

Virginia Tax Update on Pass-Through Entity Tax

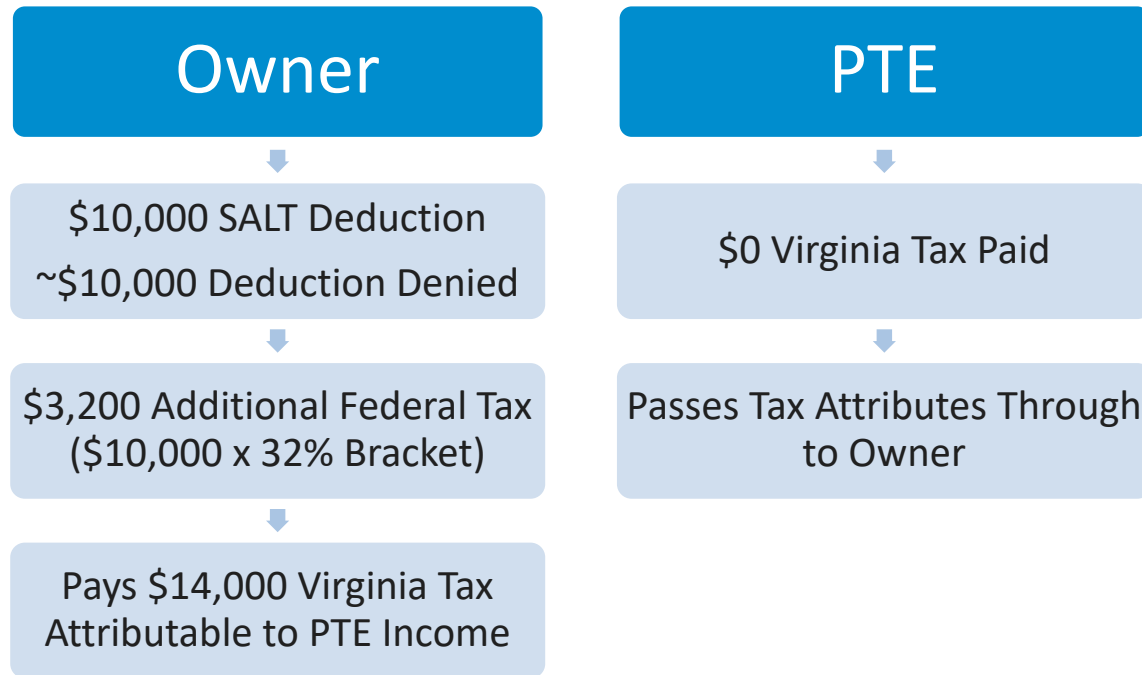
October 17, 2023

2022 Legislation (HB 1121/SB 692)

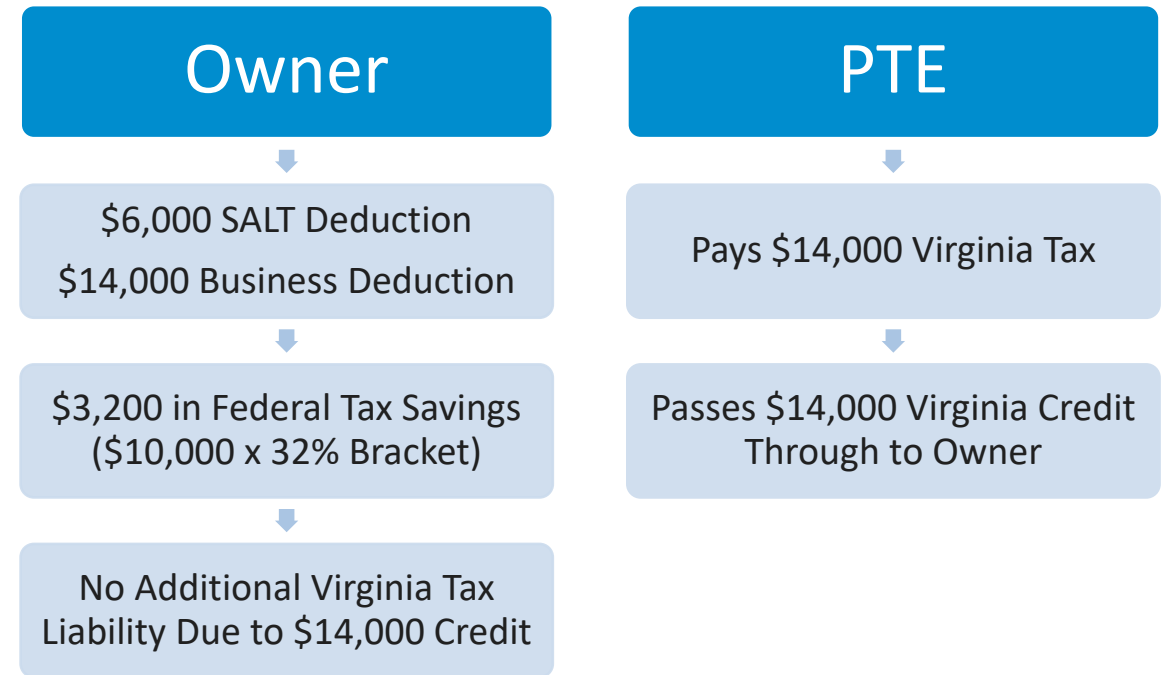
- ▶ Permits a qualifying pass-through entity to make an annual election for Taxable Years 2021 through 2025 to pay an elective entity-level income tax at a rate of 5.75%
 - ▶ Allows a corresponding refundable income tax credit for any amount of income tax paid by a PTE having Virginia taxable income if such PTE makes the election and pays the elective income tax imposed at the entity level
 - ▶ This allows the PTE to pay income tax rather than its owners and, thereby, enact a Virginia PTE workaround to the \$10,000 cap on the state and local tax deduction
- ▶ Allows individuals to claim a credit for the amount of state income tax paid by a pass-through entity under a substantially similar law in another state

How PTET Operates: Simplified Example*

No PTET Election



PTET Election



* Assumes single individual who itemizes with ~\$250,000 in PTET income owes ~\$14,000 in Virginia tax + \$6,000 in local real and personal property taxes (numbers rounded for simplicity)

2023 Legislation (HB 1456 & SB 1476)

- ▶ Removed the requirement that the PTE be 100% owned by natural persons or persons eligible to be shareholders of an S Corporation
