



MULTISTATE INCOME/FRANCHISE TAX

Nebraska enacts pass-through entity tax election Tax Alert

Overview

On May 31, 2023, Nebraska [Legislative Bill 754](#) (L.B. 754) was enacted into law. Under the legislation, eligible pass-through entities may make an annual election to pay an entity level state tax for taxable years beginning on or after January 1, 2018.

This Tax Alert summarizes some of the provisions of L.B. 754.

Pass-through entity tax election

- Effective for taxable years beginning on or after January 1, 2018, eligible pass-through entities, including partnerships and S corporations, may annually elect to pay Nebraska tax at the entity level.
- The election, once made, is irrevocable for that taxable year.
- For taxable years beginning on or after January 1, 2023, the election must be made on or before the due date for filing the electing pass-through entity's applicable Nebraska income tax return, including any extensions that have been granted.
- For taxable years beginning on or after January 1, 2018, but before January 1, 2023, the election must be made on or after January 1, 2023, but before December 31, 2025, in the form and manner prescribed by the Nebraska Tax Commissioner.

Pass-through entity tax calculation

- The entity level tax is imposed on the electing pass-through entity's net income allocated or apportioned to Nebraska.
- The tax rate for the pass-through entity tax is equal to the highest individual income tax rate under Neb. Rev. Stat. section 77-2715.03, which is currently 6.84% for taxable years beginning on or after January 1, 2014, but before January 1, 2023, and 6.64% for taxable

years beginning on or after January 1, 2023, but before January 1, 2024.

- In computing the pass-through entity tax, the electing pass-through entity must add back any amount of Nebraska tax imposed and deducted by the electing pass-through entity for federal income tax purposes under Internal Revenue Code section 164.
- An electing pass-through entity that incurs a net operating loss cannot carry the loss forward to succeeding taxable years.

Pass-through entity tax credit

- Each partner or shareholder of an electing pass-through entity may claim a refundable credit against their Nebraska income tax equal to their pro rata or distributive share of the pass-through entity tax paid by the electing pass-through entity.
- In the case of a pass-through entity that is a partner in an electing partnership, the refundable credit can be claimed by the pass-through entity's partners or shareholders in accordance with the determination of income and distributive share of the Nebraska income tax paid by the electing partnership.
- If an electing partnership is a partner of another electing partnership, the upper-tier electing partnership may claim a credit for the tax paid by the lower-tier electing partnership. The upper tier electing partnership shall distribute out the pro rata or distributive share of the credits to its partner for the pass-through entity tax paid by all tiers of electing partnerships.
- A nonresident individual who is a partner or shareholder of an electing pass-through entity is not required to file a Nebraska income tax return for the applicable taxable year if the partner's or shareholder's only source of Nebraska income is from one or more electing pass-through entities and the nonresident individual's Nebraska income tax for such taxable year is fully satisfied by the nonresident individual's pass-through entity tax credit.

Credit for residents who pay income tax to another state

- A Nebraska resident individual, estate, or trust may claim a credit for taxes paid to another state against their Nebraska income tax for their share of pass-through entity taxes paid to another state if the income tax imposed by the other state is similar to Nebraska's pass-through entity tax and imposed on income that is also subject to Nebraska income tax.

Other considerations

- Any partner or shareholder of the electing pass-through entity that is a grantor trust of a nonresident shall be disregarded and shall be treated as though the nonresident grantor is the partner or shareholder.
- For taxable years beginning on or after January 1, 2024, electing pass-through entities are required to make estimated tax payments in the same manner as corporations.
- Any estimated tax payments made by an eligible pass-through entity that chooses not to make the pass-through entity tax election will be

treated as income tax withholding on behalf of the partners or shareholders.

- The deadline for partners or shareholders of an electing pass-through entity to claim a credit or refund for taxable years beginning on or after January 1, 2018, but before January 1, 2023, shall be extended until the timeframe specified in Neb. Rev. Stat. section 77-2793 or January 31, 2026, whichever is later. Neither the electing pass-through entity nor its partners or shareholders will incur any penalties for late filing nor owe interest on such amounts. Similarly, the Nebraska Tax Commissioner will not be required to pay interest on any amounts owed to the partners or shareholders resulting from such refund claims.
- The Nebraska Tax Commissioner shall have one year from the date a pass-through entity files a pass-through entity tax election for taxable years beginning on or after January 1, 2018, but before January 1, 2023, to review and make a written proposed deficiency determination. Any notice of deficiency determination may be enforced at any time within six years from the date of the notice of deficiency determination.

Federal tax accounting considerations

- For cash basis taxpayers, the determination of whether the pass-through entity's pass-through entity tax liability is deductible for federal income tax purposes as of tax year-end is based on several key factors including:
 - Whether there is an actual pass-through entity tax liability;
 - When the payment is made against such liability; and
 - Whether the payment is applied to the pass-through entity tax liability by the state taxing authority.
- For an accrual basis taxpayer, the determination of whether the pass-through entity's pass-through entity tax liability is deductible for federal income tax purposes as of tax year-end is also based on several key factors including, but not limited to:
 - The particular state's payment and election procedures;
 - Whether the election was properly effectuated and timely made;
 - Whether the client and its counsel determined that the pass-through entity legally bound itself to make the election (e.g., through a board resolution);
 - Whether the client paid the liability by tax year-end; and
 - The potential application of the recurring item exception.
- Generally, under Internal Revenue Code section 111, where an item is deducted in one year and recovered in a subsequent year, the recovery is includible in taxable income for federal income tax purposes. For example, if an individual partner originally deducted, for federal income tax purposes, a state tax liability paid in 2018, and files a state tax refund claim in 2023 for the amount paid in 2018, the refund amount is considered taxable income for federal income tax purposes to the extent that the amount paid in 2018 was originally deducted.

Get in touch

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Have a question relating to this or any other pass-through entity tax regime?
Reach out to one of our national multistate pass-through entity tax specialists.

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