

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER
OFFICE OF TAX AND REVENUE



March 31, 2022

OTR TAX NOTICE 2022–03

District Treatment of Pass-through Entities Taxes Paid to Other Jurisdictions

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (“TCJA”) (P.L. 115-97, 131 Stat. 2054). The TCJA included a limit on the amount of state and local taxes an individual can deduct on their federal income taxes. See I.R.C. § 164(b)(6). Currently, the deduction is limited to \$10,000. Importantly, this limit does not apply to taxes “which are paid or accrued in carrying on a trade or business[.]” I.R.C. § 164(b)(6)(B).

I. Federal Law

The Internal Revenue Service announced its intent to issue proposed regulations that will clarify that “specified income tax payments” are deductible by partnerships in computing its non-separately stated income or loss. IRS Notice 2020-75, Sec. 3.01, 2020-49 IRB. Any specified income tax payment made by a partnership or an S corporation, during a tax year does not constitute an item of deduction that a partner takes into account separately in determining the partner's own federal income tax liability for the tax year. Instead, specified income tax payments will be reflected in a partner's distributive or pro-rata share of non-separately stated income or loss reported on a Schedule K-1. IRS Notice 2020-75, Sec. 3.02(3), 2020-49 IRB. Any specified income tax payment made by a partnership, or an S corporation, is not considered in applying the limitation discussed above. IRS Notice 2020-75, Sec. 3.02(4), 2020-49 IRB. As of the publishing of this notice, the Department of the Treasury and the Internal Revenue Service have not issued these proposed regulations. However, the IRS announced that taxpayers could rely on Notice 2020-75 in the meantime.

II. Response by States

In response to this notice, several states have enacted, or are contemplating the enactment of, either mandatory or elective entity-level income taxes on pass-through entities that do business in the state or have income derived from sources within the state.¹ This would result in the partners in the pass-through entities being able to receive a deduction over the limits in section 164(b)(6).

¹ See generally California (Cal. Rev. & Tax. Cd. § 17052.10(a)); Illinois (ILCS Chapter 35 § 5/201(p)(4)); Maryland (Md. Code Ann. Tax-Gen. § 10-102.1(c)(3)); Massachusetts (Mass. Gen. L. Chapter 63D §§ 2 and 3; and New York ((N.Y. Tax Law § 620(b)

III. District Law

An income tax is imposed on the taxable income of residents under D.C. Code § 47-1806.03.

Correspondingly, a credit is allowed that is “equal to the amount of individual income tax such individual is required to pay and, in fact, has paid to any state, territory or possession of the United States, or political subdivision thereof, upon income attributable to such state... while concurrently a resident of the District.” D.C. Code § 47-1806.04(a).

In addition, D.C. Code § 47-1806.04(a) states for “any taxable year after December 31, 1990, no franchise tax, license tax, excise tax, unincorporated business tax, occupation tax, or any tax characterized as such by the other taxing jurisdiction, even if applied to earned or business income, shall qualify as a credit...”

IV. Conclusion

It is the interpretation of the Office of Tax and Revenue that D.C. Code § 47-1806.04(a), enacted prior to any PTE Taxes, does not restrict a resident individual taxpayer from claiming a credit for such taxes paid by a pass-through entity so long as the PTE Tax is akin to an individual net income tax and does not fall within the enumerated tax types listed in D.C. Code § 47-1806.04(a). To the extent permitted, the resident individual generally may claim a credit on their District individual income tax return equal to the total share of state and local tax shown on the individual resident member’s tax return filed with the other state. However, the credit is limited to the District tax calculated on the resident individual’s distributive or pro-rata share of income subject to tax at the entity-level.

This notice does not change the enumerated tax types listed in D.C. Code § 47-1806.04(a), and, therefore, District residents may not claim the credit for a franchise tax, license tax, excise tax, unincorporated business tax, occupation tax, or any tax so characterized by the other taxing jurisdiction.

For additional information, please contact the OTR’s Customer Service Center at e-services.otr@dc.gov or (202) 727-4829.