



Increased Flexibility for Pass-Through Entity Tax Election Passes Through General Assembly

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03.28.2023

During its 2023 Session, the Virginia General Assembly passed legislation, **H.B. 1456** and **S.B. 1476**, that removes some of the barriers for participating in Virginia's elective Pass-Through Entity Tax (PTET). Specifically, effective July 1, 2023, the legislation makes the following changes for tax years beginning on or after January 1, 2021:

1. Removes the requirement that a pass-through entity (PTE) be 100 percent owned by natural persons or, in the case of an S corporation, persons eligible to be shareholders of an S corporation in order to make the PTET election;
2. Defines "eligible owner" as a direct owner of a pass-through entity who is a natural person or an estate or trust; and
3. States that only the pro rata or distributive share of income, gain, loss, or deduction attributable to eligible owners is subject to the PTET.

Under current law, PTEs that are not owned 100 percent by human beings, S corporations, or disregarded entities owned by them cannot make a PTET election. This has led to some owners restructuring their PTEs so they can qualify for the PTET. Other owners, including estates and certain trusts, could not restructure to make the PTE eligible for the election.

The new legislation removes these barriers. If the PTE is not 100 percent owned by an eligible owner, it can still make a PTE election for those owners that are eligible. While some PTEs may still restructure so that all of their owners can participate in the PTET election, this change allows PTEs to qualify for the PTET that otherwise wouldn't qualify because one of their owners is not an eligible owner. Also, the legislation allows PTEs owned by estates and trusts to qualify and clarifies what PTE items are subject to the PTET.

For taxpayers that choose to restructure, the Department of Taxation (the "Department") recently

released guidance (**FAQS**) confirming that PTEs may restructure at any point during the tax year in order to make themselves eligible for the PTET:

The law authorizing the PTET does not specify a time period during which the PTE must meet the "qualifying pass-through entity" test. As a result, a PTE can make the PTET election so long as it meets the "qualifying pass-through entity" test at any time during the taxable year and it only flows through refundable PTET credits to direct natural person owners (or in the case of a Subchapter S corporation, direct natural person owners or direct owners who are persons eligible to be shareholders in an S corporation) in proportion to each owner's distributive or pro rata share of income.

Conclusion

The new legislation and the FAQs issued by the Department remove some of the barriers for making the PTET election and provide flexibility for PTEs wishing to restructure during the year to maximize the benefit of the PTET election for their members.

Williams Mullen will continue to monitor developments regarding the PTET.

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