

Senator Grohoski, Representative Cloutier, Members of the Taxation Committee, my name is John Hadwen. I am a Certified Public Accountant (CPA) and Principal of Albin Randall & Bennett residing in Falmouth and I am testifying in support of LD 191.

The pass-through entity tax proposed in LD 191 represents a practical approach to taxation that aligns with contemporary trends observed in many states across the nation.

For many years, the federal government granted an unlimited deduction for state income taxes paid by individuals and trusts. Congress, in 2017 with the enactment of the Tax Cuts and Jobs Act (TCJA), capped the deduction of state taxes to \$10,000 per year ("SALT Cap"). This limitation significantly impacted individual owners of pass-through entities – S corporations, partnerships, and LLCs. This cap does not apply to taxes paid by businesses such as C corporations.

However, in 2020, the IRS – in Notice 2020-75, announced the IRS would not apply the \$10,000 SALT Cap to pass-through entities if the state income tax was imposed directly on the entity. If Maine allows an election to move its point of taxation from the individual owners of a passthrough entity to the entity itself, the federal government will not impose the \$10,000 cap on deductions claimed by the entity.

The pass-through entity tax ensures equitable taxation by taxing business income at the individual owner level. This approach avoids the issue of double taxation that can burden businesses operating as C corporations, contributing to a fair and balanced tax system.

Many small and medium-sized enterprises (SMEs) choose the pass-through structure for its flexibility. LD 191's pass-through entity tax recognizes the unique needs of these businesses, providing a tax framework that supports their growth and development.

Most states across the U.S. have implemented some form of pass-through entity tax or have made adjustments to existing structures to accommodate these business entities. This reflects a recognition of the vital role that pass-through entities play in the economic landscape and the importance of tailoring tax policies to their specific characteristics.

Maine is one of six remaining states with an individual income tax that has not implemented a pass-through entity tax.

The potential repeal of TCJA after the 2025 tax year has prompted discussions on whether the Pass-Through Entity Tax is worth implementing.

The potential repeal of TCJA raises concerns about the resurgence of the Alternative Minimum Tax (AMT) for individual taxpayers. AMT is a separate tax system that requires some taxpayers to calculate their tax liability twice. First, under ordinary income tax rules, then under the AMT, and pay whichever amount is highest. Under the AMT rules the taxpayer does not receive a deduction for taxes paid. Pass-through entities can serve as a protective mechanism against the impact of AMT, as their income is not subject to this tax at the entity level.

Under a pass-through entity tax structure, individual owners report their share of the business income on their personal tax returns. This income is then subject to regular income tax rates, avoiding the complexities and potential higher tax liability associated with the AMT. As discussions around tax reform evolve, the pass-through entity tax becomes a strategic option to shield taxpayers from the uncertainties surrounding the AMT.

An advantage of a pass-through entity tax, especially in the context of a potential TCJA repeal, is the potential for self-employment tax savings. Self-employment tax is a tax consisting of Social Security and Medicare taxes primarily for individuals who work for themselves. The self-employment tax rate is generally 15.3%. That rate is the sum of 12.4% for Social Security and 2.9% for Medicare.

Generally, the individual owners of pass-through entities taxed as partnerships are subject to self-employment taxes on any net profits reported on their personal tax returns. This tax would allow these owners to deduct their state income taxes in computing their net profits, resulting in significant savings on self-employment taxes.

LD 191 can provide tax savings for individual owners of pass-through entities of all sizes. Attached is an example of the potential tax savings for an owner utilizing the PTET under LD 191, if enacted.

In summary, I urge the Committee to support LD 191 with the amendments provided by the Maine Society of CPAs.

Thank you for your time and consideration. I am happy to answer any questions.

FOR DISCUSSION PURPOSES ONLY

PASS-THROUGH ENTITY TAX (PTET) ANALYSIS - MAINE

NOTES/ASSUMPTIONS:

- Top marginal tax rates of 37% federal and 7.15% ME
- LD 191 is a similar PTET structure to Massachusetts

Taxes on Pass-Through Entity Owners with no PTET

	\$	100,000	Federal Taxable Income from Business
29.60%	\$	29,600	Effective Federal Tax (includes 20% 199A deduction)
7.15%	\$	7,150	ME Income Tax
	\$	<u>36,750</u>	Total Taxes Paid by Owners

Taxes on Pass-Through Entity Owners with PTET

	\$	100,000	Federal Taxable Income before taxes from Business
7.15%	\$	7,150	ME Income Tax - PTET Deduction (Paid by Entity)
	\$	<u>92,850</u>	Federal Taxable Income from Business
29.60%	\$	27,484	Effective Federal Tax (includes 20% 199A deduction)
	\$	715	ME Income Tax - Additional Tax After 90% PTET Credit
	\$	<u>35,349</u>	Total Taxes Paid by Owners
	\$	2,116	Federal Tax Savings for Owners
	\$	(715)	Additional Maine Paid by Owners
	\$	<u>1,401</u>	Net Tax Savings for Owners

Additional Tax Savings for Self-Employed Owners

	\$	7,150	PTET Deduction for Business
		15.30%	Self-Employment Tax Rate*
	\$	<u>1,094</u>	Additional Tax Savings for Self-Employed Owners

* For 2024, the first \$168,600 of net earnings are subject to self-employment tax. Additional net earnings are subject to the 2.9% Medicare tax.