Georgia GOAL Education Expense Tax Credit Opportunity for Businesses

I. **Federal Tax Benefit for "C" Corporations**
II. **Federal Tax Benefit for Some Pass-Through Entities**
III. **<u>Significant New Pass-through Entity Benefit & Opportunity, effective 2022</u>**

"C" Corporations and Pass-Through Businesses Can Make a Business Payment to the Georgia GOAL Scholarship Program That Benefits Their Local Private Schools

I. In addition to a 100% Georgia income tax credit, a federal deduction is also available for "C" Corporations.

When the IRS eliminated the federal deductibility of contributions to state income tax credit programs in 2018, they followed up by providing a safe harbor for "C" Corporations [IRS Rev. Proc. 2019-12], indicating that if the contributions to state income tax credit programs constitute ordinary and necessary business expenses, then the businesses may deduct them as such.

- At any time during the year, a "C" Corporation or trust shall be allowed a 100% Georgia income tax credit for contributions to Georgia GOAL equal to the amount of the contribution, or 75% of the corporation or trust's income tax liability, whichever is less.

II. In addition to a 100% Georgia income tax credit, a federal deduction is also available for some pass-through business entities.

<u>Currently (2021) and for pass-through entities not electing to pay tax at the entity level (when that is permissible in 2022 and beyond)</u>:

On August 11, 2020, the IRS finalized its earlier proposed regulations confirming that pass-through business entities will also be permitted to deduct contributions to state income tax credit programs, like Georgia GOAL, if they qualify as <u>ordinary and necessary business expenses</u>.

- Businesses can deduct payments relevant to their trade or business that are made with the reasonable expectation of financial return commensurate with (but according to the IRS, not necessarily equal to) the amount of the payment.
  - The business expense deduction <u>reduces the taxable net income of the pass-through business owner at the federal level</u>, resulting in federal tax savings.

- If the business "reasonably believes the program will generate a significant degree of name recognition and goodwill in the communities where it operates and thereby increase its revenue," a federal business expense deduction may be available *even though the business does not have a business relationship with the SSO or private school*.
- An example in the IRS Regulations explains that the business expense deduction may be available for payments made by a business located in a state "for use in projects that improve conditions in the state," which could include greater K-12 educational opportunities that improve educational outcomes, result in fiscal and economic savings for the state, and attract business to the state.
- The business should estimate the possible goodwill benefit and document the steps taken to derive the benefit (**though the IRS does not require certainty of the outcome).**
- **For examples of federal tax benefit, which is $3,500 for a $10,000 contribution under certain circumstances, see: https://tinyurl.com/QEECredit**

- **As a pass-through entity owner, how do I make payment to Georgia GOAL so that it qualifies for both the federal deduction and the state credit?** In addition to benefiting from the federal business expense deduction taken by the business, proposed Georgia Department of Revenue Rule 560-7-8-.57 reveals that the owner of a pass-through business can apply for a Georgia GOAL Education Expense Tax Credit corresponding to his or her percentage ownership share of the payment the business makes to Georgia GOAL. The pass-through entity may make the payment and take the business deduction in order to receive the beneficial federal tax treatment, and the individual pass-through owner may receive the Georgia income tax credit.
  - Note: When you submit your tax credit application to Georgia GOAL as a pass-through owner planning to deduct the payment as a business expense, you will provide your personal information, as usual, as well as the name of the pass-through entity which will be making the payment.
- **How do I determine how much of this tax credit I can take as a pass-through owner?** All Georgia income, loss and expense from the taxpayer-selected pass-through entities will be combined to determine Georgia income for purposes of this credit. Note: even W2 income from the entity may be included as well as K-1 income (i.e., salaries and profits may be counted). Such combined Georgia income shall be multiplied by 5.75% (Georgia's 2021 income tax rate) to determine that tax that was actually paid.
  - Helpful example: the taxpayer's Georgia income from pass through entities in 2021 must be at least $173,913 to take advantage of a $10,000 tax credit ($173,913 * 5.75% = $10,000).
- **If a payment is made by the pass-through entity to GOAL, do all pass-through owners need to apply for their pro-rata share of the Georgia income tax credit?** Yes. The GA DOR regulations for the credit are very clear that, if the payment is made by a pass-through entity, the credits must be allocated pro-rata to the business owners based on their year-end profit/loss percentages.