 - ▶ “Eligible owner” defined as a direct owner who is a natural person or an estate or trust
 - ▶ Only the pro rata or distributive share of income, gain, loss, or deduction attributable to eligible owners would be subject to the PTET
- ▶ Effective July 1, 2023; however, the changes are retroactive to taxable years beginning on January 1, 2021

Guidance and Filing

- ▶ Guidance published regarding PTET:
 - ▶ [Tax Bulletin 22-6](#) published in April 2022
 - ▶ [Draft guidelines](#) published in October 2022
 - ▶ [Tax Bulletin 23-3](#) published in March 2023
 - ▶ Final guidelines will be published in fall 2023
- ▶ Filing rules:
 - ▶ The PTET return (Form 502PTET) must be filed electronically
 - ▶ PTET filing and payment requirements vary depending on the tax year

Taxable Year 2021

- ▶ 2022 legislation dictated that the retroactive TY 2021 election will be made by a date determined by Virginia Tax, no earlier than one year after the extended due date
 - ▶ PTEs can make PTET payments now or when they file their TY 2021 PTET returns
 - ▶ PTEs will be able to file their TY 2021 PTET returns during Spring/Summer 2024
- ▶ Separate guidelines will be published later with more information on how to retroactively make an election and pay the entity-level tax
- ▶ Owners will be able to claim the refundable PTET credit for TY 2021 election on their TY 2023 individual or fiduciary returns

