



Defending America's Small & Family Owned Businesses

Brian Reardon
President, S Corporation Association
In support of SB 495
before the
Kansas Senate Assessment and Taxation Committee
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Chairman Tyson and Members of the Committee:

My name is Brian Reardon and I am the President of the S Corporation Association. Today I am speaking on behalf of the S Corporation Association and a coalition of Main Street Employer Groups that strongly support SB 495.

This legislation would benefit thousands of family businesses operating in Kansas by restoring their ability to fully deduct the State and local income taxes (SALT) they pay on their business income. The bill is intended to be revenue neutral and its effect would be to make these businesses more competitive and Kansas a more attractive place to do business.

It's a win-win for Kansas and the family businesses who operate here.

SALT and S Corporations

Like C corporations, S corporations and other pass-through businesses are subject to SALT on their business income. Unlike C corporations, however, where SALT is always incurred *and* paid at the entity level, only a minority of states tax pass-through businesses directly. Most, including Kansas, tax pass-through business profits at the shareholder level.

This disparity took on new significance with the 2017 tax overhaul. The legislative history of the Tax Cuts and Jobs Act makes clear that for pass-through businesses operating in states that tax income at the entity level, those taxes remain deductible. In states like Kansas where pass-through profits are taxed at the shareholder level, however, those taxes are subject to the new, \$10,000 cap on SALT deductions.

This new policy results in two disparities for family businesses residing in Kansas. First, they are disadvantaged compared to businesses operating in the state as C corporations. Under the new law, C corporations continue to fully deduct these taxes while pass-through businesses do not. There is no policy rationale for this disparity.

Second, these Kansas businesses are disadvantaged compared to businesses operating in other states or localities with either no State or local income taxes or an entity-level tax that remains deductible.

How significant is the loss of SALT for Kansas S Corporations and other pass-through businesses? For successful businesses, it's equal to the loss of \$1.69 to \$2.11 in profits for every \$100 of business income.

How many Kansas businesses are affected? According to the IRS Statistics of Income, there are 37,000 S corporations residing in Kansas and another 39,000 partnerships. That adds up to over 76,000 businesses at risk of losing their SALT deduction.

Senate Bill 495

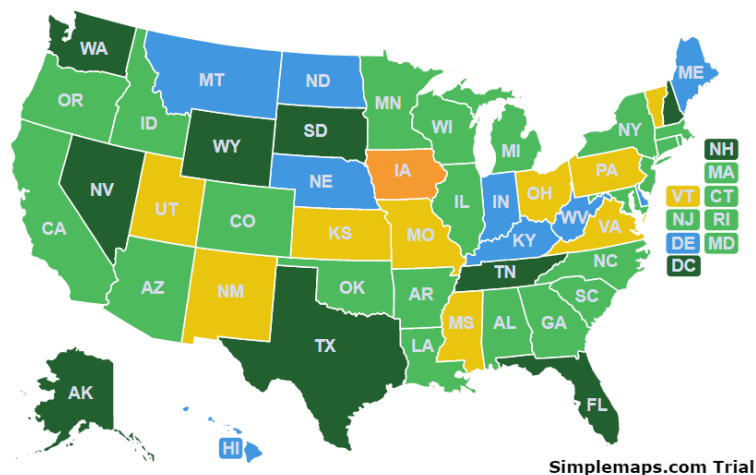
Senate Bill 223 would address this disparity and help level the playing field between pass-through businesses organized as S corporations and partnerships and those organized as C corporations. Specifically, the bill would:

- Allow Kansas S corporations and partnerships an election to pay their SALT at the entity level;
- Provide the owners of these electing businesses an exclusion on income earned by the business to avoid double taxation; and
- Ensure that owners of the businesses may continue to deduct the federal taxes paid on their business income, as under current rules.

The bill would effectively restore the deductibility of SALT to Kansas pass-through businesses that make the election. Moreover, it is designed to be revenue neutral. The tax paid by the electing businesses would be equal to the tax otherwise paid by their shareholders or partners.

Activity by Other States

If Kansas successfully enacts this reform, it would not be alone. Since the tax overhaul was passed, twenty-two states, including Colorado and Oklahoma, have adopted legislation similar to Senate Bill 495. Another nine have bills pending. This map from our MainStreetEmployers.Org website shows which states have taken action.



While some of the details of these bills differ, the goal of all these efforts is the same -- to level the rules between owners of C corporations and owners of pass-through business entities as it relates to their

ability to deduct SALT from their federal taxes. S-Corp is working with allies in additional states to increase the number of states acting on SALT parity legislation this year.

Q&A

Our efforts to restore SALT Parity are entering their fifth year, and a number of important questions have been raised about the effort, including:

Q: Has the IRS weighed in?

A: [IRS Notice 2020-75](#) published on November 9th, 2020 announced forthcoming rules clarifying that state and local income taxes paid by a partnership or S corporation are allowable as deductions for federal tax purposes. The Notice makes clear those deductions are allowed when they are the result of an election, or if the business owners receive tax credits or income exclusions equal to the taxes paid by the entity. Finally, the notice reassures taxpayers that they can rely on the Notice when filing their taxes this year, and that this interpretation applies to tax years preceding the Notice's publication. In short, our SALT Parity plan works.

Q: Will Congress or the Biden Administration repeal the SALT caps?

A: The federal outlook on SALT policy is uncertain. The House-passed Build Back Better bill is currently stalled in the Senate and may be stuck. If it does move, it proposes increasing the SALT cap to \$80,000, but it also would extend the life of the cap through 2031. Senate proposals would also extend the policy into 2031 but would reduce the size of the cap increase. Under either approach, Main Street businesses would continue to benefit from our SALT Parity model.

Q. Does SALT Parity increase complexity?

A. SALT Parity is simple – for S corporations and partnerships, it replaces multiple tax returns and payments with a single, uniform return and payment. How those dollars are apportioned among states and entities within a state can get complicated, but it already is complicated. An entire industry of accountants and tax attorneys exists to address the complexities of state and local tax policy. SALT Parity does not add to that complexity. One reason our SALT Parity bill includes an election is to ensure business owners can decide for themselves whether paying their SALT at the entity level is a good choice

Conclusion

There is no valid reason for the federal Tax Code to allow C corporations to deduct their state and local taxes while blocking S corporations and partnerships from doing the same. These taxes are an obvious cost of doing business and should be treated as such.

With Senate Bill 495, Kansas has an opportunity to address this unfairness and make its tax policies more attractive to family businesses. Shifting the incidence of S corporation taxation from the shareholder to the entity will reduce the effective tax rates paid by Kansas businesses sharply while making the state a more attractive place to do business, all while remaining revenue neutral to Kansas's Treasury.

We strongly encourage you to move forward on this legislation.