Tax Alert

Oklahoma Enacts SALT Deduction Limit Work-Around for Pass-through Entity Owners

By Sheppard F. Miers, Jr.
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(*updated May 29, 2019 to reflect the published rules)*

The Oklahoma Legislature has enacted HB 2665, the Pass-Through Entity Tax Equity Act of 2019 (Act), intended to result in Oklahoma income tax imposed on income of individual owners of a pass-through entity (e.g. partnership, limited liability company or S corporation) not being subject to the federal income tax $10,000 state and local tax (SALT) deduction limit enacted by the Tax Cuts and Jobs Act (TCJA).

The Act provides that for tax years beginning on or after January 1, 2019, a pass-through entity may elect to pay a pass-through entity tax on income that would otherwise be taxable to members of the pass-through entity holding an ownership interest in it. If the pass-through entity makes this election and pays the pass-through entity tax on the entity's income, an adjustment will exclude the distributive shares of the entity's income from Oklahoma taxable income of the entity's members.

The Act is intended to provide a "work-around" of the federal $10,000 SALT deduction limit for individuals. The federal $10,000 SALT deduction limit is provided under section 164(b)(6) of the Internal Revenue Code (Code), as amended by the TCJA, for taxable years beginning after December 31, 2017 and before January 1, 2026. Under the Act, because an electing pass-through entity will pay a pass-through entity tax, rather than its individual owners paying Oklahoma income tax on income of the entity, the federal $10,000 SALT deduction limit presumably will not apply.

The Act provides that the tax rate for the pass-through entity tax paid by an electing pass-through entity is to be based upon the classification of the members of the entity to whom the entity's income is allocable. The rate will be the highest Oklahoma marginal individual income tax rate if the entity is taxed on the Oklahoma distributive share of income of members of the entity that are individuals, trusts or estates; and the rate will be 6% on the Oklahoma distributive share of income of members of the entity that are a corporation (not classified as an S corporation) or another pass-through entity.

The provisions of the Act are effective on and after April 29, 2019, the date of its approval by the Governor.

The Act provides for procedures to be prescribed by the Oklahoma Tax Commission for a pass-through entity to elect to become an electing pass-through entity and pay the pass-through entity tax on the entity's income. The Oklahoma Tax Commission has published on its website guidance and a Pass-Through Entity Election Form for a pass-through entity to file to become an electing pass-through entity.

An election for the 2019 taxable year is required to be filed with the Oklahoma Tax Commission within sixty (60) days of enactment of the Act and by June 28, 2019.

The Internal Revenue Service (IRS) has taken a position that opposes a state law enacted to work around the federal $10,000 SALT deduction limit. The IRS issued proposed regulations in 2018 providing that charitable contribution deductions for contributions to or for a state made by individuals as authorized by the state law, as a form of work-around of the federal $10,000 SALT deduction limit, will generally not be given effect by the IRS for federal income tax purposes. Commentary has been published indicating the IRS may be considering issuing additional regulations or guidance that might challenge or limit use of a pass-through entity work-around like that provided for by Oklahoma in the Act and similar laws that have been considered and enacted by other states since the federal $10,000 SALT deduction limit was added to the Code by the TCJA.

If you would like to discuss the Act, the federal $10,000 SALT deduction limit or other tax law matters please contact your GableGotwals attorney, or a member of our Tax Law Practice Group which includes:

Sheppard F. Miers, Jr.
smiers@gablelaw.com
Direct dial: 918-595-4834

John D. Russell
jrussell@gablelaw.com
Direct dial: 918-595-4806

David B. McKinney
dmckinney@gablelaw.com
Direct dial: 918-595-4860

James M. Scears
jscears@gablelaw.com
Direct dial: 918-595-4879