Income Tax Topics: SALT Parity Act

House Bill 21-1327 and *Senate Bill 22-124* enacted and amended the SALT Parity Act. The purpose of the SALT Parity Act is to allow partnerships and S corporations to make an election to pay Colorado income tax at the entity level so that they may claim a federal deduction for state income taxes above the $10,000 deduction limitation that applies to individuals.

Within this publication, the term "electing pass-through entity" refers to a partnership or S corporation that has made an election pursuant to the SALT Parity Act to be subject to Colorado income tax. An "electing pass-through entity owner" is a partner or shareholder in an electing pass-through entity.

This publication is designed to provide general guidance regarding the SALT Parity Act, the election it authorizes, filing requirements, and tax calculations. Nothing in this publication modifies or is intended to modify the requirements of Colorado's statutes and regulations. Taxpayers are encouraged to consult their tax advisors for guidance regarding specific situations.

Election

The SALT Parity Act applies to tax years commencing on or after January 1, 2018, but prior to January 1, 2026. It permits partnerships and S corporations to make an election to be subject to Colorado income tax at the entity level for the tax period. An electing pass-through entity is considered a taxpayer with respect to the collection, administration, and enforcement of the tax as prescribed by law.

The annual election made by the partnership or S corporation is irrevocable and binding on all of its partners and shareholders, except that the election does not apply to any partner that is a C corporation that is unitary with the partnership.

The process for making the election differs depending on the tax year.

Tax years 2022 through 2025

For tax years commencing on or after January 1, 2022, but prior to January 1, 2026, a partnership or S corporation may make the election by checking the applicable box on its *Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return* (DR 0106). A partnership or S corporation that wishes to make the election prior to filing their return may do so by filing the *SALT Parity Act Election Form* (DR 1705). Forms and instructions are available online at *Tax.Colorado.gov/business-income-tax-forms*.

Partnerships and S corporations must complete a *Colorado K-1* (DR 0106K) for each of its partners or shareholders for each tax year. The partnership or S corporation must file the completed *Colorado K-1s* with the Department. Filing instructions are available online at *Tax.Colorado.gov/filing-requirement-changes-for-partnerships-and-s-corporations*. The partnership or S corporation must also furnish each partner and shareholder with a copy of the *Colorado K-1* reporting their share of income, deductions, modifications, and credits.

An electing pass-through entity is not required to file a *Colorado Nonresident Partner or Shareholder Agreement* (DR 0107) or remit payment with a *Statement of Colorado Tax Remittance for Nonresident Partner or Shareholder* (DR 0108) for the tax year with respect to any nonresident partners or shareholders. Additionally, an electing pass-through entity may not file a composite return for its nonresident partners or shareholders for the tax year of the election. Each partner or shareholder must file their own Colorado income tax return.

Tax years 2018 through 2021

For tax years commencing on or after January 1, 2018, but prior to January 1, 2022, a partnership or S corporation may make the election by filing an amended return developed by the Department specifically for making the election for these years. The electing partnership or S corporation must file this amended return on or after September 1, 2023, but before July 1, 2024. The amended return to make this election may be filed only by partnerships and S corporations who have already filed their original *Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return* (DR 0106). Filing information can be found online at *Tax.Colorado.gov/SALT-parity-act-election*.

Partner and shareholder credits and addbacks

The amended return filed to make the election for tax years 2018 through 2021, will be used to determine not only the tax owed by the electing pass-through entity, but also, with respect to each of its members:

- The credit allowed to each partner or shareholder for their share of the tax paid by the electing pass-through entity; and
- The additional tax owned by the partner or shareholder for the qualified business income deduction required as a result of the election.

Both the credit and the addback are discussed later in this publication.

Penalties and interest

Neither an electing pass-through entity nor its partners or shareholders will incur any penalties or interest with respect to the filing of the amended return to make the election for tax years 2018 through 2021. Additionally, the statute precludes the Department from paying penalties or interest on any amounts refunded to the taxpayers.

