



COMMONWEALTH of VIRGINIA

Department of Taxation

December 28, 2021

Vivian J. Page, CPA
Chair, 2021-2022 Tax Advisory Committee
Virginia Society of CPAs
4309 Cox Road
Glen Allen, Virginia 23060

Re: Ruling Request: Credit for Taxes Paid to Another State
Virginia Society of CPAs

Dear Ms. Page:

This will respond to your letter in which the Virginia Society of CPAs (the "Society") requests a ruling on the availability of Virginia's credit for taxes paid to another state for taxpayers who are owners of a pass-through entity that makes an election to be taxed at the entity level in Maryland.

FACTS

The federal Tax Cuts and Jobs Act, Public Law (P.L.) 115-97 (12/22/2017) (the "TCJA"), amended Internal Revenue Code (IRC) § 164(b)(6) to limit the federal deduction for state and local taxes (SALT) to \$10,000 for most individuals. There is no similar limitation on the SALT deduction available to business entities. In response, several states including Maryland have implemented an elective entity-level tax for certain pass-through entities (PTEs), thereby avoiding the federal deduction limitation for individuals. These schemes have become commonly known as "PTE SALT cap workarounds." The Society requests a ruling as to whether Virginia's credit for taxes paid to another state will be available to Virginia taxpayers who are owners of PTEs that make an election to be taxed at the entity level in Maryland.

ANALYSIS

Maryland's PTE SALT Cap Workaround

Md. Code Ann. § 10-102.1(b) allows PTEs subject to tax in Maryland to elect between being taxed at the member level or the entity level. If the PTE chooses to be taxed at the member level, it pays tax on the distributive or pro rate share of its nonresident members' income. The tax is treated as being imposed on the members

themselves. If the PTE chooses to be taxed at the entity level, it pays tax on the distributive or pro rata share of all members. The individual members may then claim their share of the tax paid by the PTE on their Maryland individual income tax returns. Maryland law expressly provides that when the PTE makes the election, the tax is treated as a tax imposed on the PTE itself. See *Md. Code Ann.* § 10-102.1(c)(3). To the extent that this treatment is respected for federal tax purposes and the tax is considered to be imposed on the PTE and not any individual owners, this PTE SALT cap workaround avoids the federal deduction limitation for individuals. The issue addressed in this ruling is whether a Virginia owner of a PTE making the election is eligible to claim a credit for taxes paid to another state on their Virginia individual income tax return.

Virginia's credit for taxes paid to another state

Virginia Code § 58.1-332 A allows Virginia residents a credit on their Virginia individual income tax return for income taxes paid to another state provided the income is either earned or business income or gain from the sale of a capital asset, derived from sources outside Virginia, and subject to Virginia's income tax.

The credit is limited to taxes imposed on income. Pursuant to *Virginia Code* § 58.1-332 A, no franchise tax, excise tax, unincorporated business tax, occupation tax or any tax characterized as such by the taxing jurisdiction, although applied to earned or business income, shall qualify for a credit, nor shall any tax which, if characterized as an income tax or a commuter tax, would be illegal and unauthorized under such other state's controlling or enabling legislation qualify for a credit under this section.

By reason of their character as legislative grants statutes relating to credits allowed against a tax liability must be strictly construed against the taxpayer and in favor of the taxing authority. See *Howell's Motor Freight, Inc., et al. v. Virginia Department of Taxation*, Circuit Court of the City of Roanoke, Law No. 82-0846 (10/27/1983). Virginia generally allows residents to claim a credit for income tax imposed by other states on their distributive share of PTE income sourced to that state.

Pursuant to *Virginia Code* § 58.1-332 C, the amount of tax paid by an electing S-corporation shall be deemed to have been paid by its individual shareholders in proportion to their ownership of the corporation's stock. The statute, however, does not include similar treatment for other types of PTEs. In fact, Title 23 VAC 10-110-221 C expressly provides that the credit may not be claimed by an individual for tax imposed by another state on a distributing entity in which the individual is a beneficiary or shareholder, except when the distributing entity is an S-corporation.

In addition, the *Howell's* case cited above addressed a claim by Virginia resident shareholders of an S corporation that they should be entitled to a credit for income tax paid by the corporation to other states. At the time *Howell's* was decided, the statute did not yet allow for the income tax paid by the S corporation to be treated as paid by the shareholders. In upholding the Department's denial of the credit, the court held that the statute had to be construed as written but noted that the plaintiffs had raised an issue appropriate for legislative reform.

The Society argues that Virginia should allow the credit even if the PTE makes the election because the Virginia resident taxpayer is subject to Maryland income tax on Maryland source income regardless of whether the election is made or not. It asserts that functionally, the mechanics of how the taxes are paid at the state level remain the same, it is only the character of the tax for federal income tax purposes which changes.

Like the court in *Howell's*, however, the Department is bound by the statutes and regulations as they currently exist. As stated above, *Virginia Code* § 58.1-332 expressly provides for the out-of-state credit when paid by S-corporations. Under the canon of statutory construction *expressio unius est exclusio alterius*, which provides that the mention of a specific item in a statute implies that other omitted items were not intended to be included within the scope of the statute, PTEs other than S-corporations would not come within the scope of the statute. In any event, 23 VAC 10-110-221 makes it clear that the credit is not available if the tax is imposed by another state on the distributing entity. Under the Maryland statute at issue, the tax is imposed on the distributing entity if the election is made.

RULING

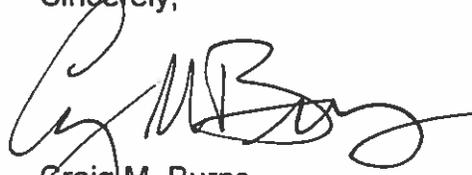
The Maryland PTE SALT cap workaround involves a tax on income for which a Virginia credit for taxes paid to another state is typically available. However, for purposes of the out-of-state credit allowable under *Virginia Code* § 58.1-332, a tax imposed at the entity level is not attributable to the individual members, unless they are shareholders of an S-corporation. Virginia residents who are shareholders of an S-corporation that elects to be taxed at the entity level pursuant to Maryland's PTE SALT cap workaround must then determine on a case-by-case basis if the tax payment would otherwise qualify for the credit for taxes paid to another state in the hands of the individual shareholder. If so, the Virginia resident would be entitled to claim the credit as if it had been paid by the individual directly.

Under current law, however, Virginia resident taxpayers holding interests in other types of PTEs that make the election in order to take advantage of Maryland's PTE SALT cap workaround will not be eligible for the credit.

Vivian Paige, CPA
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The *Code of Virginia* section and regulation cited are available online at www.tax.virginia.gov in the Laws, Rules, & Decisions section of the Department's website. If you have any questions regarding this ruling, you may contact Corey L. Kysor in the Office of Tax Policy, Appeals and Rulings, at (804) 371-6596, or via email at corey.kysor@tax.virginia.gov.

Sincerely,



Craig M. Burns
Tax Commissioner

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