

Mississippi Enacts Pass-Through Entity Income Tax Election / SALT Cap Workaround

Article By:

John F. Fletcher

Mississippi recently passed a SALT cap workaround in the form of a flow-through entity election. Consistent with the roughly 26 other states having adopted similar schemes, the Mississippi bill presents several grey areas and questions that will need to be addressed through [Department of Revenue](#) guidance or possible technical corrections.

[H.B. 1691](#), signed into law by Governor Reeves on April 14, authorizes certain pass-through entities to pay an entity-level income tax in lieu of the partners/owners paying income tax on those amounts at the individual level, thereby freeing up other state and local taxes for the limited federal itemized deduction (the “SALT Cap”). An “electing pass-through entity” is defined as a partnership, S Corporation or similar pass-through entity having made an election pursuant to the new code section (not yet codified or designated). The election will be made by submitting a designated form to the [Department of Revenue](#) on or before the 15th day of the 3d month following the close of the tax year (typically, March 15). Once made, the election is binding for all subsequent years until formally revoked by the entity.

The bill contains an interesting approval process that may override the internal voting procedures for many entities. To make or revoke an election, there must be a “a vote by or written consent of the members of the governing body of the entity as well as a vote by or written consent of the owners, members, partners or shareholders holding greater than fifty percent (50%) of the voting control of the entity, within the time prescribed in this subsection.” Thus, the approval must be made at two levels even though management decisions may be centralized in a board or other governing body, the vote must pass by a specified threshold that may not be consistent with other voting rights/thresholds provided under an entity’s governance documents, and the votes must take place within a specified time frame. A strict reading of the vote requirement may also pose questions whether a simple manager governance structure constitutes a centralized board or “other governing body.”

Once made, each “owner, member, partner or shareholder” (not explicitly limited to individuals) will report his or her distributive share of the entity’s pass-through income, but that income will be exempt at the owner level. Each such owner, etc. in turn shall be allowed a credit against the taxes imposed under this chapter in an amount equal to his or her pro rata or distributive share of tax paid by the electing pass-through entity with respect to the corresponding taxable year. It is unclear why

an individual Mississippi credit would be required with respect to this income given that it is explicitly exempt from tax, but one would assume no double benefit was intended.

The adjusted basis of the owners, members or partners of an electing pass-through entity in their ownership interests in the electing pass-through entity shall be calculated without regard to the election under this new provision.

Several additional details may need to be addressed under the new legislation:

- It is unclear how this new provision will operate in a tiered structure containing multiple pass-through entities, specifically whether the owner-level exemption is contingent on a tax payment having been made by that immediate pass-through entity as opposed to one further up the chain;
- Presumably income distributable to a corporate owner will be exempt as well as that received by individuals;
- It is unclear whether paying tax at the entity level will sever nexus for any corporate owners whose sole contact with the state is via that pass-through entity;
- The basis calculation rules in theory should help minimize federal/state differences in gain or loss calculations on a sale of an ownership interest;
- The bill does not appear to remove the existing option of filing composite returns on behalf of nonresident partners;
- The bill does not appear to alter how Mississippi apportions partnership income at the entity level, or the method of “flowing up” the entity’s apportionment factors for franchise tax purposes;
- Additional issues may arise as to how a resident partner claims the credit for income taxes paid to other states on any income exempt in Mississippi under this new law.

The bill is effective January 1, 2022, but the deadline for making an election for the 2021 tax year had already lapsed prior to passage so unless a technical correction is passed, it effectively is available for the 2022 year and thereafter.

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