Parity for Main Street Employers

SALT Parity Q&A

Increased interest in our SALT Parity efforts means increased questions about how the reform works and why it is the right plan to help Main Street employers during challenging times. Below are some of the questions we have fielded in recent months together with our responses.

Q. Where is the "parity" in SALT Parity?

A. Tax reform capped deductions for state and local income taxes at $10,000 per year. This cap applied to the business income of pass-through businesses, but not the income earned by C corporations. C corporations may continue to fully deduct the SALT they pay as a business expense against federal taxes. As most states impose tax on pass-through businesses at the owner level, the disparate treatment puts them at a significant disadvantage compared to C corporations.

Q: How does SALT Parity Work?

A: The SALT deduction cap applies to individual tax payments, not business tax payments. So, SALT paid by an individual is subject to the $10,000 cap while SALT paid by a C corporation is not. S corporations and partnerships are stuck in the middle – the SALT paid by their owners is subject to the cap but the SALT paid directly by the business is not. Our SALT Parity plan shifts the incidence of the tax from owners to the business. The business pays the tax and deducts the payment as a business expense. As a result, the income flowing through to the owners is reduced on their federal taxes. Taxes paid to the state stay the same while the taxes paid to the federal government are reduced by the full SALT payment.

Q. How is SALT Parity "revenue neutral" for states but still a tax cut?

A. SALT Parity restores the full federal SALT deduction for pass-through businesses. It does so by shifting the incidence of the SALT from the owner(s) to the business itself, thereby making those payments deductible at the federal level. SALT Parity is designed to be revenue neutral to the state by charging the business entity a tax equal to the tax previously paid by the business' owners. Depending on how their tax code is structured, some states might see a small increase in their revenues. Not enough to be considered a tax hike, but certainly enough to cover their administrative costs. Owners of electing businesses are protected from double taxation through a tax credit or income exclusion equal to their share of tax paid by the business entity. States get their revenues, and Main Street businesses restore an important deduction.

Q: Has the IRS weighed in?

A: [IRS Notice 2020-75] published on November 9th, 2020 announced forthcoming rules clarifying that state and local income taxes paid by a partnership or S corporation are allowable as deductions for federal tax purposes. The Notice makes clear those deductions are allowed when they are the result of an election, or if the business owners receive tax credits or income exclusions equal to the taxes paid by the entity. Finally, the notice reassures taxpayers that they can rely on the Notice when filing their taxes this year, and that this interpretation applies to tax years preceding the Notice's publication. In short, our pass-through SALT Parity policy works.

Q: Will the IRS Change its position?

A: Highly unlikely. Notice 2020-75 is based on the agency's reading of the relevant statutes and precedents, and those haven't changed.

Q: Will Congress or the Biden Administration repeal the SALT caps?

A: The federal outlook on SALT policy is uncertain. The Biden administration has been silent on the issue. In January, Treasury Secretary nominee Janet Yellen told a Senate committee the policy would have to be further studied before they are prepared to take a position. Meanwhile, although numerous congressional Democrats oppose the SALT cap, the revenue loss of full repeal is prohibitive and accrues almost exclusively to upper-income taxpayers. Those large revenue losses and distributional realities make full repeal both difficult and unlikely. The options available to Congress include:

1. Repeal the SALT cap entirely;
2. Increase the SALT cap;
3. Cap the tax benefit of itemized deductions; and/or
4. Restore the Pease limitation on itemized deductions.

Only Option 1, adopted without options 3 or 4, would completely eliminate the benefits of SALT Parity. On the other hand, any combination of options 2-4 would leave all or some of our SALT Parity benefits intact. For pass-through owners taking the standard deduction, our SALT Parity efforts will continue to offer a benefit regardless of future congressional action.

Q. Should my state enact SALT Parity?

A. SALT Parity works in states where taxes on pass-through business income are paid by the owners, not the business. SALT is already fully deductible in states like Tennessee that already tax pass-through business income at the entity level. Meanwhile, states with no individual income taxes, including Texas and Florida, are unaffected by the new SALT cap. Most states, however, do tax pass-through income at the owner level and would benefit from this reform. S-Corp estimates there are 41 states that would benefit from our efforts. Of those, seven have adopted SALT Parity legislation (Connecticut, Wisconsin, Oklahoma, Louisiana, Rhode Island, New Jersey and Maryland) while more than a dozen others, including New York and California, are actively considering SALT Parity in 2021.

Q. Does SALT Parity increase complexity?

A. SALT Parity is simple – it replaces multiple tax returns and payments with a single, uniform return and payment. How those dollars are apportioned among states and entities within a state can get complicated, but it already is complicated. An entire industry of accountants and tax attorneys exists to address the complexities of state and local tax policy. SALT Parity does not add to that complexity.

Q. Does SALT Parity benefit all pass-through businesses?

A. No. Depending on their facts and circumstances, including where their owners reside, SALT Parity might not work for all businesses. That is why it is critical that SALT Parity allows each business to elect whether to pay their SALT at the entity level. Those businesses that would benefit can make the election, while the other businesses continue to continue to pay their SALT at the owner level, just as they always have.

Q. What businesses benefit from SALT Parity?

A. S corporations, partnerships, and LLCs benefit from SALT Parity. Sole proprietorships and single member LLCs do not. For SALT Parity to work, there must be a legal entity – a corporation or partnership – to pay the taxes. Sole proprietorships are not separate legal entities, while single member LLCs are generally disregarded for tax purposes.

Q. Should SALT Parity be limited to businesses of a certain size, or businesses with individual owners only?

A. No. The goal of SALT Parity is to provide all pass-through businesses with the same SALT deduction available to large public corporations. If Apple and Amazon may fully deduct SALT as a business expense, so should the family businesses in your state, regardless of their size are or how their ownership is structured. Some have argued the SALT Parity election should be limited to businesses with individual owners only, excluding those owned by trusts, estates, or other business entities. The goal is to ensure simplicity and protect against gaming, but it is an unnecessary limitation. Tracking the taxes, credits, and income exclusions offered under SALT Parity is no more difficult than tracking the items of income and loss from pass-through businesses to their owners. Meanwhile, since the core of SALT Parity to for the business entity to pay the SALT, it is difficult to see how businesses with multiple layers of ownership or owners other than individuals would be able to game the new policy. The tax has already been paid.