

# Pass-Through Entity (PTE) Elective Tax in California

Colby White, California Department of Finance

Allen Prohofsky, California Franchise Tax Board

October 3, 2023

# Key Attributes:

- ❖ Began tax year 2021.
- ❖ Elective tax up to 9.3 percent of business entity's income.
- ❖ Credit is nonrefundable with no discount.
- ❖ In lieu of estimated payments, required prepayment for business entities in required June 15 that must be the greater of \$1,000 or 50 percent of the prior year's liability.
- ❖ Taxpayers on the PIT side are allowed to adjust their estimated payments to account for PTE without penalty.

# Legislative Changes in First Year:

- ❖ Calculation of Other State Tax Credit
- ❖ Ordering with Other State Tax Credit
- ❖ Election at Member Level

# 2021 Tax Year California PTE Elective Tax

	S Corporations	Partnerships	LLCs
Total Returns (Thousands)	756	148	743
Returns with PTE (Thousands)	72	11	25
PTE Generated (\$s, Billions)	7.5	3.4	3.5

## California PTE Elective Tax Payments and Credits (Billions) 2021 Tax Year

Total Amount Reported on Business Entity Returns*	14.3
Amount on Calendar Year Returns	13.6
Amount on Fiscal Year Returns	0.7
Amount Claimed on Personal Income Tax Returns	11.9
Amount Carried Over on Personal Income Tax Returns	1.3
Personal Income Tax Total	13.2

\*Amount may differ from total on previous slide due to rounding

## Lessons from Earlier Work on Responses to a New Credit

- Large Taxpayers Often Overpay
- Full Adjustment Takes 3 -4 Years

TABLE 1  
Number of Corporations, Tax Liability, and Tax Prepayments by Prepayment/Liability Category  
Minimum Tax Payers Excluded  
1995 Tax Year

Prepayments as percent of total tax liability*	Number of corporations	Tax liability amount (\$ millions)	Tax liability average (\$ thousands)	Prepayments amount* (\$ millions)	Prepayments average* (\$s)
0%	8,543	\$ 40	\$5	\$0	\$0
1%-50%	17,358	\$159	\$9	\$40	\$2,305
50%-80%	17,201	\$135	\$8	\$90	\$5,227
80%-90%	6,704	\$118	\$2	\$100	\$14,863
90%-100%	8,339	\$ 234	\$28	\$223	\$26,754
100%	3,304	\$19	\$6	\$19	\$5,601
100%-110%	8,342	\$ 780	\$ 93	\$ 813	\$97,512
110%-120%	5,865	\$ 994	\$169	\$1,132	\$193,045
120%-130%	3,056	\$ 699	\$229	\$862	\$281,993
130%-140%	3,345	\$259	\$77	\$350	\$104,782
140%-150%	1,656	\$210	\$127	\$303	\$183,109
OVER 150%	18,370	\$ 805	\$ 44	\$1,787	\$97,301
TOTAL	102,080	\$4,451	\$44	\$5,720	\$56,032

\*PREPAYMENTS = CREDIT TRANSFERS + ESTIMATED PAYMENTS + EXTENSION PAYMENTS SOURCE: 1995 B&C SAMPLE

Why we don't have 2022  
Tax Data



## Recent Trends and Observations:

- ❖ Program is highly successful. Current expected revenue run rate is roughly 13 percent of annual personal income tax revenue.
- ❖ Based on strong payments to date despite the shifting deadlines, we expect about \$18.5 billion for year 2 of the program, which is growth of nearly 30 percent.
  - ❖ Considerable bubble of uncertainty, however, roughly \$17 billion in payments received through September.
- ❖ Significant payments in early in December versus March to allow their members to get federal deduction one year early.
- ❖ Personal income taxpayers appeared to have adjusted their PIT payments in April or sooner versus adjusting in October.



## Longer-Run Issues:

- ❖ Longer-run credit usage versus payments unknown; we are currently assuming 98 percent.
- ❖ The amount of business entity refunds due to overpayments is unknown due to data limitations.
- ❖ The amount of overpayments that are reducing normal business entity payments.
- ❖ It is never known precisely how taxpayers adjust their payments patterns on the PIT side as a result of the expected credit usage.