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## **TAX BULLETIN 22-6**

### ***Virginia Department of Taxation***

**April 15, 2022**

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## **IMPORTANT INFORMATION REGARDING 2021 VIRGINIA INCOME TAX RETURNS**

### **Virginia's New Elective Pass-Through Entity Tax**

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*Under legislation enacted by the 2022 General Assembly (House Bill 1121, Chapter 690 of the 2022 Acts of Assembly and Senate Bill 692, Chapter 689 of the 2022 Acts of Assembly), Virginia established a new elective pass-through entity ("PTE") tax. This bulletin is intended to provide taxpayers with preliminary guidance regarding this new elective tax and Taxable Year 2021 Virginia income tax returns.*

#### **Virginia's Elective PTE Tax**

During the 2022 General Assembly Session, legislation was enacted that allows a qualifying PTE to make an annual election for Taxable Years 2021 through 2025 to pay an income tax at a rate of 5.75 percent at the entity level. A PTE that qualifies to make the election (a "qualifying PTE") is one that is 100 percent owned by natural persons or, in the case of a Subchapter S corporation, 100 percent owned by natural persons or other persons eligible to be shareholders in an S corporation. The legislation then provides a corresponding refundable income tax credit for Taxable Years 2021 through 2025 for any amount of income tax paid by a qualifying PTE having Virginia taxable income if such PTE makes the election and pays the elective income tax imposed at the entity level. The effect of such elective income tax and corresponding refundable credit is to allow the qualifying PTE to shift the income tax burden from the PTE owners to the PTE itself.

### **Important Notice**

Pass-through Entities: File your Taxable Year 2021 returns by your original or extended due date but **do not try to pay the elective PTE tax with your Taxable Year 2021 returns**. The Department cannot accept or process the elective PTE tax at this time.

Individuals: File your Taxable Year 2021 returns by your original or extended due date but **do not try to claim a credit for the elective tax paid by your PTE to Virginia**. If you attempt to claim this credit on your Taxable Year 2021 return, the Department will deny any such credits, which could result in the assessment of interest and penalties. If your PTE makes the election, you will receive information from your PTE on or after October 2023 informing you of the amount to claim and how to claim it. You may claim a credit on your Taxable Year 2021 Virginia return for a portion of the taxes paid by the PTE to another state so long as such tax is substantially similar to Virginia's elective PTE tax.

### **Preliminary Instructions for Taxable Year 2021 Returns**

Due to the timing of the legislation and because the filing season for Taxable Year 2021 is already under way, the Department is required to delay implementation of the elective PTE tax until at least October 15, 2023. Therefore, qualifying PTEs will not be able to make an election nor will they be able to pay the entity-level tax permitted by this legislation on Taxable Year 2021 returns by the original or extended due date. Similarly, owners of a qualifying PTE will not initially be allowed to claim the refundable income tax credit allowed by this legislation on their Taxable Year 2021 return by the original or extended due date. As a result, qualifying PTEs and their owners should file their Taxable Year 2021 returns and make any required tax payments as they normally would by the applicable due dates under current law in order to avoid penalties and interest.

Before October 15, 2023, the Department will publish guidelines regarding how to make the election retroactively for Taxable Year 2021. A qualifying PTE will then be permitted to make an election and pay the entity-level tax for Taxable Year 2021 according to the guidelines published by the Department. In addition, owners of a qualifying PTE will be allowed to claim the refundable income tax credit for Taxable Year 2021 according to such guidelines. The guidelines will also address the implementation of this legislation for Taxable Years 2022 through 2025.

### **Modification of Virginia's Existing Credit for Taxes Paid Other States**

In addition to establishing a new Virginia elective PTE tax, this legislation allows taxpayers to claim a credit on their individual income tax return for certain taxes paid by a PTE under another state's substantially similar PTE tax structure for Taxable

Years 2021 through 2025. This provision of the legislation overrules Public Document 21-156 (December 29, 2021), which generally denied a credit for a tax paid to Maryland under that state's elective pass-through entity tax. This provision only applies to taxes paid by a pass-through entity under the law of another state that is substantially similar to *Va. Code* § 58.1-390. Therefore, it does not apply to any other entity-level taxes, such as any franchise, privilege, business, license, or occupation taxes described in *Va. Code* § 58.1-332.2.

Unlike the new elective PTE tax, the implementation of this provision is not delayed. Therefore, taxpayers may claim a credit on their Taxable Year 2021 individual income tax returns for taxes paid by the PTE under another state's substantially similar PTE tax structure in proportion to their ownership in such PTE. Taxpayers who have already filed a Taxable Year 2021 Virginia income tax return but need to make an adjustment should consult the instructions for the appropriate income tax return and the Department's website for further information regarding the filing of an amended return.

### **Further Instructions**

If you have additional questions, please visit <https://www.tax.virginia.gov>, or contact the Department at (804) 367-8037.