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MULTISTATE INCOME/FRANCHISE TAX

Minnesota enacts pass-through entity tax election

Tax Alert

Overview

On July 1, 2021, the governor signed into law Minnesota's FY 2022-2023 State Budget (including HF9/SF26, among other bills), which includes a new elective pass-through entity tax. Certain qualifying pass-through entities, including partnerships, limited liability companies, and S corporations, may elect to pay an entity level state tax on income for taxable years beginning after December 31, 2020, provided that the limitation for the state and local tax deduction under IRC section 164(b)(6) still applies.

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

Pass-through entity tax election

- Effective for tax years beginning after December 31, 2020, a qualifying entity, including a partnership, limited liability company, or S corporation, can elect to pay an entity level tax in Minnesota. Qualifying entities do not include entities with a partnership, limited liability company other than a disregarded entity, or a corporation as a partner, member, or shareholder.

- The election must be made by the date the return is due or the extended due date and once made is irrevocable for that taxable year.

- The election may only be made by qualifying owners who collectively hold more than a 50% ownership interest in the pass-through entity, and the election is binding on all qualifying owners.

- The pass-through entity tax is the sum of the tax liability of each qualifying owner which is equal to the qualifying owner's income sourced to Minnesota multiplied by the highest individual income tax rate of 9.85%.

- Qualifying owners generally include a resident or nonresident individual or estate that is a partner, member, or shareholder of a qualifying entity. A qualifying owner also includes a resident or nonresident trust that is a shareholder of a qualifying entity that is an S corporation.

- Electing pass-through entities are required to make quarterly estimated payments in the same manner as estimated payments are required for composite tax. For calendar year taxpayers, estimated payments are generally due on April 15, June 15, September 15, and January 15 of the following taxable year.

- Electing pass-through entities are no longer required to withhold tax for nonresident partners or shareholders.

Pass-through entity tax credit

- Qualifying owners of electing entities may claim a credit on their individual income tax return equal to the amount of the owner's share of the pass-through tax liability.

- The pass-through entity tax election satisfies the tax liability and filing requirements of nonresident owners provided that the nonresident owner does not have any Minnesota source income other than the income from the electing pass-through entity, other electing pass-through entities, or other pass-through entities electing to file a composite return.

Credit for tax paid to other states

- A Minnesota resident taxpayer who is liable for taxes based on net income to another state is entitled to a credit for the tax paid to another state. Residents that are partners in a partnership can claim a credit for income taxes paid by the partnership to another state based on the partner's share of tax paid by the partnership.

- The legislation provides that the credit for tax paid to another state based on a partner's share of income tax paid by the partnership is also available to members of a limited liability company.

Get in touch

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