

# **Discussion Panel: The Pass Through Entity Tax– Revenue Forecasting Issues and Challenges**

Federal Tax Administrators Revenue Forecasting Conference  
Salt Lake City, October 3, 2023

## Moderator

Steven Giachetti, DC ORA

## Panelists

Joshua Goldstein, NYC OMB

Eden Mulate, NYC OMB

Colby White, CA Dept. of Finance

Allen Prohofsky, CA Franchise Tax Board



**Opinions and conclusions presented here are solely my own and do not express the views or opinions of DC ORA. All data on Virginia is publicly available.**



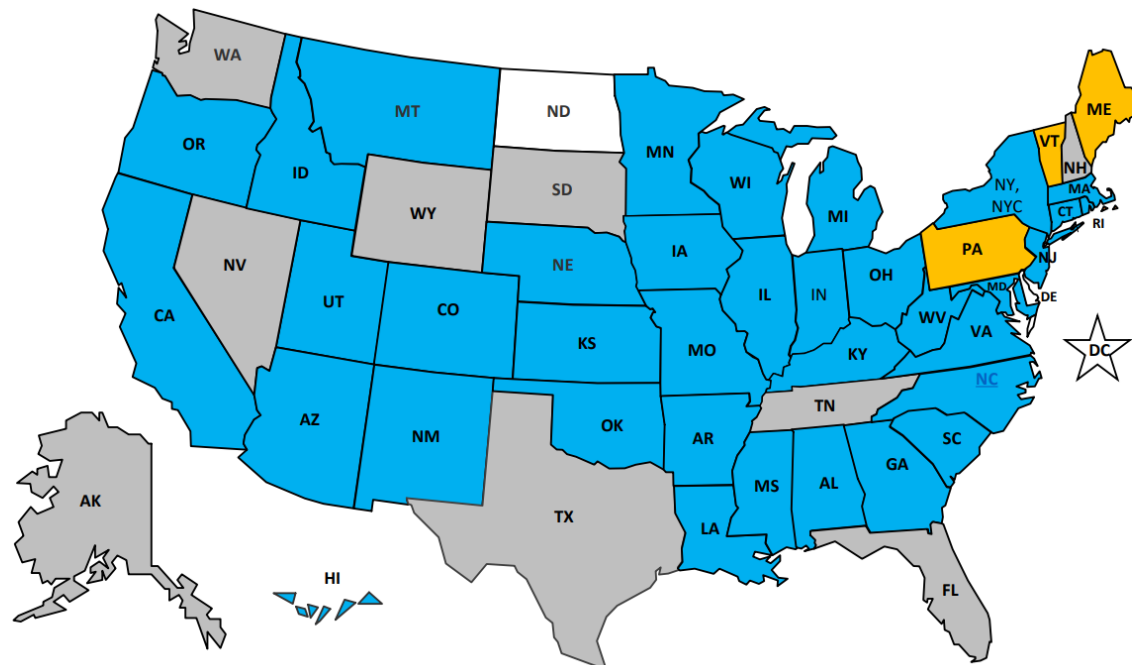
## Overview:

- Since the TCJA imposed a \$10,000 limit on SALT deductions, 36 states and one locality have enacted workarounds to circumvent the SALT limitation.
- Generally, these revenue neutral workarounds have taken the form of imposing an entity level tax on pass through income, which the IRS has ruled as an admissible deduction from Federal AGI, therefore circumventing the SALT cap that is still in effect.
- There are some precedents of pass through entity level taxes: e.g., both DC and NYC have entity level unincorporated business taxes.
- The entity level taxes proliferated post TCJA. According to a recent Tax Policy Center study, these SALT workarounds have cost the Feds up \$20 billion\*, or about 15 percent of the revenue impact assumed by the JCT resulting from the SALT limitation.

