CUMMINGS & LOCKWOOD LLC

# IRS OPENS THE DOOR TO PASS-THROUGH WORKAROUND FOR SALT DEDUCTIONS

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The Tax Cuts and Jobs Act ("the 2017 Tax Act") limited individuals to a $10,000 cap on deducting individual state and local taxes paid in a calendar year, starting in 2018 and set to sunset by 2026. As a reaction to the 2017 Tax Act, seven states passed laws that were designed to shift the deduction from the individual owners to the entities to avoid the cap. The seven states are: Louisiana, Oklahoma, Rhode Island, Wisconsin, New Jersey, Maryland and Connecticut. However, there has been uncertainty regarding how this cap works in conjunction with state and local taxes paid by pass through entities, such as partnerships and S corporations, that are passed through to individual owners.

The IRS announced, with Notice 2020-75, that it will be releasing proposed regulations regarding the ability of pass-through entities, such as partnerships and S corporations, to deduct state and local taxes with the intention of clarifying that state and local taxes imposed on and paid by a partnership or S corporation will generally be allowed as a deduction.

The proposed regulations are expected to make clear that the payment of state and local taxes by a pass-through entity will be reflected on a partner or S corporation shareholder's distributive or pro-rata share of non-separately stated income or loss on the owner's Schedule K-1 and will not be taken into account when applying the $10,000 individual cap.

By issuing Notice 2020-75, it seems the IRS is supporting these new state tax rules and should give taxpayers comfort that certain state and local taxes paid by the partnership or S corporation will not be subject to the individual cap.