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MEMORANDUM

TO: Senator Rick Billinger, Chairman
Senate Committee on Ways and Means

FROM: Mark A. Burghart, Secretary of Revenue

RE: SALT Parity Act of 2022

DATE: February 3, 2023

I. BACKGROUND

Prior to enactment of the federal Tax Cuts and Jobs Act (TCJA), individual taxpayers were able to deduct 100% of their state and local taxes (SALT), including income and property taxes, as an itemized deduction on their federal income tax returns. The TCJA was passed in late 2017 and limited the SALT deduction to $10,000. The SALT cap will expire after tax year 2025.

II. SALT CAP WORKAROUND LOGISTICS

Many individual taxpayers receive non-wage income from passive pass-through entities such as partnerships and S corporations. The SALT cap workaround now embodied in Kansas law is achieved by imposing an entity level tax for the first time on pass-through entities at the state level. Individual business owners would then receive an individual income tax credit for the tax paid on the individual's pass-through income. The SALT cap workaround effectively shifts the tax incidence from the individual owners, where the SALT deduction would have been subject to the $10,000 cap, to the pass-through entity itself, where the SALT deduction is uncapped. It allows the state taxes to be treated as a deductible business expense on the pass-through entity tax return rather than a nondeductible itemized deduction over the $10,000 cap on the individual income tax return. The imposition of these entity-level taxes is elective. The Internal Revenue Service (IRS) approved these state-sponsored workarounds in Notice 2020-75.

III. SALT PARITY ACT

2022 H.B. 2239 included the SALT Parity Act (Act) which established an entirely new tax regime for pass-through entities. Salient provisions include the following:

- an S corporation or partnership must annually elect to be subject to tax at the entity level beginning with tax year 2022
- the election is made on Form K-120S
- the election is binding on all electing pass-through entity owners
- the tax at the entity level is equal to 5.7% of the sum of each electing pass-through entity's distributive share of the electing pass-through income attributable to the state
- the entity owners are entitled to a credit on their individual income tax returns equal to the electing pass-through entity owners direct share of the tax paid by the entity
- entities are subject to the estimated tax provisions applicable to corporations, beginning in tax year 2023

IV. A SHIFT IN TAX RECEIPTS

Pass-through entities making the election under the Act has resulted in a shift of at least $231.0 million between tax types as well as the timing for receipt of those taxes. In order to claim a deduction on their federal returns, pass-through entities had to make a corporate estimated payment postmarked no later than December 31, 2022.

The below tables show the dramatic increase in corporate estimated tax in December 2022 and January 2023.

December 2022
Estimated Tax
(millions)

	December 2021	December 2022	Difference
Individual Estimated	$25.2	$26.4	$1.2
Corporate Estimated	$131.1	$262.1	$131.0

January 2023
Estimated Tax
(millions)

	January 2022	January 2023	Difference
Individual Estimated	$180.7	$154.2	($26.5)
Corporate Estimated	$27.6	$157.9	$130.3

Total Estimated Payments
From Pass-Through Entities

	Payments	Amount
December 2022	1,795	$129.6 million
January 2023	1,978	$101.4 million
	3,773	$231.0 million

Individual income tax receipts for the months of April and October will likely be reduced as the pass-through entity owners file their Kansas Individual tax returns and claim their refundable income tax credits of about $231.0 million for their direct share of the new tax paid by the pass-through entity. These shifting tax patterns will need to be taken into account by the Consensus Revenue Estimating Group.

TAXPAYER ASSISTANCE

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