



SPONSOR: Rep. Bush & Sen. Ennis
Reps. Michael Smith, Yearick

HOUSE OF REPRESENTATIVES
151st GENERAL ASSEMBLY

HOUSE BILL NO. 489

AN ACT TO AMEND TITLE 30 OF THE DELAWARE CODE RELATING TO TAXATION OF PASS-THROUGH ENTITIES.

1 WHEREAS, an entity organized and operating as a partnership or an S-corporation is commonly referred to as a
2 “pass-through entity” for tax purposes; and

3 WHEREAS, Delaware does not impose an income tax on a pass-through entity; and

4 WHEREAS, generally, for federal, Delaware and other state income tax purposes, the taxable income of a pass-
5 through entity is subject to income tax by the owner in proportion to the ownership interest in the entity; and

6 WHEREAS, the state income taxes paid by an owner of a pass-through entity are generally allowable as an
7 itemized personal deduction for federal income tax purposes; and

8 WHEREAS, one of the provisions of the 2017 federal tax reform, Pub. Law No. 115-97 and commonly referred to
9 as the Tax Cuts and Jobs Act (TCJA), reduced the longstanding and preexisting unlimited allowable amount of state and
10 local taxes that an individual can deduct for federal income tax purposes to a total of \$10,000; and

11 WHEREAS, the TCJA materially limited the federal tax benefit of state income taxes paid personally by an owner
12 on the taxable income of a pass-through entity; and

13 WHEREAS, pursuant to Internal Revenue Service Notice 2020-75, 2020-49 I.R.B. 1453 (IRS Notice 2020-75),
14 the United States Department of the Treasury and the Internal Revenue Service published their intent to issue proposed
15 regulations to clarify: (i) that state and local income taxes imposed on and paid by a partnership or an S corporation on its
16 income are allowable as a deduction by the partnership or S corporation in computing its non-separately stated taxable
17 income or loss for the taxable year of payment and (ii) that any state and local income taxes imposed on and paid by a
18 partnership or an S corporation on its income are not taken into account in applying the limitation on the amount of state
19 and local taxes that an owner of a pass-through entity can deduct for federal income tax purposes; and

20 WHEREAS, in IRS Notice 2020-75, the United States Department of the Treasury and the Internal Revenue stated
21 that taxpayers may rely on the provisions of IRS Notice 2020-75 prior to the issuance of proposed regulations; and

22 WHEREAS, at present, the United States Department of the Treasury and the Internal Revenue Service have not
23 issued proposed regulations as reported in IRS Notice 2020-75; and

WHEREAS, at present, more than 25 states have enacted legislation to mitigate the federal limitation resulting from TCJA on the federal deduction for state and local income taxes paid personally by an owner on the taxable income of a pass-through entity and Delaware has not yet enacted any such legislation; and

WHEREAS, at present, the Delaware Department of Finance, Division of Revenue is in the process of a multi-year, system conversion to a new information processing environment for the administration of all State taxes (IRAS Conversion); and

WHEREAS, the IRAS Conversion (including modernization of the State's pass-through entity tax module) is currently estimated to be completed during calendar year 2024 and due to the uncertainties associated with the IRAS Conversion, the Division of Revenue is not currently in a position to implement or administer an entirely new alternative method of taxation for pass-through entities and their owners as would be needed consistent with IRS Notice 2020-75; and

WHEREAS, the General Assembly has determined that it is in the State's economic and competitive commercial interests to enact legislation that is allowable as a result of IRS Notice 2020-75 to mitigate this new federal limitation on the federal deduction for state and local income taxes that begins with the calendar year after the year in which the Secretary of Finance certifies that the Division of Revenue has the appropriate systems in place to implement the provisions of this Act.

NOW, THEREFORE:

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF DELAWARE (Three-fifths of all members elected to each house thereof concurring therein):

Section 1. Amend Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

Title 30

CHAPTER 16. Pass-Through Entities, Estates and Trusts

Subchapter IV. Elective Taxation of Pass-Through Entities

§ 1651. Definitions.

