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MULTISTATE INCOME/FRANCHISE TAX

Indiana **enacts pass-through entity tax election**

Tax Alert

Overview

On February 22, 2023, the Indiana governor signed Senate Bill 2 (S.B. 2) into law. Under the legislation, pass-through entities may make an annual election to pay an entity level state tax for taxable years beginning after December 31, 2021.

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

Pass-through entity tax election

- Effective for taxable years beginning after December 31, 2021.
- Eligible pass-through entities include S corporations and partnerships.
- The election is an annual election and shall be made in the form and manner prescribed by the department.
- For taxable years beginning after December 31, 2021, and before January 1, 2023, the election must be made after March 31, 2023, and before August 31, 2024. The pass-through entity tax shall be paid and filed in conjunction with and consistent with the filing of the composite tax return.
- For taxable years beginning after December 31, 2022, the election may be made at any time during the taxable year or after the end of the taxable year, but not later than the earlier of:
    - The due date of the electing entity's return for the taxable year, including any extensions; or
    - The date the electing entity files its return for the taxable year.
- The election is irrevocable once made unless the election is made for a taxable year beginning after December 31, 2021, but before January 1, 2023, for which the election can be made on an amended return if the electing entity filed a return on or before April 18, 2023.

Pass-through entity tax calculation

- The entity level tax is imposed on the adjusted gross income of an electing entity which shall be the aggregate of the direct owners' share of the electing entity's adjusted gross income.
- Adjusted gross income of a pass-through entity means the aggregate of items of ordinary income and loss, modified for separately stated items of income and gains, separately stated items of deductions or losses, and any modifications to adjusted gross income required for both individual and corporations.
- The entity level tax is imposed on each nonresident direct owner’s share of the entity’s adjusted gross income after allocation and apportionment.
- The electing entity shall determine whether the entity level tax is imposed on each resident direct owner’s share of the entity’s adjusted gross income either before allocation and apportionment or after allocation and apportionment. The electing entity must use the same method for all direct resident owners.
- The tax rate for the pass-through entity level tax is equal to the Indiana individual income tax rate under Indiana Code section 6-3-2-1(b) applicable for that taxable year, which is currently 3.23% for taxable years beginning after December 31, 2016, and before January 1, 2023.
- The entity level tax shall be due on the same dates as the entity return for the taxable year is due. Estimated payments may also be due as discussed in more detail below.

Pass-through entity tax credit

- Each owner of an electing pass-through entity is entitled to a refundable credit in the amount of tax credited to the entity owner.
- The owners shall remain liable for adjusted gross income tax on their share of the electing entity's adjusted gross income but with the credit provided.

Credit for taxes paid to other states

- For purposes of determining the credit for taxes paid to other states available to Indiana residents under Indiana Code section 6-3-3-3, tax paid by an electing pass-through entity to another state which is substantially similar to the Indiana pass-through entity tax shall be considered tax paid by the owner in an amount equal to that portion of the pass-through entity tax representing the pass-through entity tax attributed to the owner.

Other considerations

- Electing pass-through entities are required to make quarterly estimated tax payments in the same manner as applicable to corporations. However, an electing entity is not required to make estimated tax payments for taxable years ending on or before June 30, 2023.
- Nonresident withholding required on behalf of nonresident owners of an electing entity is reduced by the partner’s share of pass-through entity tax credit.

Get in touch

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Have a question relating to this or any other pass-through entity tax regime? Reach out to one of our national multistate pass-through entity tax specialists.

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