

Oklahoma Law Establishes Entity-Level Income Tax Election for Pass-Through Entities - Action May Be Required by June 28, 2019

Overview

On April 29, 2019, Governor Kevin Stitt signed House Bill No. 2665 ("HB 2665") into law, also known as the Pass-Through Entity Tax Equity Act of 2019,¹ which includes the following changes to Oklahoma law:

- Establishes an election available to pass-through entities ("PTE") to allow a PTE to elect entity-level taxation at the highest marginal rate of the PTE's members, as compared to withholding and composite return requirements.
- Modifies the adjustments and calculations for determining Oklahoma taxable income and adjusted gross income of the members' income to account for a PTE making the entity-level tax election.
- Creates a net operating loss in the PTE for entities making the election.

For tax years beginning on or after January 1, 2019, and prior to January 1, 2020, the PTE election must be made within sixty days of the enactment of the legislation, which is Friday, June 28, 2019.² For any tax year beginning in 2020 or later, the election may be made at any time during the previous tax year or in the first two months and fifteen days of the tax year.³

This Tax Alert provides a high-level summary of the PTE election and its impact on Oklahoma taxable income and adjusted gross income.

Entity-Level Income Tax Election for Pass-Through Entities

HB 2665 creates an election for PTEs that grants an alternative to the requirement imposed on PTEs to either withhold tax from its members or file a composite return encompassing some or all of its members.⁴ The election is made by filing Form 586 to notify the Oklahoma Tax Commission ("OTC") of the election.⁵ Per Oklahoma administrative guidance, the OTC will then issue an acknowledgment letter to the electing PTE.⁶ The PTE is required to attach the letter to its Oklahoma income tax return and must provide a copy of the letter to its members and advise them that they must attach it to their Oklahoma income tax returns as well.⁷

Under the law, an entity is generally considered to be a PTE and permitted to make the election if any of its items of income, gain, loss, and deduction are subject to being included on another person's federal income tax return pursuant to subchapter K or S of the Internal Revenue Code.⁸ However, a single-member limited liability company

¹ Pass-Through Entity Tax Equity Act of 2019, 2019 Bill Text OK H.B. 2665, Okla. Stat. tit. 68, 2355.1P. A copy of the enacted legislation is available [here](#).

² Okla. Stat. tit. 68, § 2355.1P-4.H.

³ *Id.*

⁴ Okla. Stat. tit. 68, § 2355.1P-4.F.

⁵ *Pass-Through Entity Tax Equity Act of 2019 – General Information*, Oklahoma Tax Commission (May 28, 2019), https://www.ok.gov/tax/Businesses/Tax_Types/Income_Tax_Corporate/Pass-Through_Entity_Tax_Equity_Act_of_2019.html.

⁶ *Id.*

⁷ *Id.*

⁸ Okla. Stat. tit. 68, § 2355.1P-2.6.

may only make the election if it elects to be treated as an S corporation under federal income tax law so it is no longer a disregarded entity whose activities are reported on its owner's federal income tax return.⁹

Once an election is made, the PTE first computes its Oklahoma net entity income or loss, which is the positive or negative sum or the PTE's Oklahoma items of income, gain, loss and deduction.¹⁰ If the PTE has Oklahoma net entity income, it computes the tax due as described in greater detail below.¹¹ If the PTE has Oklahoma net entity loss, the loss may be carried back and carried forward in the same manner as federal net operating losses under IRC section 172 (*i.e.*, losses may not be carried back and may be carried forward indefinitely for tax years beginning on or after January 1, 2018).¹²

To compute the tax if the PTE has Oklahoma net entity income, the PTE multiplies each member's distributive share of the PTE's Oklahoma net entity income by: 1) the highest Oklahoma marginal income tax rate imposed on natural persons if the member is an individual, trust, or estate; 2) six percent (6%) if the member is a corporation, a PTE, or a financial institution; or 3) the highest Oklahoma marginal income tax rate that would be applicable to the income or gain absent this election if the member is an exempt entity under Okla. Stat. tit. 68, § 2359.¹³ The PTE then aggregates the amounts calculated for each member to calculate the total tax due under the election.¹⁴

The PTE tax is due and payable on the same date as the PTE's Oklahoma income tax return.¹⁵ Estimated tax payments are required in the same manner as the Oklahoma income tax under Okla. Stat. tit. 68, § 2385.9 for tax years beginning in 2020.¹⁶ A nonresident individual member is not required to file an Oklahoma income tax return if the member's only income allocable or apportionable to Oklahoma is from one or more electing PTE, which files and pays the PTE tax under these provisions.¹⁷