As used in this subchapter:

(1) "Distributive proceeds" means both of the following:

a. In the case of a pass-through entity classified as a partnership as set forth in § 1601 of this title, the sum of both of the following:

1. The distributive share of partnership taxable income derived from sources both inside and outside this State as determined under § 1601(2) of this title for all members of the pass-

53 through entity who are resident members that the partnership is required to report under §
54 1605(a) of this title plus

55 2. The distributive share of partnership taxable income derived from sources inside this
56 State as determined under § 1601(2) for all members of the pass-through entity who are not
57 resident members that the partnership is required to report under § 1605(a) of this title.

58 b. In the case of an electing S corporation, the pro rata share of S corporation taxable income
59 allocated to this State as determined under § 1601(2) of this title. For purposes of determining distributive
60 proceeds, a pass-through entity shall apply the allocation factors by application of § 1124 of this title.

61 (2) “Electing pass-through entity” means a pass-through entity that makes an election to pay tax at the
62 entity level for a taxable year as allowable under § 1653 of this title.

63 (3) “Qualified pass-through entity” means a pass-through entity as defined in § 1601(6) of this title except
64 that:

65 a. With respect to a person classified as a partnership as defined in § 1601(6)a. of this title, such
66 partnership is limited only to a partnership that is 100% directly owned and controlled by persons eligible
67 to be specified shareholders of an S corporation;

68 b. With respect to a person classified as a “S corporation” as defined in § 1601(6)b. of this title,
69 such S corporation is limited only to an S corporation that is 100% directly owned and controlled by
70 persons eligible to be specified shareholders of an S corporation and,

71 c. For the taxable year, the pass-through entity cannot realize credits allowed by Chapters 18 and
72 20 of this title against taxes imposed by Chapter 11 of this title.

73 (4) “Specified shareholders of an S corporation” means such persons eligible to be shareholders of an S
74 corporation under § 1361 of the Internal Revenue Code [26 U.S.C. § 1361], except that, with respect to §
75 1361(b)(1)(B) of the Internal Revenue Code, such persons can include only an individual or a trust as described in
76 § 1361(c)(2)(A)(i) or § 1361(c)(2)(A)(v) of the Internal Revenue Code.

77 (5) “Subordinate pass-through entity” means a qualified pass-through entity that is a member of another
78 qualified pass-through entity.

79 § 1652. Scope.

80 Notwithstanding anything to the contrary, the provisions of this subchapter cannot be applicable to the persons set
81 forth in subsections (1) through (5) of § 1633 of this title.

82 § 1653. Election, method, and timing.

83 (a) A qualified pass-through entity with at least 1 member who is liable pursuant to subchapter II of this title for
84 tax imposed by Chapter 11 of this title on that member's share of distributive proceeds of the pass-through entity in a
85 taxable year may elect to be liable for, and pay, a pass-through business alternative income tax in the taxable year.

86 (b) The election to pay tax at the entity level under this section is available if consent is made by each member of
87 the electing entity who is a member at the time the election is filed or by any officer, manager, or member of the electing
88 entity who is authorized, under law or the entity's organizational documents, to make the election and who represents to
89 having such authorization under penalties of perjury.

90 (c) The election to pay tax at the entity level under this section can be made annually on or before the due date of
91 the entity's return. This election cannot be made retroactively. If the members decide to revoke an election, that revocation
92 shall occur on or before the due date of the entity's return.

93 § 1654. Tax imposed. Payment of tax.

94 (a) The tax imposed on an electing pass-through entity pursuant to this subchapter must be equal to the product of
95 each member's share of distributive proceeds attributable to the pass-through entity for the taxable year times 8.7%.

96 (b) The tax imposed pursuant to this section must be payable as follows:

97 (1) Calendar year pass-through entities – 25% of the estimated tax liability for the current taxable year shall be
98 paid with the tentative return filed on April 15 of the current taxable year, and the balance of the estimated tax shall be paid
99 in 3 installments as follows: 25% on June 15 of the current taxable year; 25% on September 15 of the current taxable year;
100 and 25% on December 15 of the current taxable year.

101 (2) Fiscal year pass-through entities – 25% of the estimated tax liability for the current taxable year shall be paid
102 with the tentative return filed on the fifteenth day of the fourth month of the current taxable year, and the balance of the
103 estimated tax shall be paid in 3 installments as follows: 25% on the fifteenth day of the sixth month of the current taxable
104 year; 25% on the fifteenth day of the ninth month of the current taxable year; and 25% on the fifteenth day of the twelfth
105 month of the current taxable year.

