

Passing the SALT – New Jersey SALT Cap Workaround

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On January 13, 2020, Governor Murphy passed the Pass-Through Business Alternative Income Tax Act (“NJ PBAIT”) into law. In doing so, New Jersey joins a growing number of states that have also enacted similar legislation regarding entity-level tax on pass-through entities in an effort to mitigate the adverse effects brought on by the \$10,000 state and local tax (“SALT”) deduction cap for federal income tax purposes.

NJ PBAIT establishes an elective, entity-level tax to be paid by pass-through entities and provides offsetting tax credit to taxpayers who receive income from a pass-through business starting in 2020. Pass-through entities that qualify for the election are partnerships, S-corporations, and limited liability companies (that are taxed as partnerships or S-corporations), which have at least one owner that is subject to the New Jersey Income Tax at the time the election is filed. The election must be filed by the due date of the entity’s return (excluding extensions).

If the election is made, the entity level tax imposed is calculated by multiplying the sum of distributive proceeds (the entity’s New Jersey sourced income allocable to New Jersey resident and non-resident owners) by the applicable tax rate. The applicable tax rates are as follows:

- 5.675% if distributive proceeds are up to \$250,000
- 6.52% if the distributive proceeds are between \$250,000 and \$1,000,000
- 9.12% if the distributive proceeds are between \$1,000,000 and \$5,000,000
- 10.9% if the distributive proceeds are greater than \$5,000,000

This new law should provide welcome relief from the SALT cap to many owners of S-corporations, LLCs, and partnerships with New Jersey source income. Entities anticipating making the election and their owners may need to consider the effects on estimated tax payments throughout the year.

It is possible the SALT cap workaround could be challenged by the IRS. However, for S-corporations, Internal Revenue Code §164(e) would appear to provide a defense to a challenge. See, Maxitrol Co. v. Dep’t of Treasury, 551 N.W.2d 471 (Mich. Ct. App. 1996). For partnerships and LLCs, Internal Revenue Code §702 and §703 (singling out only foreign taxes for separately stated treatment) and Rev. Rul. 71-278 may also provide a similar defense.

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