



Pass-Through Entity Tax (PTET) Background

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

Corporations may deduct state and local income taxes in determining their taxable income. Corporations also have an effective tax rate of 21 percent.

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.

The IRS allows the payment of a pass-through entity tax to be fully federally deductible and permits the partners/owners to claim a state and local tax credit or deduction on the owner's state income tax return. This helps to provide some parity between corporations and pass-throughs.

Under tax legislation currently being considered in the Senate and recently passed in the House of Representatives, specified service trades or businesses (SSTBs) (e.g., accountants, veterinarians, dentists, doctors, lawyer, nurses) are no longer able to deduct any state and local income tax at the federal level, regardless of partners'/owners' income level or the state in which they live.

The proposed bill unfairly excludes these SSTBs from deducting state and local income taxes at the partnership level, as is currently permitted. It also 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.

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.