106 (3) Any additional tax due as computed in the final return required to be filed pursuant to § 1655 of this title shall
107 be paid with such final return.

108 (3) Tentative tax declarations and payments are not required for returns for taxable periods of less than 92 calendar
109 days.

110 (c) Notwithstanding any provision of law to the contrary, a member of an electing pass-through entity will not be
111 liable for the tax imposed by Chapter 11 of this title for the member's respective share of the portion of income on which
112 tax was actually paid under this section.

(d) An electing pass-through entity is not subject to the provisions of §1158 of this title.

§ 1655. Returns for electing pass-through entity.

(a) A tentative return, covering estimated tax liability for the current income year, to be in such form and containing such information as the Secretary of Finance shall prescribe, shall be filed with the Secretary of Finance as follows:

(1) In the case of a calendar year taxpayer, on or before April 15 of the current income year.

(2) In the case of a fiscal year taxpayer, on or before the fifteenth day of the fourth month of the current income year.

(b) A final return in such form and containing such information as the Secretary of Finance shall prescribe shall be filed with the Secretary of Finance on the date on which the taxpayer's federal return is due.

(c) Every return shall have annexed thereto a certification by the officer, manager, or member of the electing entity who is authorized, under law or the entity's organizational documents duly authorized so to act to the effect that the statements contained therein are true to the best of the authorized person's knowledge and belief.

§ 1656. Annual report of distributive proceeds. Basis of members.

(a) An electing pass-through entity must provide an annual report to each of its members, for the taxable year, the member's share of distributive proceeds and such other information, if any, as the Director may prescribe pursuant to § 513 of this title.

(b) The election of a pass-through entity to pay tax at the entity level for a taxable year will have no impact on the determination of the basis of the members in their interests of such electing pass-through entity, except that such members' distributive share of the tax paid or accrued by the electing pass-through entity pursuant to such election must be taken into account in determining such basis.

§ 1657. Credit for tax paid in other states.

For resident electing pass-through entity members, an electing pass-through entity is entitled to the credit under § 1111 of this title in the same manner as if the credit had been realized directly by a member, and subject to the limitations of § 1111 of this title, for taxes paid to other states with respect to the electing pass-through entity's distributive proceeds not attributable to this state, whether the tax was paid by the electing pass-through entity itself or by the electing pass-through entity members. Resident electing pass-through entity members are not entitled to any credit under § 1111 of this title with respect to income of the electing pass-through entity. An electing pass-through must provide the pass-through entity's determination of credit as allowable under this section as the Director may prescribe pursuant to § 513 of this title.

§ 1658. Limitations.

(a) In each case as the same are or may become effective for the taxable year, the provisions of this subchapter are subject to and shall be limited by all of the following:

(1) The provisions of the Internal Revenue Code of 1986 [26 U.S.C. § 1 et seq.] and amendments thereto.

(2) Other laws of the United States relating to federal taxes.

(3) Any notice published by the United States Department of the Treasury and the Internal Revenue Service on which the Secretary may rely as authoritative with respect to the subject matter of this subchapter.

(b) Notwithstanding any provision of law to the contrary, an electing pass-through entity cannot claim a deduction for a net operating loss.

(c) Except as provided by this chapter or in § 1106(b) of this title, no electing pass-through entity, nor any members of an electing pass-through entity, shall be entitled to any credit under § 1111 of this title with respect to such tax so paid or any deduction for such income under chapter 11 of this title.

(d) In computing the net income that is subject to taxation, the electing pass-through entity cannot be allowed any deduction for taxes that are based on or measured by gross or net income or any other variant thereof.

§ 1659. Special rule for subordinate pass-through entity.

A subordinate pass-through entity is subject to the provisions of this subchapter as a separate and stand-alone qualified pass-through entity.

Section 2. Amend § 101, Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

§ 101. Definitions.

As used in this title:

(5) "Taxable" means any person, fiduciary, association of persons, syndicate, joint ~~venture or copartnership~~ venture, copartnership, or pass-through entity subject to making return or to payment of tax imposed by this title.

