

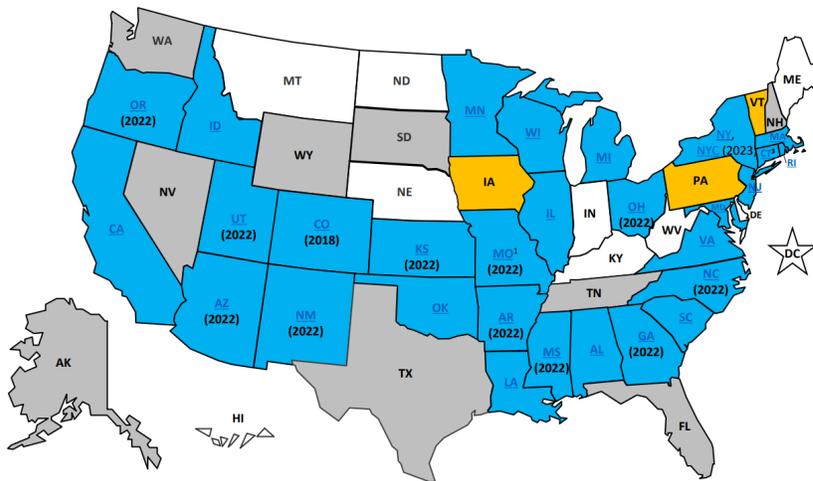
## Ohio Enacts Elective Pass-Through Entity Tax

On June 14, 2022, Governor DeWine signed Senate Bill 246, permitting Ohio to join many states that allow pass-through entities to pay state income tax at the entity level, thereby circumventing the \$10,000 itemized deduction limitation on state and local taxes at the individual level. Senate Bill 246 will become effective September 12, 2022 and is estimated to save Ohio small business owners over \$100 million in tax costs.

Currently, there are only 10 states with an owner-level personal income tax that have not proposed or enacted pass-through entity (PTE) taxes.

### States with Enacted or Proposed Pass-Through Entity (PTE) Level Tax

As of July 19, 2022



- 29 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted: [AL](#), [AR](#)<sup>1</sup>, [AZ](#)<sup>1</sup>, [CA](#), [CO](#)<sup>2</sup>, [CT](#)<sup>3</sup>, [GA](#)<sup>1</sup>, [ID](#), [IL](#), [KS](#)<sup>1</sup>, [LA](#), [MA](#), [MI](#), [MD](#), [MN](#), [MO](#)<sup>1</sup>, [MS](#)<sup>1</sup>, [NC](#)<sup>1</sup>, [NJ](#), [NM](#)<sup>1</sup>, [NY](#), [OH](#)<sup>1</sup>, [OK](#), [OR](#)<sup>1</sup>, [RI](#), [SC](#), [UT](#)<sup>1</sup>, [VA](#), [WI](#), and [WV](#)<sup>1</sup>
- <sup>1</sup> Effective in 2022 or later – on map (2022) or (2023)
- <sup>2</sup> Retroactive to 2018
- <sup>3</sup> Mandatory
- 3 states with proposed PTE tax bills: [IA](#) - [HF 2087](#), session over, not enacted; [PA](#) - [HB 1709](#), in committee; [VT](#) - [H.0527](#), session over, not enacted
- 9 states with no owner-level personal income tax on PTE income: AK, FL, NH, NV, SD, TN, TX, WA, WY
- 10 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes: DE, HI, IN, KY, ME, MT, NE, ND, VT, WV



Source: AICPA, American Institute of Certified Public Accountants

## What's the big deal?

Pass-through entities, by definition, do not pay their own tax and instead pass the taxable income through to the individual level where tax is calculated on the individual's total income (federal and state). Current federal law limits the itemized deduction for state and local taxes (including real estate taxes) paid by individuals during the year to \$10,000. By allowing the state tax to be paid at the entity level, the overall federal income flowing through to the partner, shareholder, or member-level is reduced, without being subject to the limitation, even if the entity owners don't itemize.

## How does it work?

Eligible pass-through entities may make an annual election with the filing of their entity return. This election is irrevocable and entities will make this decision each year. The partnership or S corporation pays the allocable tax and deducts the amount of income tax payments made during the year, which reduces the amount of income that ultimately passes through to its investors.

It is currently unclear how this election will be made. The election could be a checkbox on Ohio's withholding return or a new 2022 Ohio pass-through entity return could be created. For tax year 2022, the entity income tax rate is 5%, therefore, 5% of the Ohio apportioned income will be paid by the entity. Beginning in 2023, the Ohio tax rate will be reduced to 3% to match the Ohio business income tax rate.

When the partner, shareholder, or member computes their Ohio tax liability, they will be required to add-back their respective federal state tax deduction attributable to the Ohio tax. The entity owner would also be granted a refundable credit equal to their proportionate share of the tax paid.

## Who is an eligible Ohio pass-through entity and owner?

Eligible pass-through entities include partnerships, S corporations, or limited liability companies (LLCs) not taxed as a corporation. Disregarded entities, such as single member LLCs, are not permitted entities. Eligible owners include any person that is a partner, member, shareholder, or investor in an electing pass-through entity.

## Estimated Tax Payments

Electing pass-through entities will be required to file an estimated tax returns and make the following quarterly estimated tax payments:

**1st quarter** payment of 22.5% of the PTE's estimated tax liability for the tax year

**2nd quarter** payment of 45% of the PTE's estimated tax liability for the tax year

**3rd quarter** payment of 67.5% of the PTE's estimated tax liability for the tax year

**4th quarter** payment of 90% of the PTE's estimated tax liability for the tax year

We expect more guidance to be provided regarding 2022 estimated taxes ahead of Senate Bill 246's effective date in September. Since Ohio already imposes a withholding requirement for non-resident shareholders, it appears Ohio will allow pass-through entities that made composite or withholding estimates to move those funds to/from their pass-through entity account.

Resident and non-resident investors in Ohio businesses may benefit from Senate Bill 246. We will be reviewing our clients' entity ownership to evaluate the best course of action. If you have questions about the election or the corresponding refundable credit and how it might pertain to a specific scenario, please do not hesitate to contact us.

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Information as of July 29, 2022

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