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MULTISTATE INCOME/FRANCHISE TAX

California enacts changes to pass-through entity tax

Tax Alert

Overview

On February 9, 2022, the California governor signed Senate Bill 113 (S.B. 113), which includes certain technical corrections to California's recently enacted elective pass-through entity tax (see our previously issued Tax Alert for more details about this tax). An identical bill, Assembly Bill 87 (A.B. 87), was introduced, however, S.B. 113 is the legislation the California Legislature chose to enact.

This Tax Alert summarizes some of the provisions of S.B. 113.

California S.B. 113

Effective for tax years beginning on or after January 1, 2021:

- Allows the pass-through entity tax credit to reduce the net income tax below the tentative minimum tax.
- Includes guaranteed payments to consenting qualified taxpayers in the qualified entity tax base for purposes of computing the pass-through entity tax.
- Includes single member limited liability companies ("SMLLCs") owned by individuals, estates, or trusts in the definition of a qualified taxpayer (allowing these SMLLCs to consent and for their owners to receive a pass-through entity tax credit).
- Includes entities that have partnerships as partners in the definition of a qualified entity, allowing them to make the pass-through entity tax election. However, partnerships are not qualified taxpayers, which means their income is not included in the pass-through entity tax base and the partnership does not receive a pass-through entity tax credit.

Effective for tax years beginning on or after January 1, 2022:

- Re-orders credit usage to allow for use of other state tax credits before the pass-through entity tax credit for tax years beginning on or after January 1, 2022 and before January 1, 2026.

- Eliminates the $5 million business credit limit for tax years beginning on or after January 1, 2022.
- Removes the net operating suspension for tax years beginning on or after January 1, 2022.

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