\*Source: WSJ August 27, 2023 <https://www.wsj.com/politics/the-salt-cap-has-a-20-billion-hole-a0cd2db>



## Thirty-Six States and One Locality Have Enacted SALT Workarounds



● 36 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:

[AL](#), [AR<sup>1</sup>](#), [AZ<sup>1</sup>](#), [CA](#), [CO<sup>3</sup>](#), [CT<sup>4</sup>](#), [HI<sup>2</sup>](#), [GA<sup>1</sup>](#), [IA<sup>1</sup>](#), [ID](#), [IL](#), [IN<sup>1</sup>](#), [KS<sup>1</sup>](#), [KY<sup>1</sup>](#) (& [KY](#)), [LA](#), [MA](#), [MI](#), [MD](#), [MN](#), [MO<sup>1</sup>](#), [MS<sup>1</sup>](#), [MT<sup>2</sup>](#), [NC<sup>1</sup>](#), [NE<sup>3</sup>](#), [NJ](#), [NM<sup>1</sup>](#), [NY](#), [OH<sup>1</sup>](#), [OK](#), [OR<sup>1</sup>](#), [RI](#), [SC](#), [UT<sup>1</sup>](#), [VA](#), [WI](#), [WV<sup>1</sup>](#), and [NYC<sup>1</sup>](#)

<sup>1</sup> Effective in 2022

<sup>2</sup> Effective in 2023 or later

<sup>3</sup> Retroactive to 2018

<sup>4</sup> Mandatory 2018-2023, elective starting 2024

● 3 states with proposed PTE tax bills:  
ME - [LD 1891](#) introduced (session ended)  
PA - [SB 659](#) and [HB 1584](#) introduced

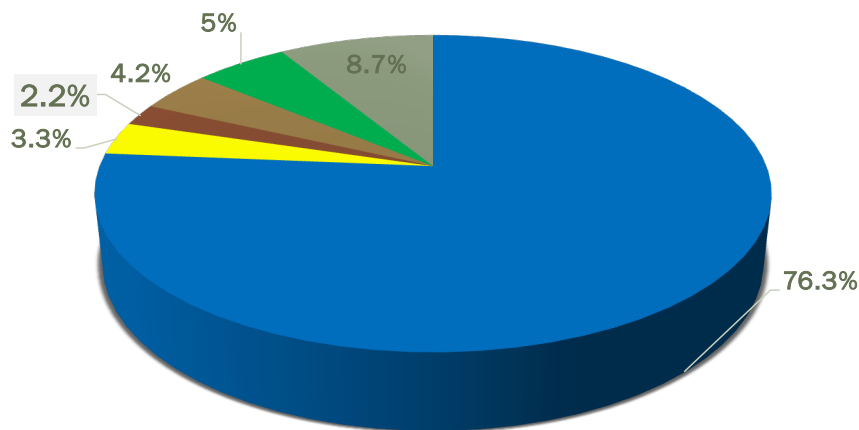
VT - [SB45](#) passed Senate, in House (session ended)

● 9 states with no owner-level personal income tax on PTE income:  
AK, FL, NH, NV, SD, TN, TX, WA, WY

○ 3 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes:  
DC, DE, and ND

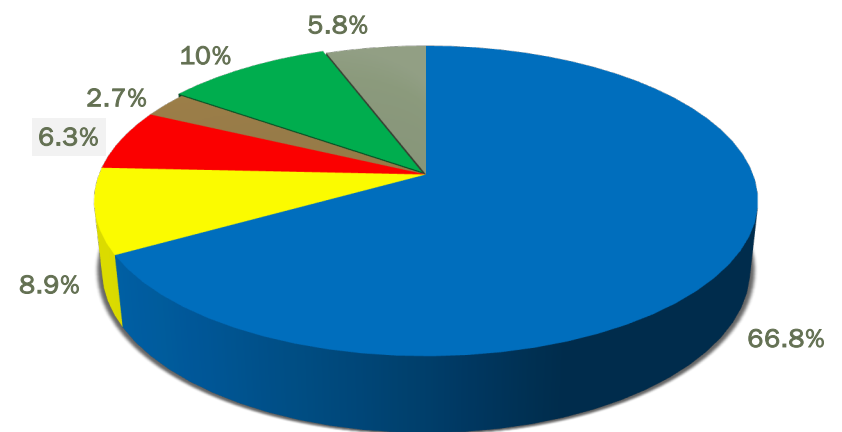
## Partnership related income has almost tripled as a share of AGI since 1990

Percent of AGI by Source of Income, 1990



- Salaries and wages
- Net capital gain
- Rents, royalties, partnerships, estates, trusts, etc.
- Business or professional net income
- Retirement Related
- Other

