

**New SALT Cap Workaround
(AB 150)
May Provide
Tax Savings for You**

by Alyse M. Frederick, Esq.

California has enacted AB150, joining the growing list of states implementing a workaround on the current \$10,000 cap on state and local tax deductions.



California AB-150

**New Tax Savings for
Business Owners**

A Little Background

In 2017, as part of the Tax Cuts and Jobs Act (TCJA), Congress greatly limited the ability of taxpayers to deduct their state and local taxes (SALT). In general, the law was established so that individual taxpayers can deduct no more than \$10,000 from their state and local taxes for the 2018-2025 tax years.

It should be noted that through TCJA, Congress made some other general changes that favor taxpayers, such as lowering overall tax rates, effectively eliminating alternative minimum tax, etc. However, the so-called "SALT limitation" adversely impacted taxpayers living in high tax jurisdictions such as California.

Many of our clients have experienced an inadvertent tax increase as a result of the SALT limitation.

Shortly after the 2017 act was passed, states started developing an idea to avoid the limitation. The idea is that certain pass-through entities (PTE) could pay the tax. Since the SALT limitation only applied to individual tax returns, having a business entity pay the tax thereby avoided the limitation. In 2020 the IRS issued its support of SALT workarounds, clarifying that PET taxes are allowed as a deduction and are not subject to the \$10,000 annual SALT cap.

Several states out east were the first to pass legislative changes to cause business entities to pay tax to avoid this limitation.

AB 150

On July 16, 2021, California enacted AB150, which is our state's SALT workaround for pass-through entities. Eligible pass-through entities include non-publicly traded Partnerships, S-Corporations, LLCs taxed as Partnerships, and LLCs taxed as S-Corps. Accordingly, California residents can elect to pay an entity-level tax, thereby avoiding the SALT limitation. Thus, for tax years starting on or after January 1, 2021, pass-through entities can elect to pay and deduct California taxes at the entity level.

Under the terms of AB150, qualifying entities can elect to pay a 9.3% tax on CA income, allowing an entity owner to claim a credit on their CA tax return for the PET's taxes paid on their behalf. Essentially this workaround enables entity

owners to claim a non-refundable tax credit equal to 9.3% of their pro-rata or distributive share of qualified net income.

For example, assume you have a pass-through entity that makes one million dollars in distributions to its owners per year. This entity is now eligible to elect to pay 9.3%, or \$93,000, to California.

AB150 provides a direct tax credit on the owner's personal tax return for the taxes paid by the entity. Therefore, under this hypothetical, the entity owners would receive a \$93,000 collective tax credit on their personal returns. Another benefit is that the \$93,000 is proportionally deducted from the individual owner's personal federal tax return. The income is reduced to \$907,000 for federal income tax purposes; the owner's do not pay federal tax on the state taxes paid by the entity.

Moreover, in cases where an owner makes most of their income from an entity, they have the ability to effectively eliminate personal state and local income tax, as the taxes would, in effect, be paid by the entity.

Clients whose PET currently falls in a CA tax bracket of less than 9.3% may not be able to utilize all of the tax credit in the current year. However, AB150 provides a five-year carryover period to alleviate this concern.

Because the tax savings with AB150 are so great, we encourage our clients to review their partnership or LLC operating agreements to determine if a SALT workaround is allowed.



Additional Planning Opportunities

Our firm is also working with AB150 to provide additional tax savings benefits to clients with substantial stock investment accounts. Many of our clients currently hold their investment accounts in their name. By holding such accounts in their name, their tax savings are limited in that they do not get to deduct any of the state income tax attributable to their earnings.

For example, if a client earns \$500,000 a year in dividends and pays \$50,000 a year in state tax, they get little or no deduction. With AB150, if that same client simply contributes their portfolio to a pass-through entity like an LLC or partnership, they can deduct the state tax.

Using rough numbers, this same client would get a \$25,000 a year benefit (assuming they are in a 45% federal tax bracket) simply by contributing their portfolio to an LLC.

This planning strategy provides our clients the opportunity to achieve significant tax savings. Keeping in mind the annual \$800 franchise tax board fee for LLCs, plus any accounting costs, the numbers make enough sense that high net worth clients should seriously consider planning of this nature.

Optimizing Tax Savings for the 2021 Tax Year

Currently, there is some discussion in Congress on repealing the SALT limitation. AB150 includes an automatic "repeal," which provides that California's SALT workaround will become inoperative if Congress modifies or repeals the federal SALT limitation before December 1, 2026.

We are sending this article because AB150 can significantly impact individuals and entities for the rest of 2021 in early 2022. Many of our clients who own pass-through entities typically make estimated payments for their individual state income taxes. Accordingly, we urge such clients to immediately consult with their accountants to determine whether they should be adjusting their third quarter and fourth quarter estimated personal tax payments. Additionally, we encourage clients to consider having their businesses develop a reserve of cash; the entity level tax is due March 15, 2022.

As stated above, with the enactment of AB150, many of our clients can significantly reduce their individual state taxes (since the entity will be paying these taxes in 2022 for the 2021 tax year). Due to AB150's effective date being January 1, 2021, the benefits of the state and local deductions can be achieved for the entire 2021 tax year.

In Closing

AB 150 has provided our clients with a substantial tax savings opportunity. If any clients reading this newsletter have any questions or would like to learn how they can best take advantage of AB150's planning opportunities, please do not hesitate to contact our office.



We look forward to serving you & wish you the best

We continue to work for new and existing clients during COVID-19 (coronavirus) while placing safety and health as a priority. We are happy to accommodate your needs, including Facetime, SKYPE and ZOOM for virtual, face-to-face connections. Contact us directly to speak with someone who can help answer your questions.

T (949) 501-4800

Or send us a private email at the link below and we will respond promptly:

info@lawandsteinllp.com

Visit our website for more information and to review our partner and attorney bios:

www.LawandSteinllp.com

The Law & Stein Newsletter is a monthly publication to share useful information with our clients in matters of estate planning, tax planning, inheritance dispute litigation, elder abuse, probate and business litigation, and premises and product liability defense.

LAW & STEIN LLP
2601 Main Street, Suite 1200
Irvine, CA 92614
info@lawandsteinllp.com