HB 2665 states that an election is binding on the electing PTE and all members until revoked by the PTE by completing and filing Part 2 of Form 586, pursuant to procedures to be established by the OTC.¹⁸ However, an election by one PTE is not binding on any others and each PTE must make its own election.¹⁹ If a PTE revokes the election within two months and fifteen days of the start of its tax year, the effective date for the revocation is the first day of the tax year.²⁰ If the election is made after that time, the effective date for the revocation is the first day of the following tax year.²¹ The bill also provides the OTC may establish procedures to revoke the PTE election, if the PTE does not pay the tax when due.²²

Modifications to Determination of Oklahoma Taxable Income and Adjusted Gross Income for Members

HB 2665 also modifies the calculations of Oklahoma taxable income and adjusted gross income for the members of an electing PTE for members to subtract their distributive share of any item or gain subject to the PTE entity-level tax from their Oklahoma taxable income and adjusted gross income, and add items of loss or deduction. To effectuate this change, HB 2665 amends several Oklahoma statutes by adding language detailing treatment when a PTE makes a valid election. A prominent amendment included in the bill is a new subsection added to the determination of Oklahoma taxable income and Oklahoma adjusted gross income at Okla. Stat. tit. 68, § 2358.A.11.²³

⁹ *Pass-Through Entity Tax Equity Act*, Frequently Asked Questions, Oklahoma Tax Commission (last visited June 4, 2019), <https://www.ok.gov/tax/faqs.html#c579>.

¹⁰ Okla. Stat. tit. 68, § 2355.1P-4.A.1., -2.5.

¹¹ Okla. Stat. tit. 68, § 2355.1P-4.A.1.

¹² Okla. Stat. tit. 68, § 2355.1P-4.D.; § 2358.A.3.b.

¹³ Okla. Stat. tit. 68, § 2355.1P-4.A.1.

¹⁴ Okla. Stat. tit. 68, § 2355.1P-4.A.2.

¹⁵ Okla. Stat. tit. 68, § 2355.1P-4.C.

¹⁶ *Id.*

¹⁷ Okla. Stat. tit. 68, § 2355-1P.E; -1P.G.

¹⁸ Okla. Stat. tit. 68, § 2355.1P-4.H; *Pass-Through Entity Tax Equity Act*, Frequently Asked Questions, Oklahoma Tax Commission (last visited June 4, 2019), <https://www.ok.gov/tax/faqs.html#c579>.

¹⁹ *Pass-Through Entity Tax Equity Act of 2019 – General Information*, Oklahoma Tax Commission (May 28, 2019), https://www.ok.gov/tax/Businesses/Tax_Types/Income_Tax_Corporate/Pass-Through_Entity_Tax_Equity_Act_of_2019.html.

²⁰ Okla. Stat. tit. 68, § 2355.1P-4.H.

²¹ Okla. Stat. tit. 68, § 2355.1P-4.H.

²² Okla. Stat. tit. 68 § 2355.1P-4.G

²³ 2019 Bill Text OK H.B. 2665, Sec. 5.

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Under this new provision, items of income or gain and items of loss or deduction are subtracted from or added to Oklahoma taxable income or adjusted gross income, respectively, of an electing PTE if those items would be allocated to a member or indirect member.²⁴ The additions or subtractions for specific items are only made if the electing PTE accounted for the item in its Oklahoma net entity income or loss computation and any attributable tax has been paid.²⁵

Considerations

A PTE election for tax years beginning in 2019 must be made or revoked by Friday, June 28, 2019. Eligible PTEs should review current filing methodology and consult with their tax advisors to evaluate electing into the new entity-level tax regime, as compared to the composite return or withholding regimes. Clients considering making the PTE election should consult with their advisors to determine financial statement implications related to the election, if any. Additional possible considerations in making the PTE election include, but are not limited to, tax-exempt partners or partners not subject to Oklahoma income tax, use of depletion deductions, credit utilization because credits generated by the PTE no longer pass through to members, and sales of interests in a publicly-traded partnership.

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²⁴ Okla. Stat. tit. 68, § 2358.A.11.

²⁵ Okla. Stat. tit. 68, § 2358.A.11.