

# State and Local Taxes Paid by Partnerships and S Corporations

## Cross References

- Notice 2020-75

The Tax Cuts and Jobs Act (TCJA) limited an individual's state and local tax deduction to \$10,000 (\$5,000 MFS). State and local taxes subject to this limitation include:

- Real property taxes,
- Personal property taxes,
- Income, war profits, and excess profits taxes, and
- General sales taxes.

This limitation applies to tax years beginning after December 31, 2017, and before January 1, 2026. The limitation does not apply to taxes imposed by a foreign country or to taxes paid and incurred in carrying on a trade or business.

In enacting this limitation, Congress stated that taxes imposed at the entity level, such as a business tax imposed on a partnership or S corporation, that are reflected in a partner's or S corporation shareholder's distributive or pro-rata share of income or loss on a Schedule K-1 will continue to reduce such partner's or shareholder's distributive or pro-rata share of income as under present law.

Certain jurisdictions have enacted, or are contemplating the enactment of tax laws that impose either a mandatory or elective entity-level income tax on partnerships and S corporations that do business in their jurisdiction or have income derived from or connected with sources within their jurisdiction. In certain instances, the jurisdiction's tax law provides a corresponding or offsetting, owner-level tax benefit, such as a full or partial credit, deduction, or exclusion.

As a result, the IRS has issued a notice stating that it intends to issue proposed regulations to provide certainty to individual owners of partnerships and S corporations in calculating their state and local income tax deduction limitations on their individual income tax returns.

The notice states that if a partnership or an S corporation makes a payment to a state, a political subdivision of a state, or the District of Columbia to satisfy its liability for income taxes imposed by such state or local government, then the partnership or S corporation is allowed a deduction for such payment in computing its taxable income. The deduction is allowed without regard to whether the imposition of and liability for the income tax is the result of an election by the entity or whether the partners or shareholders receive a partial or full deduction, exclusion, credit, or other tax benefit that is based on their share of the amount paid by the partnership or S corporation.

The tax payment made by a partnership or an S corporation does not constitute an item of deduction that a partner or an S corporation shareholder takes into account separately in determining the partner's or shareholder's own federal income tax liability. Instead, the tax payment is reflected in a partner's or an S corporation shareholder's distributive or pro-rata share of nonseparately stated income or loss reported on a Schedule K-1. Thus, such a tax payment made to a state or local government by the partnership or S corporation is not taken into account in applying the \$10,000 (\$5,000 MFS) limitation to any individual who is a partner in the partnership or a shareholder of the S corporation.

The guidance in IRS Notice 2020-75 and corresponding proposed regulations is effective for partnership and S corporation tax years ending after December 31, 2017.