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Pending Changes to Illinois Tax Laws Include SALT Workaround

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UPDATE 8/30/2021: All of the pending changes discussed in this article have been approved by Gov. J.B. Pritzker.

Illinois lawmakers have approved legislation that is both good news and bad news for Illinois taxpayers. The good news is that, if approved by Gov. Pritzker, Illinois taxpayers will be able to take advantage of a workaround to the federal \$10,000 state and local tax (SALT) deduction cap. The bad news is that, if approved by Gov. Pritzker, some tax benefits currently available to businesses will be eliminated.

Let's start with the good news.

SALT WORKAROUND

Background

Prior to the 2017 tax law changes effectuated by the Tax Cuts and Jobs Act (TCJA), an individual could take an unlimited deduction on its federal income tax return for SALT payments. However, the TCJA capped such SALT tax deduction at \$10,000 for tax years beginning after December 31, 2017, and before January 1, 2026.

Senate Bill 2531, anticipated to be signed by Gov. Pritzker, provides owners of partnerships or S corporations with a workaround to the federal \$10,000 SALT deduction cap effective for tax years ending on or after December 31, 2021, and beginning before January 1, 2026.

Under the legislation, a partnership or S corporation (each a "pass-through entity") may elect to pay Illinois income tax at the entity level (which will be allowed as a deduction by the pass-through entity on its federal income tax return), and each owner of the pass-through entity may claim a credit on its Illinois individual income tax return equal to its share of the amount paid by the pass-through entity, effectively bypassing the \$10,000 SALT deduction cap.

The IRS issued a notice in 2020¹ blessing this type of workaround late last year. Approximately a dozen other states have enacted similar workarounds.

How the Workaround Works

A pass-through entity must make an annual irrevocable election (PTE election) to take advantage of this workaround. The electing pass-through entity pays a 4.95% Illinois income tax (PTE tax) on its federal taxable income, with certain modifications (Federal Taxable Income), which is the same tax rate applicable to Illinois individual taxpayers. The electing pass-through entity may deduct the PTE tax in computing its taxable income for federal purposes in the year the PTE tax payment is made, which will reduce each owner's distributive share of income from the pass-through entity. Each owner of the electing pass-through entity is entitled to a

credit against its Illinois individual income tax equal to 4.95% of its distributive share of the pass-through entity's Illinois taxable income (Federal Taxable Income, plus the PTE tax deducted by the pass-through entity), up to the owner's share of the PTE tax.

For example, Partnership X has two equal partners and makes the PTE election for calendar year 2022. Partnership X has \$1,000,000 of Federal Taxable Income before deducting the PTE tax. Partnership X pays a \$49,500 PTE tax, and each partner receives a \$24,750 credit against its Illinois individual income tax (4.95% times \$500,000, each partner's distributive share of Partnership X's Illinois taxable income), which is equal to each partner's Illinois individual income tax liability. Partnership X's Federal Taxable Income is reduced by \$49,500 in the year the \$49,500 PTE tax is paid, which will also reduce each partner's federal taxable income by \$24,750.

An electing pass-through entity is required to pay quarterly estimated taxes for the taxable year for which it makes the election if the entity can reasonably expect that the estimated tax will exceed \$500.

An electing pass-through entity is liable for the PTE tax. However, if the entity fails to pay any portion of the tax, its owners are liable for the unpaid amount, including penalties and interest (based on their proportional ownership) of the entity.

ELIMINATION OF CERTAIN TAX BENEFITS

And here's the bad news: The FY2022 Budget Implementation Act (BIA), pending Gov. Pritzker's approval, will make certain changes to current tax benefits.

Decoupling from bonus depreciation. One of the changes made by the TCJA was to allow a 100% bonus depreciation for property acquired and placed in service after September 27, 2017, and before January 1, 2023, by any business. Prior to the BIA, Illinois required taxpayers to reverse the effects of 30, 40 or 50 percent bonus depreciation allowed under federal law by adding back the bonus depreciation amount in determining Illinois taxable income, but it did not require the reversal of the 100% bonus depreciation. Effective for property acquired on or after December 31, 2021², Illinois will decouple itself from the federal law by requiring the amount of all bonus depreciation to be added back in determining Illinois taxable income.

Cap on corporate NOLs. For any taxable year ending on after December 31, 2021, and prior to December 31, 2024, a corporation's carryover deduction of its net operating losses (NOLs) are limited to \$100,000 for such taxable year. This change is only applicable to corporations and does not apply to NOLs from pass-through entities (including S corporations) or sole proprietorships.

Corporate franchise tax extended. Corporations are subject to an annual franchise tax of 0.1% on the value of either the corporation's property or its total paid-in capital. The corporate franchise tax was set to be phased out, with increasing exemptions each year, and repealed in full on December 31, 2025. Now, the phase out and repeal of the corporate franchise tax have been eliminated, although the first \$1,000 of the corporate franchise tax continues to be exempt.

GILTI and foreign sourced dividends. In determining a corporation's taxable income, Illinois previously followed the federal treatment of allowing a deduction for a corporation's global intangible low-taxed income (GILTI) and certain foreign sourced dividends. For taxable years ending on or after June 30, 2021, Illinois will treat GILTI and certain foreign sourced dividends like domestic dividends, thereby eliminating the deduction currently allowable to corporations.

If you have any questions about this proposed legislation or how it applies to your income tax situation, please contact Jennifer Tolsky or Ilana Bley, or any member of Gould & Ratner's [Tax Planning Practice](#).

¹ [Notice 2020-75](#)

² This provision is also effective for property that is acquired prior to December 31, 2021 but is placed in service on or after December 31, 2021.