



MULTISTATE INCOME/FRANCHISE TAX

## California enacts pass-through entity tax election Tax Alert

### Overview

On July 16, 2021, the California governor signed [Assembly Bill 150](#) (AB 150), which includes a new elective pass-through entity (“PTE”) tax. Under the legislation qualifying PTEs, including entities taxed as a partnership or S corporation, may elect to pay an entity level state tax on income for taxable years beginning on or after January 1, 2021 and before January 1, 2026. Qualified taxpayers receive a credit for their share of the entity level tax, reducing their California personal income tax.

This Tax Alert summarizes some of the provisions of the California pass-through entity tax election.

### Pass-through entity tax election

- Effective for tax years beginning on or after January 1, 2021 and before January 1, 2026.
- Qualifying entity is defined as a partnership or S corporation that has exclusively corporations, individuals, fiduciaries, estates, or trusts as partners, shareholders, or members.
- Qualifying entity does not include:
  - PTEs with partners that are partnerships,
  - publicly traded partnerships, or
  - entities required to be included in a California combined reporting group.
- The election is an annual election.
- Once made, the election is irrevocable for that year and is binding on all partners, shareholders, and members of the PTE.

- The election is made on an original, timely filed return.

## Pass-through entity tax calculation

- The PTE tax shall be computed at 9.3% of qualified net income, which is the sum of the pro rata share or distributive share of income subject to personal income tax under Part 10 of the California Revenue and Taxation Code of each “qualified taxpayer”.
- A qualified taxpayer includes a taxpayer as defined under the California Revenue and Taxation Code section 17004 excluding partnerships, that is a partner, shareholder, or member of an electing qualified entity that consented to have their pro rata share or distributive share of income to be subject to the PTE tax. Taxpayers as defined under section 17004 includes individuals, fiduciaries, estates, and trusts. Qualified taxpayers do not include business entities that are disregarded for federal tax purposes.
- For California resident qualified taxpayers, the full amount of their distributive share of income is included in the tax base.
- For nonresident qualified taxpayers, the California sourced portion of their distributive share of income is included in the tax base.
- For corporations, disregarded entities and other partners, shareholders or members that are not qualified taxpayers, none of their distributive share of income is included in the tax base.

## Pass-through entity tax payments

- For taxable years beginning on or after January 1, 2021 and before January 1, 2022, the PTE tax is due on or before the due date of the original return without regard to any extensions.
- For each taxable year beginning on or after January 1, 2022 and before January 1, 2026:
  - On or before **June 15<sup>th</sup>** of the taxable year an amount equal to, or greater than, either 50% of the elective tax paid the prior taxable year or \$1,000, whichever is greater is due.
  - On or before the due date of the original return for the taxable year of the election without regard to any extension of time for filing the return, an amount equal to the amount of the elective tax less the payment made on or before June 15th of the taxable year is due.
- For each taxable year beginning on or after January 1, 2022 and before January 1, 2026, if no payment is made in the form and manner prescribed by the California Franchise Tax Board, the qualified entity may not make the election for that taxable year.

## Pass-through entity tax credit

- AB 150 allows a credit against net tax to a qualified taxpayer that is a partner, member, or shareholder of the electing PTE. The amount of the credit is equal to 9.3% of the qualified taxpayer’s pro rata or distributive share of qualified net income subject to the PTE election.

- If the qualified taxpayer's credit exceeds the qualified taxpayer's net California personal income tax, the excess is not refundable. Instead the excess may be carried over for up to 5 years.

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