



Defending America's Individually & Family Owned Businesses

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To: Members of the Minnesota House Tax Committee

From: Brian Reardon, S Corporation Association

Date: March 2, 2020

Subject: Pass-Through SALT Parity

The Federal Tax Cuts and Jobs Act (TCJA) was the most comprehensive rewrite of federal tax law since the 1986 Tax Reform Act and, while many businesses clearly benefitted from the TCJA, the impact on other businesses was decidedly mixed.

Depending on where they reside and how they are organized, many small businesses were put at a competitive disadvantage under the new law. A key reason for this is that while the TCJA allowed C corporations to fully deduct their state and local income taxes (SALT), those same taxes paid by pass-through businesses (S corporations, partnerships, LLCs, and sole proprietorships) were subject to the new \$10,000 cap on deductions that applied to individuals.

A simple way to think about it is this -- SALT paid at the entity level continues to be fully deductible as a business expense, but SALT paid at the individual owner's level is subject to the new cap. Property taxes, sales taxes, and State and local income taxes charged directly to the pass-through business are fully deductible. The same taxes paid by the owner of the business on their individual returns, however, are not.

As a result of this policy, Minnesota's nearly 170,000 partnerships and S corporations could be subject to tax rates 2.9 to 3.6 percentage points higher than if they were allowed to deduct those legitimate business expenses. These higher rates put them at a disadvantage compared to C corporations and other pass-through business operating states with no income taxes -- or, as in the case of neighboring Wisconsin, states that have already adopted the SALT Parity legislation described below.

To address this disparity, the S Corporation Association supports legislation introduced by Representative Greg Davids (HF 871). This legislation will allow pass-through businesses to elect to pay their Minnesota taxes at the entity level and thereby restore the full federal SALT deduction. Specifically, the bill:



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- Provides an election for Minnesota S corporations, limited liability companies and partnerships to pay their state and local taxes at the entity level;
- Includes an income exemption, so that owners of businesses making the election are not subject to two layers of tax; and
- Provides Minnesota business owners with a credit for business taxes paid to other states, like Wisconsin, that have adopted similar SALT Parity reforms.

This last provision is designed to ensure that businesses operating in multiple states are not disadvantaged by double taxation. This provision is increasingly important as the number of states adopting the SALT Parity approach is growing. To date, six states have adopted the reform while five others, including Minnesota, are actively considering it.

Finally, it is important to note that HF 871 is designed to be revenue neutral -- the revenues paid to Minnesota through the entity level tax should equal the revenues that would have otherwise been paid by owners. This reform, therefore, is a win/win for the state and its pass-through businesses. Minnesota businesses enjoy the restoration of their full SALT deduction and the State makes its Main Street employers more competitive, all at no cost to the Minnesota Treasury.

For these reasons, the S Corporation Association strongly supports HF 871 and asks the members of the Minnesota House Tax Committee to vote in favor of the legislation.

States Acting on Pass-Through SALT Parity

Enacted

- Connecticut S.B. 11 (enacted May 31, 2018)
- Wisconsin S.B. 883 (enacted Dec. 14, 2018)
- Oklahoma H.B. 2665 (enacted April 29, 2019)
- Louisiana Senate Bill 223 (enacted June 22, 2019)
- Rhode Island H. 5151A (enacted July 7, 2019)
- New Jersey S. 3246 (enacted January 13, 2020)

Actively Considering

- Alabama (Task Force Recommendation)
- Arkansas H.B. 1714
- Maryland SB0523 and HB0129
- Michigan SB 1170 (Initial bill vetoed by Governor)
- Minnesota HF 871