



## **Bill Analysis**

Author: Portantino

Sponsor:

Bill Number: SB 1192

Related Bills: See Legislative  
History

Introduced: February 14, 2024  
Amended: April 2, 2024

### **SUBJECT**

Small Business Relief Act (SBRA)

### **SUMMARY**

This bill would extend the sunset date of provisions related to the pass-through entity (PTE) elective tax, under the SBRA, and the PTE elective tax credit, under the Personal Income Tax Law (PITL) by two years.

### **RECOMMENDATION**

No position.

### **SUMMARY OF AMENDMENTS**

The April 2, 2024, amendments extended the changes to the calculation of the Other State Tax Credit to January 1, 2028, and corrected the reference to Internal Revenue Code (IRC) section 164(b)(6) for taxable years through 2025 inclusive (rather than through 2027 inclusive).

This is Franchise Tax Board's (FTB) first analysis of the bill.

### **REASON FOR THE BILL**

The reason for the bill is to extend the operative dates under the SBRA and the PTE elective tax credit.

### **ANALYSIS**

The bill would extend the existing sunset dates for the SBRA and the PTE elective tax credit of January 1, 2026, to allow these provisions to be operative for taxable years beginning before January 1, 2028. The SBRA would remain in effect until January 1, 2028, unless the federal state and local tax (SALT) limitations are repealed.

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### *Effective/Operative Date*

This bill would be effective January 1, 2025, and specifically operative for taxable years beginning before January 1, 2028. These provisions could also expire earlier upon the repeal of the federal SALT limitations.

### *Federal/State Law*

#### *Federal Law*

Federal law, prior to 2018, allowed individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses were considered miscellaneous itemized deductions and only the portion that exceeded 2% of adjusted gross income could be deducted. Also, itemized deductions were further limited for high-income taxpayers.

Federal law, for taxable years 2018 through 2025, under the Tax Cuts and Jobs Act, changed several itemized deductions, including:

- Suspending both the deduction for miscellaneous itemized deductions and the overall limitation on itemized deductions for high-income taxpayers for taxable years beginning after December 31, 2017, and before January 1, 2026.
- Limiting the total deduction for state and local income, sales, and property taxes to \$10,000 (\$5,000 if married filing separate). This is commonly referred to as the SALT deduction limitation.

The Internal Revenue Service (IRS) issued Notice 2020-75, dated November 9, 2020, which provides that the Department of Treasury and the IRS intend to issue regulations clarifying that tax payments made at the entity level would not be subject to the SALT deduction limitation applicable to partners and shareholders, who itemize deductions.

Specifically, the announcement said the proposed regulations would:

“...clarify that State and local income taxes imposed on and paid by a partnership or an S corporation on its income are allowed as a deduction by the partnership or S corporation in computing its non-separately stated taxable income or loss for the taxable year of payment, and therefore are not subject to the State and local tax deduction limitation for partners and shareholders who itemize deductions.”

The Notice provides that these PTEs can pay SALT at the entity level, and the tax deduction that flows through to the individual partners and shareholders will not be subject to the individual SALT limitation for itemized deduction purposes.

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In addition, existing federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption or first-time home buying) or to influence behavior, including business practices and decisions (e.g., research credits or hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

There is no federal credit currently comparable to the California PTE tax credit.

### *State Law*

State law generally conforms to federal law as of the "specified date" of January 1, 2015, with modifications, allowing individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. State law retains the deduction for SALT, miscellaneous itemized deductions, and the limitation on itemized deductions for high-income taxpayers.

### *Elective Tax at Entity Level*

The SBRA, under Part 10.4 of the Revenue and Taxation Code (RTC), for taxable years beginning on or after January 1, 2021, and before January 1, 2026, allows a qualified entity doing business in this state to annually elect to pay an elective tax. For entities required to file a return under Sections 18633 (partnership returns), 18633.5 (limited liability company (LLC) returns), or 18601 (S corporation returns), the elective tax is 9.3% of the qualified net income for the taxable year for which the election is made. The qualified net income of the qualified entity is the sum of the pro rata share or distributive share of income and guaranteed payments subject to tax under the PITL for the taxable year of each qualified taxpayer that consents.

