Businesses Using Passthrough Entities Win Big in Trump Tax Bill

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Frost Brown Todd's Mark F. Sommer, Elizabeth M. Ethington, and Kenneth Schwalbert Jr. authored an article in *Bloomberg Tax* analyzing the impact of recent federal tax legislation on the Pass-Through Entity Tax (PTET), a strategy that allows business owners to bypass the state and local tax (SALT) deduction cap. Read the full article below:

President Donald Trump's signature tax legislation solidified a major benefit for business owners who have been maneuvering around state and local tax deduction caps for years, cementing something that for many years had been in part theoretical until now—the passthrough entity tax.

On its face, a PTET is levied on a flow-through entity, such as a partnership or an S corporation, under which passthrough entities can pay a tax in return for a credit or deduction against the state tax imposed on the owner of the passthrough entity. Owners "pay" their tax at the entity level, as opposed to paying individual income tax on their share of the pass-through entity profits.

The PTET concept—part of the 2017 Tax Cuts and Jobs Act—provided taxpayers an opportunity to work around the $10,000 annual SALT cap for individuals, sparking further growth opportunities for businesses with regards to capital and money saved. Since the IRS approved the concept in 2020, three dozen states have enacted laws allowing pass-through entities to use a PTET to avoid the SALT deduction cap.

The new tax law increases the limit on the SALT cap to $40,000 annually ($20,000 for married couples filing separately) and will adjust for inflation. Barring another act of Congress, the SALT cap will revert back to $10,000 in 2030. Meanwhile, the SALT cap limit will phase down for taxpayers with modified adjusted gross incomes over $500,000, bottoming out at $10,000 for gross incomes of $600,000.

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For the first time, Congress' fingerprints are on the PTET strategy/concept. The result is that pass-through entity business owners can still pay a PTET in return for a credit or deduction against the state tax imposed—and this method isn't limited at all by the SALT deduction cap.

This will allow businesses to maximize tax savings by reducing cash flow and individual liability at the state level. Business owners will be able to use the credit/deduction from the PTET and apply it to their state tax liability, which is a huge tax savings. Using the PTET will promote business growth by allowing capital that otherwise would be eaten up by tax bills to be used to promote other endeavors because the SALT deduction cap doesn't apply to the PTET.

States will likely continue to enact and modify their own legislation regarding the PTET, as many states have framework in place that vary from the federal version. Additionally, the One Big Beautiful Bill Act and the SALT cap deduction increase will likely cause states to modify their respective PTET legislation. At least five states will have to take legislative action in 2025 as their respective versions of the PTET were linked to the original SALT cap life and will need to extend the cap life through 2030, whent the reversion to $10,000 takes place.

The new federal tax law and its reaffirmance of the PTET is a major win for pass-through entities and business owners. While there is cause to celebrate this victory, there is something important to note in the periphery.

In the coming months, the IRS and Treasury likely will be proposing regulations for the many provisions in the new tax law, including the PTET. While these regulations will help clarify the implementation and impact of the law, there is another impact to be on the lookout for: the president's 10-to-1 Deregulation Initiative.

The directive states that for every new regulation issued, at least 10 will be repealed by the respective federal agency. While it is premature to determine which regulations will be repealed as a result of new guidance issued in relation to the new tax law, it is still pertinent.

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Attorneys and tax practitioners should stay current on legislative developments happening state-by-state to best guide clients wishing to use the PTET and its benefits. It is possible that the needs of the client will change year-to-year, state-to-state, and practitioners need to be well versed in entity structure and elections as both of these are critical in regard to the PTET and potential deductions. Additionally, as federal guidance from the IRS and Treasury is released, practitioners will need to stay up to date with what is happening at the federal level as well.

The Trump administration's tax legislation cemented the PTET as a big win for the business community. With no restrictions added to limit the PTET's scope, the new legislation allows business owners of passthrough entities to pay state income tax at the entity level, while reaping major tax benefits. It's an exciting time for businesses and tax practitioners all the same.

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