Statute of limitations

The statute of limitations under sections 39-21-107(2) and 39-21-108(1), C.R.S., do not preclude the filing of the amended return between September 1, 2023, but before July 1, 2024, to make the election for tax years 2018 through 2021 and do not apply to payments or refunds of tax made pursuant to the return.

Under the law, the Department may review the amended return and make a written proposed adjustment at any time within the 12 months following the filing of the return. The Department may thereafter assess any additional tax due as provided by law.

Tax calculation

The tax imposed on the electing pass-through entity is determined by multiplying the entity's Colorado taxable income by the applicable tax rate for the tax year. The entity's Colorado taxable income is the aggregate of the relevant income amounts for each partner or shareholder, as described below. Any partner that is a C corporation that is unitary with the partnership is excluded from this calculation.

Resident partners and shareholders

The Colorado taxable income of the electing pass-through entity includes each resident member's distributive or pro rata share of the pass-through entity's entire income, gain, loss, or deduction, all modified as prescribed by Colorado law. If a resident member's net income from the electing pass-through entity is negative, that resident member is excluded from this calculation. This amount should equal the sum of the income, gains, losses, deductions, and modifications reported in Column A of each resident partner's or shareholder's *Colorado K-1* (DR 0106K), except that any resident member whose net income from the pass-through entity is negative and any guaranteed payments are excluded from this calculation. The aggregate of the resident partners' or shareholders' income, gains, losses, deductions, and modifications is reported in Part III of the *Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return* (DR 0106). For additional information, please see the instructions for the DR 0106 and *Colorado K-1* (DR 0106K), both of which are available online at *Tax.Colorado.gov/business-income-tax-forms*.

For assistance in determining Colorado residency, please see section 39-22-342(5), C.R.S.; *1 CCR 201-2*, Rule 39-22-103(8)(a); and *Part 1* of the *Colorado Individual Income Tax Guide*.

Nonresident partners and shareholders

The Colorado taxable income of the electing pass-through entity includes each nonresident member's distributive or pro rata share of the pass-through entity's income, gain, loss, or deduction attributable to this state, all modified as prescribed by Colorado law. If a nonresident member's net income from the electing pass-through entity is negative, that nonresident member is excluded from this calculation. This amount should equal the sum of the income, gains, losses, deductions, and modifications reported in Column B of each nonresident partner's or shareholder's *Colorado K-1* (DR 0106K), except that any resident member whose net income from the pass-through entity is negative and any guaranteed payments are excluded from this calculation. The aggregate of the nonresident partners' or shareholders' income, gains, losses, deductions, and modifications is reported in Part III of the *Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return* (DR 0106). For additional information, please see the instructions for the DR 0106 and *Colorado K-1* (DR 0106K), both of which are available online at *Tax.Colorado.gov/business-income-tax-forms*.

Income tax credits

Any allowable income tax credits that are attributable to the activities of an electing pass-through entity in the taxable year are passed through to the electing pass-through entity owners. The partners and shareholders must file their own Colorado income tax returns to claim their distributive or pro rata share of any refundable or nonrefundable credits attributable to the activities of an electing pass-through entity. The electing pass-through entity may not claim any refundable or nonrefundable credits on its return.

Estimated tax payments

For tax years commencing on and after January 1, 2023, electing pass-through entities are subject to the same requirements for estimated tax payments as C corporations. In general, an electing pass-through entity must remit four quarterly estimated tax payments if its net Colorado tax liability for the tax year exceeds $5,000. The electing pass-through entity can calculate its estimated tax payments based on its net tax liability for the preceding year only if the entity made a SALT Parity Act election for that preceding tax year. Please see *Part 9* of the *Colorado Corporate Income Tax Guide* for additional information regarding estimated tax payment requirements.

A pass-through entity that makes a SALT Parity Act election for any tax year commencing prior to January 1, 2023, is not required to make estimated tax payments for that tax year.

Partners and shareholders

Every electing pass-through entity owner must file their own Colorado income tax return for the year of the election. The electing pass-through entity may not file a composite return on behalf of any of its nonresident partners or shareholders.

