



2021-2022 General Assembly

# SENATE BILL 105: 2021 Appropriations Act, Sec. 42.5: Reduce Impact of Federal SALT Cap by Allowing Certain Pass-Throughs to Elect to Pay Tax at the Entity Level

**Committee:**  
**Introduced by:**  
**Analysis of:** Sec. 42.5 of S.L. 2021-180

**Date:** January 26, 2022  
**Prepared by:** Finance Team

**OVERVIEW:** Section 42.5 of S.L. 2021-180 allows pass-through entities to elect to pay the State income taxes at the entity level, which is not subject to the federal state and local tax (SALT) cap of \$10,000.

*This section is effective for taxable years beginning on or after January 1, 2022.*

**CURRENT LAW & BACKGROUND:** The 2017 Tax Cuts and Jobs Act (TCJA) imposed a \$10,000 cap on the amount of SALT individual taxpayers can deduct on their federal returns. Typically, pass-through entities such as partnerships and S corporations allocate business income to the owners' individual income tax returns, which is subject to the SALT cap. In proposed regulations, Notice 2020-75, the Internal Revenue Service and the Department of the Treasury signaled their approval of a workaround that allows the pass-through entity to pay the state income taxes at the entity level, which is not subject to the SALT cap. This workaround allows the owners to avoid the SALT cap on the taxes paid by the entity. The workaround only works for shareholders and members of S corporations, partnerships, and LLCs treated as partnerships for federal income tax purposes.

**BILL ANALYSIS:** Section 42.5 of S.L. 2021-180 adopts the aforementioned workaround by allowing pass-through entities to elect to pay the State income taxes at the entity level, which is not subject to the federal state and local tax (SALT) cap of \$10,000.

Subsection (c) allows an S corporation to elect to be taxed at the State level. The election is made on its timely-filed annual return, is irrevocable, and covers that taxable year. The election must be made each year. Tax credits and any carryforwards or installments of those tax credits must be taken by the taxpayer that filed the return for the year the initial tax credit was taken. The full amount of tax payable as shown on the return must be paid within the time allowed for filing the return. If the taxed S corporation does not pay the amount shown as due, the Secretary must issue a notice of collection for the tax debt to the taxed S Corporation. If the tax debt is not paid within 60 days of the date the notice of collection is mailed to the taxed S corporation, Secretary must send the shareholders a notice of proposed assessment.

Subsection (h) allows a partnership to elect to be taxed at the State level. The provisions governing this election are the same as the provisions for a taxed S corporation. The election cannot be made by a publicly traded partnership or by a partnership that has, at any time during its taxable year, a partner who is not an individual, an estate, a trust, or an organization described in section 1361(c)(6) of the Code.

Subsection (i) allows an individual income taxpayer who is a shareholder of a taxed S corporation or a partner of a taxed partnership to make the following adjustments to the taxpayer's adjusted gross income:

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# Senate Bill 105

Page 2

- A deduction of the amount of the taxpayer's pro rata share or distributive share of income from the taxed pass-through entity to the extent it was included in the taxed pass-through entity's NC tax income and the taxpayers AGI.
- An addition of the amount of the taxpayer's pro rata share or distributive share of loss from the taxed pass-through entity to the extent it was included in the taxed pass-through entity's NC taxable income and the taxpayer's AGI.

Subsection (j) does not allow a shareholder or partner of a taxed pass-through entity, or fiduciaries and beneficiaries of estates and trusts who are shareholders or partners of a taxed pass-through entity, a credit for taxed paid by the taxed pass-through entity to another state or country. The taxed pass-through entity is allowed the credit. Subsection (m) provides that a taxed pass-through entity must pay estimated taxes.

**EFFECTIVE DATE:** This section is effective for taxable years beginning on or after January 1, 2022.