For purposes of the SBRA, a qualified entity means an entity that is taxed as a partnership, an S corporation, or certain disregarded LLCs; and that entity's partners, members, or shareholders in that taxable year are exclusively corporations as defined under the Corporation Tax Law, or individuals, fiduciaries, estates, or trusts subject to tax under the PITL. A qualified entity cannot be a publicly traded partnership or an entity permitted or required to be included in a combined reporting group.

### *PTE Elective Tax Credit*

Existing state laws also provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses or to influence behavior, including business practices and decisions.

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Under the PITL, for taxable years beginning on or after January 1, 2021, and before January 1, 2026, a qualified taxpayer, who is a partner, shareholder, or member of a qualified entity under the SBRA that makes an annual election to pay the elective tax, is allowed a PTE tax credit in an amount equal to the qualified amount.

For the PTE tax credit, the following definitions apply:

- Electing qualified entity means a qualified entity, as defined above that has elected to pay the elective tax under the SBRA.
- Qualified amount means an amount equal to 9.3% of the qualified taxpayer's pro rata or distributive share, as applicable, of qualified net income and guaranteed payments subject to the election made by an electing qualified entity under the SBRA.
- Qualified taxpayer means a taxpayer that is an individual, fiduciary, estate, or trust that is a partner, shareholder, or member of an electing qualified entity that consented to have their pro rata share or distributive share of income and guaranteed payments included in the qualified net income of the electing qualified entity; and does not include a business entity that is disregarded for federal tax purposes, or its partners or members, except for certain disregarded LLCs.

The PTE tax credit can be carried over for five years until exhausted.

#### *Implementation Considerations*

None noted.

#### *Technical Considerations*

None noted.

#### *Policy Considerations*

None noted.

### **LEGISLATIVE HISTORY**

SB 113 (Senate Committee on Budget and Fiscal Review, Chapter 3, Statutes of 2022), among other items, modified the definition of "qualified net income" to include guaranteed payments and expanded the definition of a "qualified entity" to allow the entity's partners, shareholders, or members to include a partnership. In addition, for purposes of the PTE elective tax credit, under the PITL, the bill modified the definition of "qualified amount" on which the credit is based to include guaranteed payments and modified a "qualified taxpayer" eligible to claim the credit to include certain disregarded LLCs. The bill also changed the order in which credits are used to offset a tax liability.

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SB 851 (Portantino, Chapter 705, Statutes of 2022) under the PITL, changed the calculation of the other state tax credit to increase the net tax payable by the allowed PTE elective tax credit amount claimed in the same taxable year.

AB 150 (Assembly Committee on Budget, Chapter 82, Statutes of 2021), among other items, created the SBRA, and for taxable years beginning on or after January 1, 2021, and before January 1, 2026, allows entities taxed as a partnership or an S corporation to pay an additional elective tax at the entity level. In addition, under the PITL, AB 150 allows a qualified taxpayer, who is an owner of a qualified entity that makes an annual election to pay an additional elective tax authorized by the bill, a tax credit in an amount equal to 9.3% of the qualified taxpayer's pro rata or distributive share, as applicable, of the qualified net income subject to the election made by an electing qualified entity for taxable years beginning on or after January 1, 2021, and before January 1, 2026.

## **PROGRAM BACKGROUND**

None noted.

## **FISCAL IMPACT**

The FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined. Due to the limited initial duration of this expenditure and the limited time for implementation, FTB has not implemented technology to adequately support this expenditure, which has created operational impacts that are unsustainable. As this bill moves through the process, FTB will continue to discuss the need for implementing a technology apparatus to support this expenditure.

## **ECONOMIC IMPACT**

### *Revenue Estimate*

This bill as amended on April 2, 2024, would not impact state income or franchise tax revenue.

### *Revenue Discussion*

Under current federal law, IRC section 164(b)(6), relating to the limitation on individual deductions, sunsets on January 1, 2026. Absent an extension of the provision by the United States Congress, the SBRA PTE elective tax and PTE tax credit as allowed under this bill would become inoperative as of that date.

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**LEGAL IMPACT**

None noted.

**APPOINTMENTS**

None noted.

**SUPPORT/OPPOSITION**

*Support*

Per the Senate Committee on Revenue and Taxation analysis of SB 1192, dated April 5, 2024, California Life Sciences and the California Society of Certified Public Accountants support this bill.

*Opposition*

None on file.

**ARGUMENTS**

To be determined.

**LEGISLATIVE CONTACT**

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