In addition to any other requirements prescribed by Colorado, each electing pass-through entity owner must claim on their return their share of the Colorado income tax paid by the electing pass-through entity. They must also add back to federal taxable income on their Colorado return any qualified business deduction claimed on their federal return and their share of state income tax deducted by the pass-through entity on its federal return.

Electing pass-through entity owner tax credit

Each electing pass-through entity owner is allowed a credit against their Colorado income tax liability equal to the share of the tax imposed upon and paid by the entity with respect to the partner's or shareholder's income. The credit is allowed only if the electing pass-through entity actually paid the tax and provided sufficient information on the electing pass-through entity tax return to identify the electing pass-through entity owner.

The electing pass-through entity must state the amount of the credit on the *Colorado K-1* (DR 0106K) provided to the electing pass-through entity owner. If the credit allowed to the electing pass-through entity owner exceeds the Colorado income tax they otherwise owe, the excess will be refunded to them.

If a partnership is a partner (an "upper-tier partnership") in another partnership (a "lower-tier partnership") that made a SALT Parity Act election, the credit allowed to the upper-tier partnership for tax paid by the lower-tier partnership passes through to the upper-tier partnership's partners. The upper-tier partnership must report each partner's share of the credit on line 22 of the partner's *Colorado K-1* (DR 0106K). Each partner may claim their share of the credit on their own Colorado income tax return.

Qualified business income addback

If a partnership or S corporation makes the SALT Parity Act election, all of its partners or shareholders must add back to federal taxable income on their Colorado return any qualified business deduction claimed under section 199A of the Internal Revenue Code on their federal return. The addback is required for the full amount of the qualified business deduction claimed by the electing pass-through entity owner on their federal return.

State income tax addback

Partners and shareholders must make an addition on their Colorado income tax returns for their distributive share of state income deducted tax by the partnership or S corporation on its federal return. For additional information, please see Department publication *Income Tax Topics: State Income Tax Addback*, available online at *Tax.Colorado.gov/guidance-publications*.

Colorado K-1 (DR 0106K)

Every partnership and S corporation must furnish each partner and shareholder with a copy of the *Colorado K-1* (DR 0106K) reporting their share of income, deductions, modifications, and credits. For additional information regarding the *Colorado K-1*, please see the *Colorado K-1*, its instructions, and the *Individual Partner and Shareholder Instructions For Colorado K-1 (DR 0106K)*, all of which are available online at *Tax.Colorado.gov/business-income-tax-forms*.
Information about income tax apportionment for part-year residents and nonresidents is provided in *Income Tax Topics: Part-Year Residents & Nonresidents*, available online at *Tax.Colorado.gov/individual-income-tax-guidance-publications*.

Additional resources

The following is a list of statutes, regulations, forms, and guidance pertaining to the SALT Parity Act. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

Statutes and regulations

- *House Bill 21-1327*
- *Senate Bill 22-124*
- § 39-22-340, et seq., C.R.S. SALT Parity Act.
- § 39-22-601, C.R.S. Returns.
- § 39-22-606, C.R.S. Failure by corporation to pay estimated income tax.
- § 39-22-104, C.R.S. Income tax imposed on individuals, estates, and trusts.
- 26 U.S.C. § 164. Taxes.

Forms and guidance

- *Colorado.gov/Tax*
- *Tax.Colorado.gov/business-income-tax-forms*
- *Tax.Colorado.gov/SALT-parity-act-election*
- *Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return* (DR 0106)
- *SALT Parity Act Election Form* (DR 1705)
- *Colorado K-1* (DR 0106K)
- *Individual Partner and Shareholder Instructions For Colorado K-1 (DR 0106K)*
- *Part 1* of the *Colorado Individual Income Tax Guide*
- *Part 9* of the *Colorado Corporate Income Tax Guide*
- *Tax.Colorado.gov/individual-income-tax-guidance-publications*
- *Income Tax Topics: Part-Year Residents & Nonresidents*