

Virginia's Tax Workaround for Business Owners:

At Canal Capital Management, we provide objective guidance and disciplined investment management for our clients. Importantly, tax strategies are a part of every decision we make.

A topic we have been discussing with business owner clients is related to recent legislation that provides an opportunity for business owners to reduce their federal income tax liability if the business makes an election to pay Virginia taxes at the entity level.

Following the Tax Cuts and Jobs Act in 2017, the State and Local Tax (SALT) cap of \$10,000 has been a pain point for many Virginia tax filers. This spring, Virginia became the 25th state to pass legislation permitting a qualifying business to make an annual election for Tax Years 2021 through 2025 to pay an elective income tax at a rate of 5.75% at the business level. If the business makes an election and pays the Virginia tax, the business owner receives a corresponding Virginia credit for his/her pro rata share of tax paid, and the business can deduct the full amount of state income tax paid from federal income – thus the SALT deduction is maximized.

This law generally impacts business owners that file as an S Corp, Partnership or LLC. Sole proprietorships and single member LLCs do not qualify. For SALT parity to work, there must be a legal entity – a corporation or partnership – to pay the taxes.

Of note, this new legislation creates a retroactive election for tax year 2021 with guidelines for filing the election expected to be posted by the Department of Taxation by October 15, 2023. For tax years 2022 through 2025, an electing business will be required to make an annual election on or before the due date for filing the business return.

As an example of the potential tax savings, if a business has income of \$500,000 in 2022 and elects to pay the Virginia business tax of \$28,750 ($\$500,000 \times 5.75\%$), the \$28,750 is a federal tax deduction which saves the owners an estimated \$10,600 in federal income taxes ($\$28,750 \times 37\%$, assuming the highest federal rate).



As more concrete details emerge, it is important for business owners to reach out to their tax and legal counsel to ensure their individual circumstances apply.

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