

NEBRASKA ENACTS PASS-THROUGH ENTITY TAX LAW

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ON MAY 31, 2023, GOVERNOR JIM PILLEN SIGNED LB754 into law. Among other changes, LB754 adds a retroactive to 2018 Nebraska pass-through entity tax, or PTET, law.

By way of background, the Tax Cuts and Jobs Act of 2017 generally limits the amount of state and local taxes that taxpayers can annually deduct from their federal income to \$10,000. This limitation is commonly referred to as the “SALT cap.” The SALT cap has stung many owners of Nebraska’s small and family-owned businesses who pay more than \$10,000 in property and state income taxes, dampening the relief intended by the 2017 federal tax bill.

PTET laws allow pass-through entities (entities taxed as partnerships or subchapter S corporations) to voluntarily elect to pay state income taxes on behalf of their owners. These laws, which have been approved by the Internal Revenue Service (Notice 2020-75) and adopted by almost all states that impose an income tax, avoid the impact of the SALT cap by shifting the tax from the business owner to the owner’s business, effectively creating a deductible business expense that is not impacted by the SALT cap.

The impact of Nebraska’s PTET law impact will be company specific, but for many business owners, Nebraska’s PTET law could be worth anywhere from \$29.60 to \$37 of federal income tax savings for every \$100 of Nebraska business income taxes paid. Businesses that are not eligible to voluntarily elect include single-member LLCs (unless they elect to be treated as a subchapter S corporation), sole proprietorships, trusts, and non-profit corporations.

Like most other states, if a pass-through entity elects to voluntarily pay Nebraska income taxes on behalf of its owners, it is on behalf of all its owners. An owner of the pass-through entity does not have the ability to “opt-out” if the pass-through entity makes the PTET election.

Net operating losses are not allowed to be used against pass-through entity taxable income. Further, to avoid state taxes being deductible from state income, the Nebraska PTET expense will be added back to taxable income for Nebraska state income tax purposes.

Nebraska’s PTET tax rate is the highest individual rate (tax rates were changed in LB754). Following LB754’s enactment, Nebraska’s highest individual tax rates are scheduled to be:

- ▶ 6.84% for 2018-2022;
- ▶ 6.64% for 2023;
- ▶ 6.44% for 2024;
- ▶ 5.20% for 2025;
- ▶ 4.55% for 2026 (note that the SALT cap is scheduled to expire at the end of 2025); and
- ▶ 3.99% for 2027 and subsequent years.

The PTET credit to owners is 100% of their distributive share of the PTET tax paid. The PTET credit is a refundable credit, where the owners receive the full amount to offset their Nebraska income tax due and could increase their Nebraska income tax refund. Nonresident individual owners of an electing pass-through entity with no other Nebraska activity would not be required to file a nonresident Nebraska income tax return. As for tiered structures, where a lower tier entity receives a PTET credit, the credit must be redistributed to its owners.

When making an election, it is important to consider the effect of a PTET election on owners’ estimated payments and nonresident withholding requirements. While the PTET statute does not require estimated payments by electing pass-through entities until 2024, in order to take the deduction for taxes paid in 2023 (depending on whether the pass-through entity is a cash or accrual basis taxpayer), the pass-through entity must make its PTET payment in 2023. If a pass-through entity elects and pays its PTET for tax year 2023, the pass-through owners could avoid having to make

further individual estimated Nebraska tax payments or may be able to reduce their third and fourth quarter estimated payments. The owners' estimated installments and any related penalty is reduced or eliminated due to the PTET credit received from the electing pass-through entity.

In addition, Nebraska's PTET law, like Colorado's, is retroactive to 2018. Pass-through entities will be able to voluntarily elect to pay prior year income taxes during 2023, 2024, or 2025, which will generate a federal income tax deduction for the year in which taxes for the prior years are paid. A pass-through entity's payment of these taxes will also generate a refundable credit for its owners equal to their pro rata or distributive share of the Nebraska income tax paid by the electing pass-through entity.

The retroactive application of Nebraska's PTET law will require a method to be implemented by the Nebraska Department of Revenue in order for pass-through entities to elect to pay Nebraska income taxes for tax years 2018-2022.

The statute provides that the individuals will claim the retroactive refund in the *time and manner* as prescribed by the tax commissioner. The statute itself does not specifically require the filing of separate amended returns for each year the pass-through entity makes a retroactive election. The authors believe the most efficient manner to implement the retroactive application of Nebraska's PTET law is to follow the Colorado Department of Revenue and use a "composite-like" form that allows a pass-through entity to elect

and submit payment. Such a form would not permit changes to previous years other than those directly related to the retroactive pass-through entity election. With this approach, the current owners would claim the PTET credit in the year the pass-through entity elects to pay the prior year income taxes. This approach, as opposed to one that requires amended returns, would avoid multiple amended returns that would have to be prepared by taxpayers and processed by the Nebraska Department of Revenue and would also make it much easier for the current owners of many pass-through entities that have undergone ownership changes since 2018 to benefit from the retroactive application of the PTET law. ◀



Jeff Schaffart and Nick Bjornson, both business and tax attorneys at Koley Jessen, were deeply involved in the passage of Nebraska's PTET law.

Among other actions, they drafted and submitted proposed legislation to state senators, collaborated with the Omaha and Nebraska Chambers to have this law added as an amendment to LB754, testified in front of the Nebraska Unicameral's Revenue Committee in support of the PTET law, and published a commentary piece in the Nebraska Examiner advocating for adoption of a PTET law. For further details about Nebraska's PTET law or to get in touch with them, email jeff.schaffart@koleyjessen.com and nick.bjornson@koleyjessen.com, respectively.



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