III. There is a new, more generous opportunity allowing a SALT workaround and larger pass-through entity contribution for 100% Georgia income tax credit (HB 149).

Pass-through entities electing to pay tax at the entity level (effective in 2022):

Federal Action: Through IRS Notice 2020-75, issued on November 9, 2020, the IRS has allowed for a "SALT Workaround" for pass-through entities paying state income tax. In other words, the IRS will allow for state and local income taxes *imposed on and paid by a pass-through entity with respect to its income* to be taken as a deduction by the pass-through entity in computing its taxable income or loss for the year. *These taxes are not subject to the SALT limitation for partners and shareholders who itemize deductions.*

Georgia Action: HB 149, which the Georgia General Assembly passed during its 2021 legislative session, represents Georgia's response to this IRS Notice, and provides that pass-through entities may make an annual election to pay the tax due on income earned by the entity *at the entity level* at the rate of 5.75%.

GOAL Impact:
HB 149 specifically provides that the electing entity shall be eligible for the Georgia GOAL credit and will be treated as an "other entity" ***that is eligible for a credit in an amount up to 75% of the entity's Georgia income tax liability.*** Additionally, the electing pass-through entity will not be required to claim any business purpose for the payment besides satisfying the entity's Georgia tax liability.

Additional Information related to HB 149, effective in 2022:

- S corporations and partnerships will be allowed to annually make an irrevocable election, on a timely filed applicable income tax return including extensions, to pay tax on their Georgia allocated or apportioned income at the entity level. The income will be subject to a 5.75% tax rate, and no deduction will be allowed for taxes based on gross or net income.

- Electing S corporations and partnerships will be subject to the estimated payment requirements that apply to C corporations.

- The income on which tax is paid by the electing S corporation or partnership will not be reported on the Georgia personal tax returns of the shareholders and partners and therefore will not be taxed at the shareholder/partner level.

- Resident shareholders and partners of electing S corporations and partnerships will also not be subject to Georgia income tax on income that is allocated or apportioned to other states.

- Nonresident shareholders and partners of electing S corporations and partnerships will not be subject to Georgia tax on the income allocated or apportioned to Georgia that will be subject to the entity-level tax. Also, the required withholding on distributions to nonresident members of partnerships, S corporations and LLCs will not apply to electing S corporations and partnerships.

- Electing S corporations and partnerships will be eligible to claim the following income tax credits: the Qualified Education Expense Credit, Qualified Rural Hospital Organization Expense Credit, and Qualified Education Donation Credit. For purposes of these credits the electing S corporation or partnership will be treated as an "other entity", and therefore will be eligible to claim a credit of up to 75% of the entity's Georgia tax liability.

- The election will not impact shareholder or partner tax basis except that their pro rata share of tax paid by the entity will be considered.

- An electing S corporation or partnership must be directly owned by persons eligible to be shareholders of an S corporation. Eligible S corporation shareholders include individuals (except for nonresident aliens), estates and certain trusts, and exclude corporations, partnerships and LLCs.

Other Information for Businesses

Can this tax credit be carried forward? No.

For C corporations, fiduciaries, or "other entities" (including pass-through entities electing to pay tax at the entity level), the credit is limited to the lesser of the actual amount expended or 75% of the entity's income tax liability, with no carryforward opportunity.

For pass-through entities not electing to pay tax at the entity level, if the entity's owner is approved for an amount that exceeds their calculated tax as a result of their pass-through ownership when their return is filed (i.e., all Georgia income, loss, and expense from the taxpayer selected pass-through entities multiplied by the Georgia marginal tax rate, which is 5.75% for 2021), the excess amount cannot be claimed by the taxpayer and cannot be carried forward.

However: Any amount of the credit claimed but not used on the taxpayer's Georgia income tax return shall be allowed to be carried forward to apply to the taxpayer's succeeding five years' tax liability (this applies to "C" Corporations, fiduciaries and "other entities" as well). [An example of this situation: the credit could have been taken based upon income, but perhaps other credits offset the tax liability, such that the QEE credit is not being fully used in the current year.]