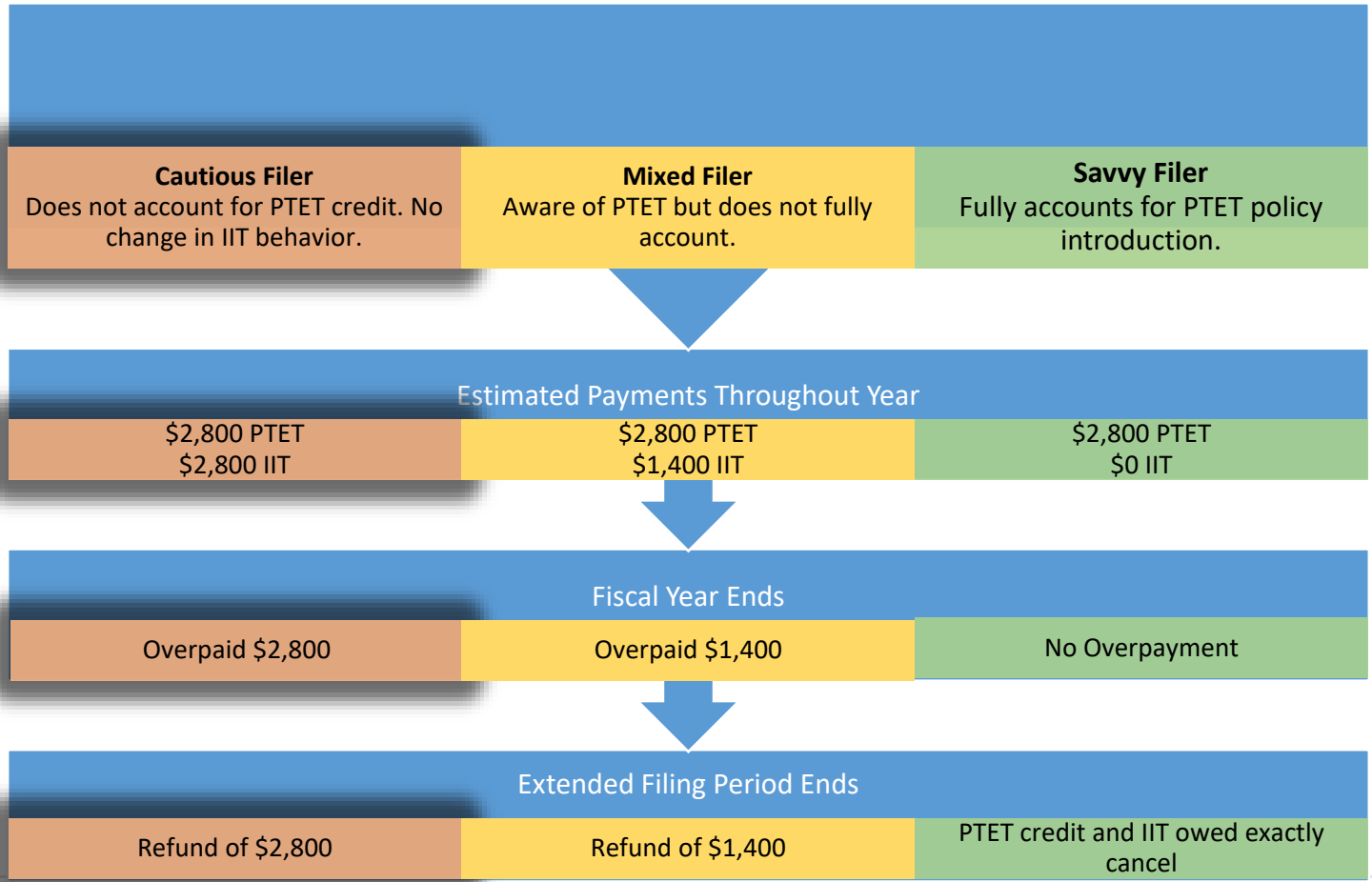
Taxable Year 2022

- ▶ Estimated payments were not required for Taxable Year 2022
- ▶ Electing PTEs were required to pay at least 90% by original due date (April 15, 2023 for calendar year filers) to avoid penalties
- ▶ Not all tax filing software vendors chose to support PTET filing
 - ▶ To address this issue, Virginia Tax will offer a new, free electronic filing option through our online application for businesses in mid-December
 - ▶ Because the filing extension deadline for calendar year filers is October 16, 2023, the minimum late filing penalty will be waived for entities that have paid and full and use this free online filing option by February 1, 2024

Taxable Year 2023

- ▶ Beginning with TY 2023, electing PTEs are required to make estimated payments, typically on a quarterly basis
- ▶ An entity must pay the elective PTET before an eligible owner can claim a refundable credit on their individual and fiduciary returns
- ▶ Free online filing option will be available for TY 2023

Example: Filer with \$50,000 in PTE Income (~\$2,800 Owed)



- ▶ Filers with PTE income behaved more cautiously than anticipated, by not accounting for PTET credits in their individual income tax (IIT) liability
- ▶ Because these taxpayers tend to file on extension, these overpayments will not be corrected until late in CY 2023