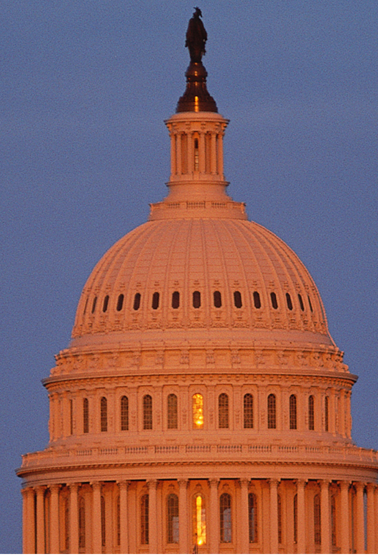
TaxNewsFlash

United States



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California: Reminder that PTET elections and payment due June 15

The due date for making the first installment of California's passthrough entity tax (PTET) for the 2022 tax year is Wednesday, June 15, 2022. Read ***TaxNewsFlash***

The election for 2022 will not be valid unless a sufficient payment is timely made. The amount of the payment must be the greater of 50% of the tax "paid for" 2021 or $1,000. The amount "paid for" is determined based on the passthrough entity elective tax liability shown on the passthrough entity's 2021 tax return.

- If the 2021 tax year PTET has been filed, then that amount is known.
- If the 2021 tax year PTET has not yet been filed, then the 2021 tax year PTET due is not a certain amount and the passthrough entity (PTE) must make a conservative estimated payment for the 2022 tax year by June 15, 2022.

Paying a sufficient amount is crucial because an insufficient estimated payment would mean that the PTE is not permitted to elect for the 2022 tax year. The Franchise Tax Board (FTB) has noted that exceptions will not be made. If no 2021 tax year PTET election has been or will be made, then the payment amount must be at least $1,000. Payment must be made electronically through the state's **Web Pay System**.

Overview

The PTET election allows a "qualified entity" to elect to pay an entity-level tax equal to 9.3% of qualified net income. A "qualified entity" means an entity that is taxed as a partnership or an S corporation, except publicly traded partnerships and entities required or permitted to be in a combined reporting group are not considered "qualified entities."

The "qualified net income" of a qualified entity means the sum of the pro rata share or distributive share of income subject to tax under California's individual (personal) income tax law for the tax year of each "qualified taxpayer." A "qualified taxpayer" means a partner, shareholder, or member of an electing qualified entity that consented to the election. A "qualified taxpayer" does not include a business entity that is disregarded for federal tax purposes, or its partners or members except for certain disregarded limited liability companies and their owners. Other disregarded entities, as well as corporations and partnerships, are not "qualified taxpayers."

The tax is based on the sum of the pro rata share or distributive share of income attributable to electing partners, shareholders or members. A partner, shareholder or member that does not consent does not prevent the qualified entity from making an election to pay the elective tax. A qualified taxpayer (i.e., the owner of the passthrough entity defined above) is entitled to a credit against its individual income tax for 9.3% of the taxpayer's distributive or pro rata share of qualified net income subject to the election.

If the credit exceeds the net tax due, the remaining amount of credit may be carried over by the owner for five years. If the $10,000 federal state and local tax (SALT) cap is not repealed in the intervening years, the election may be made for tax years beginning on or after January 1, 2021, and before January 1, 2026.

For the 2022 tax year and beyond, the first installment payment is due on or before June 15 of the election year. If that first payment is not made by June 15, the election cannot be made for that year. The first installment will be the greater of $1,000 or 50% of the elective tax paid in the prior tax year. Once made, the election is irrevocable. The second installment is due on original due date of the return without regard to extensions.

Guidance

The FTB has published guidelines for the new tax at **CA Pass-through entity elective tax FAQs**. In addition:

- Regarding the ordering of credits, for tax years beginning before January 1, 2022, the PTE credit is taken with the other credits that may reduce tax below the tentative minimum tax (the credit falls under Cal. Rev. & Tax. Cd. § 17039(a)(5)(A)).
- Regarding the ordering of credits, for tax years beginning on or after January 1, 2022, the PTE credit must be applied after the other state tax credit (e.g., credit falls under Cal. Rev. & Tax. Cd. § 17039(a)(7)).
- Guaranteed payments to partners are included in the entity's qualified net income.

KPMG observation

The FTB interprets that the California tax liability used for the other state tax credit (OSTC) calculation would be reduced by the California PTET; this could significantly reduce the benefit of the OSTC to PTE owners.

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