



Restoring the SALT Deduction

The Challenge

S Corporations pay state & local income taxes on their business income just like C corporations. But where C corporations always pay those taxes at the entity level, S corporations pay three different ways:

1. Entity level State and local income taxes;
2. Composite/withholding State and local income tax liability; and
3. Individual State and local income tax liability on business income.

This distinction is very important! Under the new tax law, State & local business income taxes paid at the entity level continue to be deductible, but those taxes paid at the owner level are not. Since the vast majority of S corporations pay their State & local income taxes at the owner level, they will lose the SALT deduction.

The result is a two-fold disadvantage for S corporations and other pass-through businesses:

- All pass-through businesses are disadvantaged when competing against C corporations – C-corps continue to deduct these taxes while S-corps, partnerships, and LLCs do not.
- Those pass-through businesses operating in states with high income tax rates are at a disadvantage compared to those businesses operating in states with low or no income taxes.

The Solution

States should change their laws to allow S corporations and other pass-through businesses the option of paying their taxes at the entity level. Connecticut, New Jersey, and other states are working on this solution. Specifically, they would:

- Switch the incidence of tax on pass-through business income from the owner to the entity, making those taxes deductible at the Federal level; and
- Giving those owners a credit for the taxes paid at the entity level;
- Recognize the value of similar credits paid by other states to pass-through owners.

The result of these three steps is to restore the deductibility of State & local taxes owed on pass-through business income, all at no cost to the state. To help additional states adopt this fix, we are providing the following resources:

- S-CORP Wire on SALT Fix
- S-CORP One-Pager on SALT Fix
- Model State Legislative Language
- Description of State Legislative Language