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New Jersey Establishes Elective Entity Tax for Pass-Through Entities (PTE)

On January 13, 2020, Governor Phil Murphy signed into law the "Pass-through Business Alternative Income Tax Act." This important law establishes a new elective pass-through business alternative income tax (PTE tax) with a corresponding income tax credit for members of eligible pass-through entities and applies to taxable years beginning on or after January 1, 2020.

This law was passed and signed into law in New Jersey in direct response to the 2017 Federal Tax Cuts and Jobs Act's \$10,000 limitation on the deductibility of state and local income and property taxes on a federal personal income tax return. The limit is \$5,000 for a married individual filing a separate return.

The new law creates an elective pass-through entity business alternative income tax (PTE tax). This provision allows pass-through entities (PTEs) to report and pay tax at the entity level. A qualifying PTE is a partnership, S corporation, or a limited liability company, with at least one member who is liable for New Jersey tax on income of the PTE.

For a PTE to make an election, the members of the PTE (at the time the election is filed) must execute a consent under penalties of perjury. The PTE election must be made annually on or before the due date of the entity's return. PTEs can revoke an election until the due date of the return for that tax year.

The PTE tax is imposed on the sum of each member's share of distributive proceeds, at the following rates for taxable years beginning on or after January 1, 2020:

- 5.675%, if the distributive proceeds of the PTE are less than or equal to \$250,000 in the taxable year;
- \$14,187.50 plus 6.52% of the distributive proceeds greater than \$250,000, but not over \$1,000,000, in the taxable year;
- \$63,087.50 plus 9.12% of the distributive proceeds greater than \$1,000,000, but not over \$5,000,000, in the taxable year; or
- \$427,887.50 plus 10.9% of distributive proceeds greater than \$5,000,000 in the taxable year.

Electing PTEs are required to file an entity tax return and make payments on or before the 15th day of the third month following the entity's taxable year for federal income tax purposes.

Electing PTEs are required to make estimated PTE tax payments on or before the 15th day of fourth, sixth, and ninth month of the taxable year, and the first month succeeding the end of the tax year.

In addition to entity level filing requirements, PTEs must also report a member's share of distributive

proceeds to its members.

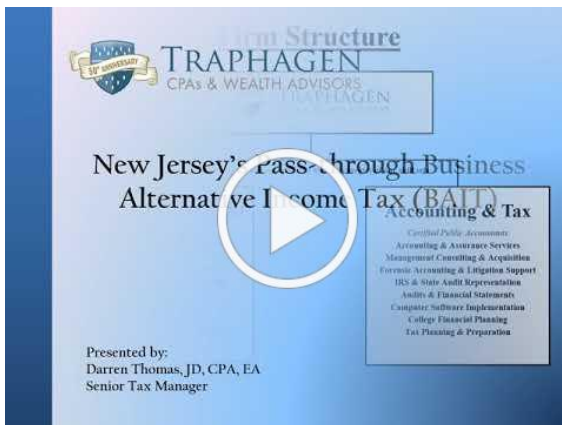
The vital benefit under the new law is it provides a refundable tax credit on an individual income tax return for members of an electing PTE subject to New Jersey gross income tax, which is equal to the member's pro rata share of the PTE tax for that period.

The law specifies that any credit is only available after the application of all other credits allowed by law and claimed by the taxpayer in the taxable year. If the amount of credit is bigger than that of tax otherwise due, then the excess amount of credit over tax will generally trigger a refund. A trust or estate which receives the credit can allocate the credit to beneficiaries or use against their tax liabilities.

Notably, single-member LLCs and sole proprietorship's may **NOT** elect to pay the pass-through business alternative income tax. As such, the refundable tax credit will not be available to the individual owners of single-member LLCs and sole proprietorship.

As such, clients should review their business structures for 2020 to determine if it makes sense to convert to a pass-through business structure to take advantage of the benefits afforded by the new elective entity tax.

Traphagen CPAs & Wealth Advisors can assist in your business entity structure review and provide valuable guidance. However, the time to act in order to have any changes to business structure effective for 2020 is limited, so immediate action is needed. Contact Traphagen CPAs & Wealth Advisors today to make an appointment for a consultation.



The BAIT presentation by Darren Thomas, JD, CPA, EA will cover the above topics and more.

[Watch Now](#)

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