connected with sources within the State.

14 (2) "Member" means a member of a limited liability company; a partner
15 in a general, limited, or limited liability partnership; or a shareholder of an S
16 corporation, provided the member is a natural person.

17 (3) "Pass-through entity" means a limited liability company, a
18 partnership, or an S corporation.

19 (4) "Pass-through entity business income tax" means the tax imposed
20 under this subchapter.

1 (5) “Share of distributive proceeds” means the portion of distributive
2 proceeds attributable to a member of a pass-through entity during a taxable
3 year.

4 § 5921b. PASS-THROUGH ENTITY INCOME TAX; ELECTION

5 (a) A pass-through entity may elect to be liable for and pay a pass-through
6 entity income tax during the taxable year, provided:

7 (1) at least one member of the entity is liable for income tax under this
8 chapter on that member’s share of distributive proceeds of the pass-through
9 entity during a taxable year;

10 (2) each member of the pass-through entity is a natural person and no
11 member is a C corporation or a pass-through entity; and

12 (3) consent is given by:

13 (A) each member of the electing entity who is a member at the time
14 the election is filed; or

15 (B) any officer, manager, or member of the electing entity who is
16 authorized, under law or the entity’s organizational documents, to make the
17 election and who represents having such authority under penalties of perjury.

18 (b) The tax imposed on a pass-through entity under this section shall be
19 equal to the sum of each member’s share of taxable distributive proceeds
20 attributable to the pass-through entity for the taxable year, multiplied by the
21 second-highest marginal tax rate in section 5822 of this chapter.

1 (c) The election under this section shall be made annually, on or before the
2 due date for filing the entity's return as established by the Commissioner, and
3 shall not apply retroactively. An election made under this section shall be
4 binding on all members of the pass-through entity for the year in which the
5 election is made. If the members decide to revoke an election, that revocation
6 shall occur on or before the due date for filing the entity's return.

7 (d) Each pass-through entity that makes an election for a taxable year
8 under this section shall annually report to each of its members the member's
9 share of distributive proceeds for the taxable year.

10 (e) Each pass-through entity that makes an election for a taxable year under
11 this section shall file an entity tax return and make payments on or before the
12 15th day of the third month following the close of each entity's taxable year as
13 determined for federal income tax purposes. A pass-through entity shall make
14 estimated entity tax payments as provided under subchapters 10A and 10B of
15 this chapter except that a pass-through entity shall make the estimated entity
16 tax payments for residents and nonresidents alike.

17 (f) A member of a pass-through entity shall not be liable for the individual
18 income tax imposed under section 5822 of this chapter and shall not be
19 required to file an individual income tax return as prescribed under section
20 5861 of this chapter, provided:

21 (1) the member is a nonresident of this State; and

1 (2) the member's only Vermont income during the taxable year is
2 derived from a pass-through entity that has paid the tax imposed under this
3 section on the member's Vermont income.

4 § 5921c. REFUNDABLE INCOME TAX CREDIT; INDIVIDUAL

5 MEMBERS OF PASS-THROUGH ENTITIES

6 An individual taxpayer of this State shall be entitled to a refundable credit
7 against the income tax paid under this chapter for the taxable year, provided
8 the individual is a member of a pass-through entity that elects under section
9 5921b of this chapter to be liable for and pay the pass-through entity income
10 tax during the taxable year. For each pass-through entity of which the
11 individual is a member, the amount of the credit shall equal 90 percent of the
12 individual's pro rata share of the tax paid under section 5921b of this chapter
13 for the taxable year, and that credit shall be available to the member during the
14 same taxable year. The credit under this section shall be available after the
15 application of all other credits allowed by law and claimed by the individual
16 during the taxable year.

17 Sec. 3. 32 V.S.A. § 5825 is amended to read:

18 § 5825. CREDIT FOR TAXES PAID TO OTHER STATES AND

19 PROVINCES

20 * * *

1 (c) The credit claimed under this section shall include an amount of the tax
2 paid to another state that imposes a tax on the distributive proceeds of a pass-
3 through entity, provided the other state’s tax is substantially similar to the pass-
4 through entity income tax imposed under subchapter 10C of this chapter. The
5 nonrefundable credit under this subsection shall equal 90 percent of the
6 taxpayer’s pro rata share of tax paid to another state, provided the amount of
7 the credit does not exceed the amount of pass-through entity business income
8 tax owed or that would have been owed if the pro rata share of tax paid were
9 subject to the pass-through entity income tax under subchapter 10C of this
10 chapter. As used in this subsection, “distributive proceeds” and “pass-through
11 entity” have the same meanings as under section 5921a of this chapter.

12 ~~Sec. 4. EFFECTIVE DATE~~

13 ~~Notwithstanding 1 V.S.A. § 214, this act shall take effect retroactively on~~
14 ~~January 1, 2023 and shall apply to taxable years beginning on and after~~
15 ~~January 1, 2023.~~

Sec. 4. REPEALS; SALT DEDUCTION CAP WORKAROUND

(a) 32 V.S.A. chapter 151, subchapter 10C (Elective Pass-Through Entity Income Tax) is repealed.

(b) 32 V.S.A. § 5825(c) (credit for taxes paid to other states and provinces) is repealed.

Sec. 5. EFFECTIVE DATES

(a) Notwithstanding 1 V.S.A. § 214, this section and Secs. 1–3 (SALT deduction cap workaround) shall take effect retroactively on January 1, 2023 and shall apply to taxable years beginning on and after January 1, 2023.

(b) Sec. 4 (repeals; SALT deduction cap workaround) shall take effect on the later of December 31, 2025 or the date on which the federal limitation on individual deductions for state and local taxes under 26 U.S.C. § 164(b)(6) is repealed or otherwise abrogated.