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S.45

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

Hinsdale

Referred to Committee on

Date:

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

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

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 paid,  
18 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 under  
8       this section shall annually report to each of its members the member's share of  
9       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        (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.