Pass-Through Entity Tax (PTET)

Bottom Line: The proposed tax legislation from the House Ways and Means Committee takes away the ability for all accounting firms to use the pass-through entity tax (PTET) deduction. By eliminating (PTET), the proposed legislation indirectly raises taxes on millions of businesses to pay for tax cuts for corporations.

Currently, the federal deduction for state and local income taxes for individuals is capped at $10,000. This has a disproportionate impact on business owners who are operating as sole proprietorships, disregarded entities, or pass-through entities.

- Corporations may fully deduct state and local income taxes in determining their taxable income. Corporations also have an effective tax rate of 21 percent.
- To ensure pass-through entities can access the same tax benefit that is offered to large corporations, many states have enacted various approaches to mitigate the $10,000 SALT limitation by shifting the state and local tax liability on pass-through entity income from the owner to the pass-through entity itself.
- For the purposes of trying to create a level playing field between corporations and pass-throughs, Treasury determined the payment of a pass-through entity tax, paid at the entity level, to be federally deductible and permitted the partners/owners to claim a state and local tax credit/deduction on the owner's state income tax return.

The House Ways and Means Committee's proposed tax legislation makes the situation worse for pass-through entities, while leaving their competitor corporations' ability to deduct state and local taxes untouched. Under the House Ways and Means Committee's proposed tax legislation that was released earlier this week and is currently moving through the House of Representatives, specified service trades or businesses (SSTBs) (e.g., accountants, veterinarians, dentists, doctors, lawyers, nurses) are subject to the individual state and local tax deduction limits regardless of partners'/owners' income level or the state in which they live.

- The proposed bill would unfairly exclude these SSTBs from deducting state and local income taxes at the partnership level, as is currently permitted.
- The proposed bill sets individual state and local tax deduction limits of $30,000 for most filers, and $15,000 for married individuals filing separately. Under the proposed bill, state and local taxes for SSTBs would be disallowed

at the entity level and would flow through the partnership to the partners/owners – therefore, contributing toward their individual SALT deduction limitation.

- This proposal additionally increases tax on CPA firms beyond their tax liability prior to implementation of the pass-through entity tax deduction approach. Specifically, the proposal newly subjects local entity level taxes to the individual cap.
- The bill includes no such limitation on the federal deductibility of state and local taxes for corporations.
- By eliminating the entity level deduction for pass-throughs, the bill is targeting service providers, who were already substantially limited under the SSTB rules for the qualified business income (QBI) deduction.
- The targeting of SSTBs would further increase taxes on millions of service-based businesses, discourage the creation and growth of such businesses, and expand the advantages of C corporations over pass-through entities.

Congress should continue to retain the ability for ALL pass-throughs, which make up the vast majority of businesses, to deduct entity-level state and local taxes at the federal level. Eliminating this deduction hurts millions of American job creators in order to provide corporations with extended benefits.