Butterfield + Co.
CPAs, Inc.

December 21, 2021

To our Clients and Friends,

California Assembly Bill 150 (AB 150) established the Small Business Relief Act which allows qualified passthrough entities to elect to pay and deduct a California passthrough entity tax (PTE) of 9.3% on qualified net income. This is the long awaited "work around" to the federal income tax limitation on state and local income taxes (SALT) and pertains to taxable years beginning on or after January 1, 2021 and before January 1, 2026. This elective tax is an entity level tax that is deductible by the entity for federal tax purposes. By deducting the tax at the entity level, the benefit of the tax is passed on to the individual partner and reduces their overall tax.

Qualifying Entity

A qualifying PTE is an entity taxed as a partnership or S corporation. Qualified entities do not include publicly traded partnerships, entities required to be in a combined reporting group, **<u>and an entity that has a partnership owner</u>.** Qualified entities make the annual election, and each individual owner can choose if they want the entity to pay the tax on their share of the entity's income.

Qualified Taxpayer

A "qualified taxpayer" is an individual, trust or estate subject to California personal income tax that is a partner, shareholder, or member of an LLC treated as a partnership or S corporation that consented to have the entity pay tax on their pro rata or distributive share of the entity's income.

A qualified taxpayer does not include a corporation or a business entity that is disregarded for federal tax purposes, "or the members or partners of a disregarded entity."

PTE Election

The annual election is made on an original, timely filed tax return. Once the election is made, it is irrevocable for that year and is binding on all partners, shareholders, and members of the PTE.

For the 2021 taxable year, the election must be made on a timely-filed tax return.

Beginning on or after January 1, 2022 and before January 1, 2026, the election must be made when the tax return for the taxable year is filed, and the PTE must make an initial payment by June 15.

PTE Elective Tax Calculation

The elective tax is 9.3% of the entity's qualified net income, which is the sum of the pro rata or distributive share of each qualified taxpayers' income subject to California personal income tax.

Year of Federal Deduction

Tax payments made in 2021 will be deductible on the 2021 federal tax return. Payments made in 2022, for tax year 2021, will be deductible on the 2022 federal tax return.

Tax Credit

Qualified taxpayers are eligible to claim a nonrefundable credit for the amount of tax paid on the qualified taxpayers' pro rata or distributive share of the qualified entity's qualified net income. Unused credits can be carried over for up to 5 years. Please note: The passthrough entity elective tax (PEET) credit does not reduce California tax below tentative minimum tax (TMT). This means the benefits of the PEET credit may be limited for some taxpayers, especially those with large amounts of income from their passthrough entities.

How to claim your tax credit

Qualified taxpayers can claim the credit on their personal income tax return.

Please contact us if you have questions regarding the ramifications of AB 150's various provisions on your tax situation.

Very truly yours,

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