



DEPARTMENT OF AUDITS AND ACCOUNTS

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February 15, 2021

Honorable Shaw Blackmon
Chairman, House Ways and Means
133 State Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill 149 (LC 43 1869)

Dear Chairman Blackmon:

The bill modifies the tax treatment of S-corporation and partnership income. It allows entities each year to make an irrevocable election to pay the tax due on the income earned by the entity at the entity level at the rate of 5.75 percent. If this election is made, the shareholders would not recognize this income on their individual returns.

Under the bill, the entity or its shareholders would not be eligible for credits under section 48-7-28 or deduction specified under section 48-7-27(d). When computing net income subject to tax, the entity would not be allowed any deduction for taxes based on or measured by gross or net income or any other variant thereof. The provision is only applicable to an S-corp or partnership that is 100 percent directly owned and controlled by natural persons. The legislation is effective for tax years beginning on or after January 1, 2022.

Impact on State Revenue

Georgia State University's Fiscal Research Center found that the bill would have no impact on state revenue. The bill's provisions ultimately impact a taxpayer's federal return by impacting the \$10,000 limit on state and local tax deductions. However, the bill does not allow a pass-through entity to claim the deduction for taxes paid on a state tax return. The total level of deductions taken against state income tax does not change, and state revenue is not affected.

Impact on State Expenditures

The Department of Revenue (DOR) would have annual and one-time costs associated with the bill. DOR noted that auditing just 1% of affected returns would require three additional auditors at an annual cost of \$246,470. One-time costs of \$4,050 would be incurred for computers and phones.

Sincerely,

A handwritten signature in blue ink, appearing to read "Greg S. Griffin".

Greg S. Griffin
State Auditor

A handwritten signature in black ink, appearing to read "Kelly Farr".

Kelly Farr, Director
Office of Planning and Budget

GSG/KF/mt

Analysis by the Fiscal Research Center

The legislation allows for the election of entity level taxation for qualified Subchapter S corporations and partnerships. This provision is estimated to have no revenue effect on state income tax receipts.

The election creates the possibility for a workaround for the \$10,000 SALT limitation for the eligible pass-through entities on their federal taxes. Under current law, pass-through entities in Georgia are not subject to tax, but instead pass their income and deductions through to the shareholders or partners of the entity who then include their share of the income and deductions on their personal income tax returns and are taxed at graduated rates up to 5.75 percent. In the case of resident shareholders and partners, all pass-through entity income is subject to tax. In the case of non-resident shareholders and partners, only pass-through income apportioned to Georgia is subject to tax.

Under the Tax Cuts and Jobs Act of 2017 (TCJA), individual income tax filers are subject to a cap of \$10,000 on the deduction for state and local taxes (SALT). Businesses, on the other hand, may deduct these taxes as a business expense and are not subject to a limitation. By moving the tax liability of pass-through income to the entity level, individuals are able to reduce the amount of state and local tax reported on their personal returns. Thus, this provision provides for a workaround for federal purposes for the cap on SALT deductions in the case of shareholders and partners of pass-through entities that qualify for this election.

Recent guidance issued by the IRS in November of 2020 clarifies that such an entity-level tax could be allowed as a deduction by the pass-through entity. Several states have, since passage of TCJA, adopted an entity-level tax, the first being Connecticut, which adopted it for tax years beginning January 1, 2018. Rhode Island, Louisiana, New Jersey, Oklahoma, and Wisconsin have also adopted similar provisions. In addition, Tennessee, DC, New Hampshire, and New York City have levied entity-level taxes for many years prior to the passage of TCJA.

Although the legislation allows for this workaround for federal tax purposes, the legislation also denies the pass-through entity's ability to claim, on the entity's Georgia return, the deduction for taxes paid (that is, it would have to be added back to the entity's taxable income on the Georgia return). Thus, on the whole, the total level of deductions taken against state income tax does not change and revenue effect for the state is not affected.