Section 3. Amend § 534, Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

§ 534. Failure to file tax return or to pay tax.

(c) (1) a. For tax periods beginning after December 31, 1999, if any pass-through entity required to file a return under § 1605(a)(1) of this title for any taxable year fails to file such return by the date prescribed therefor (determined with regard to any extension of time for filing) or files a return which fails to show the information required under § 1605(a)(1) of this title, such pass-through entity shall be liable for a penalty determined under paragraph (c)(2) of this section for each

month, or fraction thereof, during which such failure continues (but not to exceed 5 months), unless it is shown that such failure was due to reasonable cause.

b. If any electing pass-through entity fails to file a return under this subchapter by the date prescribed therefor (determined with regard to any extension of time for filing) or files a return which fails to show the information required under § 1605(a)(1) of this title, such pass-through entity shall be liable for a penalty determined under paragraph (c)(2) of this section for each month, or fraction thereof, during which such failure continues (but not to exceed 5 months).

(2) a. For purposes of paragraph (c)(1)a. of this section, the amount of penalty for any month is the product of \$25, multiplied by the number of persons who were members in the pass-through entity during any part of the taxable year; provided, however, that the maximum penalty for any taxable year shall not exceed \$10,000.

b. For purposes of paragraph (c)(1)b. of this section, the amount of penalty for any month is the product of \$25, multiplied by the number of persons who were members in the pass-through entity during any part of the taxable year; provided, however, that the maximum penalty for any taxable year shall not exceed \$10,000.

Section 4. Amend § 535, Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

§ 535. Fraud and other penalties.

(c) (1) In the case of any underpayment of tentative tax or installment of estimated tax required by Chapter 19 of this title or by Subchapter IV of Chapter 16 of this title, there shall be added to the tax for the taxable year an amount equal to 1 ½ % per month, or fraction thereof, of the amount of such underpayment for the period of the underpayment.

(5) Paragraph (c)(4) of this section ~~shall~~ will apply only in the case of a small corporation and a small electing pass-through entity. For purposes of this paragraph, the term “small corporation” ~~shall~~ will have the meaning set forth in § 1905(5) of this title and the term “small electing pass-through entity” means an “electing pass-through entity” as defined under § 1651 of this title that satisfies the limitations on gross receipts under § 1905(5) of this title as if such small electing pass-through entity were a small corporation.

Section 5. Amend § 1106, Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

§ 1106. Modifications.

(b) Subtractions. — There shall be subtracted from federal adjusted gross income:

(11) The individual’s distributive proceeds of electing pass-through entity income as reported under § 1656 of this title.

Section 6. Amend § 1605, Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

§ 1605. Returns.

(a) Pass-through entities. — (1) Returns. — In addition to the requirements set forth in subchapter IV of this chapter, ~~Every~~ every pass-through entity having any income from sources within this State shall make a return to this State for the taxable year setting forth the information required by § 6031 or § 6037 of the Internal Revenue Code [26 U.S.C. § 6031 or § 6037] and such other information as the Director may prescribe pursuant to § 513 of this title. Such return may, to the extent prescribed by the Director, require the separate statement of any item of the pass-through entity's income, gain, loss or deduction if the separate treatment of such item could affect the liability for tax under this title of any member.

Section 7. Amend § 1621, Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

§ 1621. Taxation of pass-through entities; in general.

(a) Income tax. — Except as otherwise provided in subchapter IV of this chapter, ~~A~~ a pass-through entity as such shall not be subject to the income tax imposed by Chapter 11 or Chapter 19 of this title. Members of a pass-through entity shall be liable for the tax imposed by Chapter 11 or Chapter 19 of this title only in their separate or individual capacities.

Section 8. Amend § 1624, Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

§ 1624. Special rules for certain tax credits of pass-through entities.

(b) *Qualifications for credits.*— Independent of an election by a pass-through entity to pay tax at the entity level for a taxable year as allowable under subchapter IV of this title, ~~The~~ the qualification of a pass-through entity for any credit allowed by Chapter 18 or Chapter 20 of this title shall be determined by treating such entity as the taxpayer for purposes of Chapter 18 or Chapter 20, as the case may be.

