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 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 continue to fully deduct their SALT payments as a business expense on their federal taxes. In most states, pass-through business income is taxed at the owner level and is subject to the new cap. This disparate treatment puts them at a significant disadvantage compared to C corporations. Our legislation is designed to restore parity.

Q: How does SALT Parity Work?

A: The SALT deduction cap applies to individual tax payments, not business tax payments. So while SALT paid by pass-through owners on their business income is subject to the cap, 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 while taxes paid to the state stays the same.

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 owners to the business, 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 otherwise paid by the business' owners. Depending on how its 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 SALT Parity plan works.

Q: Will the IRS Change its position?

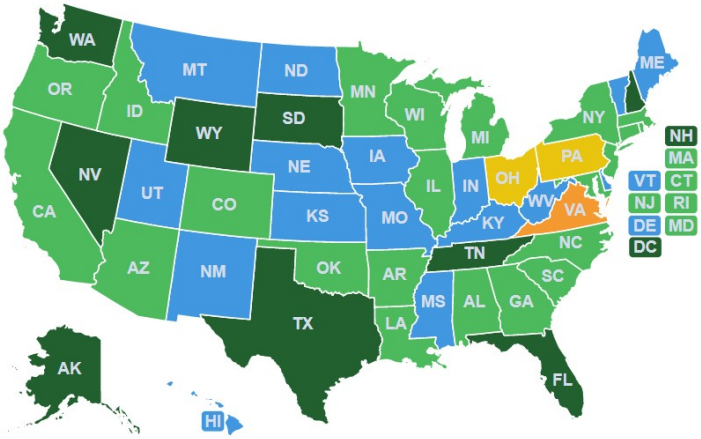
A: Highly unlikely. Notice 2020-75 is based on the agency's reading of the relevant statutes and precedents, and those remain the same.

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

A: The federal outlook on SALT policy is uncertain. The House-passed Build Back Better bill proposes increasing the SALT cap to $80,000, but it also would extend the life of the cap through 2031. Senate proposals would also extend the policy into 2031 but would reduce the size of the cap increase. Under either approach, Main Street businesses would continue to benefit from our SALT Parity model.

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 identifies 41 states that would benefit from our efforts. Of those, 22 have adopted our SALT Parity legislation while several others are actively considering SALT Parity in 2022.



Q. Does SALT Parity increase complexity?

A. SALT Parity is simple – for S corporations and partnerships, 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. One reason our SALT Parity bill includes an election is to ensure business owners can decide for themselves whether paying their SALT at the entity level is a good choice.

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. The range of business sizes that benefit depends on each state's tax code, including the tax rates and the income thresholds. Smaller pass-through businesses almost always benefit, however, as SALT Parity allows them to restore the deduction at the entity level, while their owners can take the standard deduction at the individual level.

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 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. The effect of SALT Parity is for the business entity to pay the SALT, so it is difficult to see how businesses with multiple layers of ownership would be able to game the new policy. The tax has already been paid.

Q. Does SALT Parity treat pass-through business owners better than wage-earners?

A. No. A basic principle of the U.S. income tax system is that businesses pay tax on their *net* income – the difference between their revenue and any tax-deductible expenses – while individuals pay tax on their *gross* income. The 2017 tax reform bill violated this rule by disallowing pass-through businesses – but not C corporations – a legitimate business deduction: the tax paid to states and localities on their business income. SALT Parity restores this deduction to pass-through businesses and levels the playing field between them and their C corporation competitors.