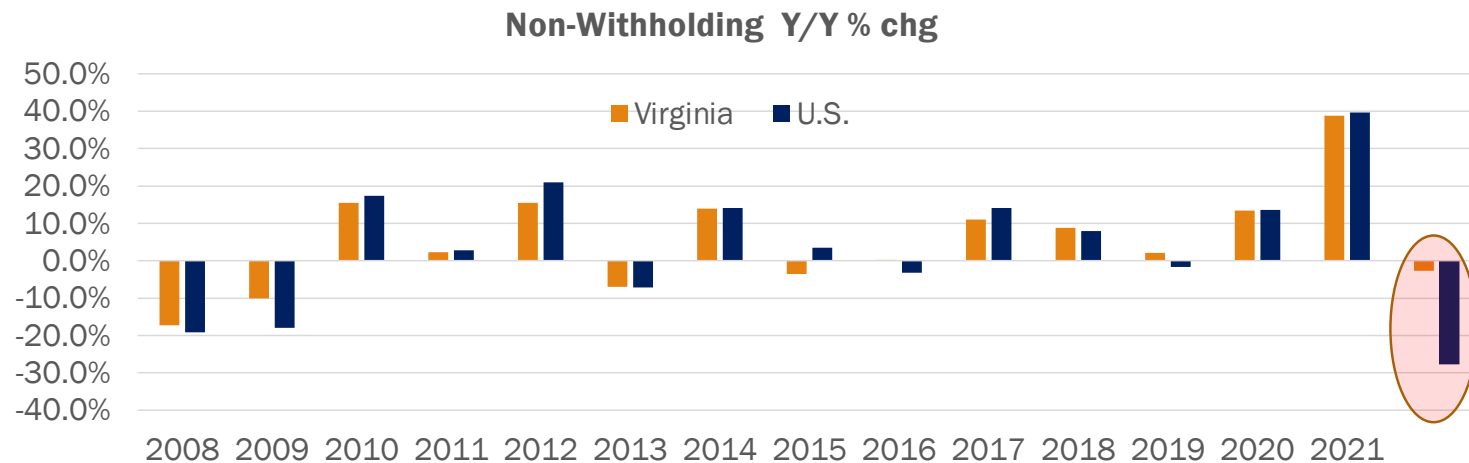
Percent of AGI by Source of Income, 2020



- Salaries and wages
- Net capital gain
- Rents, royalties, partnerships, estates, trusts, etc.
- Business or professional net income
- Retirement Related
- Other

Source: IRS Statistics of Income

**Virginia non-withholding “typically behaves” like the US, but so far not in TY 2022, when VA first implemented PTET. Taxpayer behavior was likely the cause.**



- Using the US as a control, VA estimates that taxpayers overpaid IIT by \$1B, due to taxpayers not adjusting to the PTET credit during the current FY.
- Source : SOI Statistics of Income, Virginia Secretary of Finance Joint Money Committee Report August 2023

## Revenue Forecasting Challenges and Issues Posed by the new PTET

### Behavioral/Timing adjustments to the tax-

1. Taxpayers do not seem to respond and adjust immediately to the new tax, which all else equal should allow them to lower ITT payments, given the PTE credits.
  - Do early adapters have any insights to offer about the path of timing responses ?
  - Insights from academic literature- *How Quickly Do Corporations Respond to Changes in Tax Law? Evidence from the California Manufacturer's Investment Credit*, ALLEN PROHOFSKY
- 2 Taxpayer/tax practitioner caution and preference for refunds/carryovers
  - “*An Investigation of Why Taxpayers Prefer Refunds: A Theory of Planned Behavior Approach*”, Donna D. Bobek, Richard C. Hatfield, Kristin Wentzel, Journal of the American Taxation Association (2007)

## **Revenue Forecasting Challenges Posed by the new Pass Through Entity Taxes**

3) The structure of the entity tax can potentially create overpayments

- In a structure where the entity pays at the top marginal rate, potentially disregarding an individual's other deductions or losses , inherently there is a potential for overpayments on pass through income

4) Puzzle of unclaimed credits lingering

- Filers forget about the credits, this happens with other credits, is there any reason to believe that this might be a bigger issue or different for PTET?

5) Implementation issues

6) Other issues ....