Section 9. Amend § 1633, Title 30 of the Delaware Code by making deletions as shown by strike through and insertions as shown by underline as follows:

§ 1633. Tax not applicable.

The following persons shall not be subject to tax under Chapter 11 of this title:

(6) Pass-through entities.—Except as otherwise provided in subchapter IV of this chapter, ~~An~~ an association or other unincorporated organization that is a pass-through entity.

Section 10. Limitation on Civil Liability.

Notwithstanding any law of this State to the contrary, no claim or cause of action shall arise, and no judgment, damages, penalties, costs or other money entitlement shall be awarded or assessed against the State or the Secretary, in any civil suit or proceeding at law or in equity, where the act or omission complained of arose out of and in connection with the performance of an official duty involving the exercise of discretion on the part of the Secretary with respect to the certification of the Secretary set forth in Section 12.

Section 11. This Act shall be known as “The Delaware Pass-Through Entity Elective Income Tax Act”.

Section 12. If any provision of this Act or the application of this Act to any person or circumstance is held invalid, the provisions of this Act are severable if the invalidity does not affect the other provisions of this Act that can be given effect without the invalid provision or the application of this Act that can be given effect without the invalid application.

Section 13. Applicability Clause.

Sections 1, 2, 3, 4, 5, 6, 7, 8, and 9 of this Act take effect on the first day of January of the immediately ensuing year after the calendar year following the date of publication in the Register of Regulations of a notice that both of the following have occurred:

(1) The Secretary of Finance (Secretary) certifies in writing that the Department has, on information and belief, the informational, operational and other necessary and appropriate systems in place to implement the provisions of this Act that are consistent with either the provisions Internal Revenue Service Notice 2020-75, 2020-49 I.R.B. 1453 (IRS Notice 2020-75) or such then applicable regulations issued pursuant to IRS Notice 2020-75, if any and whether they may be proposed, temporary or final, as may be promulgated by the United States Department of the Treasury and the Internal Revenue Service as of the date of the certification by the Secretary.

(2) The Secretary has provided notice to the Registrar of Regulations that the contingency in (1) has been fulfilled.

This Act is void unless the Secretary notifies the Registrar of Regulations of the fulfillment of the contingency in this Section and a notice is published in the monthly Register of Regulations by December 31, 2025.

SYNOPSIS

This legislation imposes a new, elective entity-level tax on the income of partnerships and S-corporations, each of which are commonly referred to as “pass-through entities” for tax purposes. Prior to this legislation, the income of a pass-through entity was subject to the personal income tax of the owner in proportion to the ownership interest in the entity. In 2017, federal tax law reduced from an unlimited amount to \$10,000 the amount an individual can claim as an itemized deduction for state and local taxes paid on an individual taxpayer’s annual tax return. State and local income taxes are commonly referenced to for tax purposes as “SALT” taxes. This 2017 federal limitation on the itemized deduction for SALT taxes included state taxes paid on the income of a pass-through entity and, as a result, materially limited the federal tax benefit of state income taxes paid personally by an owner on the taxable income of a pass-through entity.

Consistent with guidance from the United States Department of the Treasury and the Internal Revenue Service as published in Internal Revenue Service Notice 2020-75, 2020-49 I.R.B. 1453, this legislation will enable the pass-through entity, rather than the owners of a pass-through entity, to take a federal tax deduction for SALT taxes elected to be paid by the pass-through entity. Accordingly, this legislation, conceptually similar to legislation enacted in more than 25 other

states, will mitigate the new federal limitation on the personal itemized deduction for SALT taxes that otherwise would have been paid personally by an owner on the taxable income of a pass-through entity.

Generally, the approach undertaken by this legislation follows a two-step process. First, an eligible pass-through entity that elects to pay the new entity-level tax, computes and pays Delaware income tax on income taxable in the State, which income, in the absence of the election, would have been subject to Delaware income tax at the individual level for each member of the entity. All income tax elected to be paid by the pass-through entity is taxed at 8.7%. Second, the electing pass-through entity allocates modified income to its members in proportion to their ownership interest in the entity, for which allocation each member is entitled to a reduction from federal adjusted gross income for individual State income tax purposes.