



## The Virginia Department of Tax Publishes Pass-Through Entity Tax FAQs

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The Virginia Department of Taxation (Department) recently published **Virginia Pass-Through Entity Tax Frequently Asked Questions for Taxable Years 2022 and After** (FAQs). As summarized below, the FAQs provide helpful guidance to many questions that were left unanswered when the Pass-Through Entity Tax (PTET) was enacted in 2022.

The FAQs also confirm that the **Draft Guidelines** issued by the Department on October 31, 2022 may be relied upon until the Department issues Final Guidelines. Importantly, it is worth noting that the Draft Guidelines and FAQs address only tax year 2022 and later years. It does not affect tax year 2021. We anticipate additional guidance on tax year 2021 later this year.

### **PTEs May Qualify at Any Time During Tax Year**

One of the most important questions practitioners have asked is whether a pass-through entity (PTE) needs to be a qualifying PTE for the entire year. This issue is important because a qualifying entity must be 100% owned by natural persons, or in the case of an S corporation, 100% owned by persons eligible to be shareholders of an S corporation.

When the law was enacted in 2022, LLCs found they could not make the PTET election if they had owners who were not natural persons. This feature of the law prompted questions as to whether an LLC could change its ownership during the year so that it would be treated as a qualifying PTE.

The FAQs answer this question by stating that a PTE can make the PTET election as long as it is a qualifying PTE at any time during the taxable year and it flows through refundable PTET credits to natural persons, or in the case of an S corporation, persons who are eligible to be shareholders of an S corporation, in proportion to each owner's distributive share.

### **Short-Year PTE Filers Permitted**

The FAQs state that a PTE filing a short-year return can make a PTET election for 2022. They also

provide that if there was no mechanism for the short-year filer to pay the PTET by the applicable due dates, the PTET may file an offer-in-compromise on Form OIC B-2 documenting why the extension, late payment, or other penalties should not be imposed.

If there was no mechanism for such PTE to file the PTET return by the applicable extended due date, taxpayers also may file an offer-in-compromise on Form OIC B-2 documenting why a late filing of the Form 502PTET should be allowed. Such offers will be considered on a case-by-case basis.

### **Other Procedural Matters Addressed by the FAQs**

The FAQs also state that owners who paid estimated tax payments during 2022 may request that their payments be transferred so that they count as estimated payments of Virginia PTET. To prevent processing issues and erroneous bills from the Department for unpaid taxes, the FAQs state the request should be made before the respective individual and PTE returns are filed.

The FAQs also reiterate that the PTET electronic payment and filing are required to make a valid PTET election. Submitting a paper Form 502V (Pass-Through Entity Tax Payment Voucher) with a check will not count as a valid PTET election.

The FAQs add that while all payments made previously using online Form 502V will be processed and count as a valid election, all future payments should be made using online Form PTET-PMT instead of online Form 502V. Taxpayers can make an ACH Credit payment using return code 00032, and such payments will count as a valid election.

In addition, the FAQs state that a non-Virginia PTE that does not have Virginia source income and no Virginia tax filing requirements may make the election and pay the Virginia PTET on behalf of its partners, owners, or members that are Virginia residents.

### **Questions Left Unanswered**

The FAQs still leave unanswered some questions and issues raised by practitioners. For example, the FAQs do not address whether the Department will respect partnership agreements that contain special allocations of the PTET for purposes of eligible owners claiming the refundable credit for the PTET. Additionally, some practitioners have expressed concern that for federal income tax purposes accrual basis PTEs will not be able to accrue unpaid PTET as of December 31 because the PTET is elective. Under this argument, the PTE has no affirmative liability at the entity level for an elective tax until the election is actually made, and under Virginia's PTET statute the election cannot be made until the return is filed in the subsequent taxable year. Even in that instance, a PTET payment for a prior taxable year should still be deductible for federal income tax purposes in the taxable year when actually paid. If the Internal Revenue Service fails to issue guidance on this issue, hopefully the General Assembly will amend Virginia's PTET statute to permit an election to be made at any time during the taxable year.

Williams Mullen will continue to monitor developments relating to the Virginia PTE election. Should you have any questions regarding the FAQs or Draft Guidelines, please do not hesitate to reach out to any member of the firm's Tax Section.

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