

The Rise—and (Almost) Demise—of the Pass-through Entity Tax Regimes

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As seen in Bloomberg Tax:
<https://news.bloombergtax.com/tax-insights-and-commentary/gops-big-beautiful-bill-poses-disadvantages-to-high-tax-states>

Note: The following is a reprint of our article that appeared in Bloomberg's tax publication on June 20, 2025, focusing on the SALT-related provisions in the recent House legislation. This analysis addresses only a narrow segment of the proposed legislation, which remains fluid. The bill is both complex and far-reaching—with Senate provisions costing an estimated \$441 billion, including key items such as those outlined below—and forms part of a much larger legislative package.

While the House proposal sought to increase the Section 199A deduction from 20% to 23% for qualified business income, the Senate proposal did not adopt this expansion, instead retaining the current 20% deduction. Similarly, the Senate scaled back the House's more generous treatment of the PTET deduction for non-specified service trades or businesses (SSTB's), preserving a reduced benefit for all businesses. The Anchin team continues to actively monitor both the House and Senate proposals, tracking all key developments, and will assess how the final

legislation may affect our clients as the process unfolds.

The May 22nd tax bill proposed by the House increases the state and local tax deduction cap, partially repeals pass-through entity tax deductibility, and makes modifications to tax code Section 199A's qualified business income deduction. These proposed changes carry several implications for how the tax code treats different types of income, industries, and taxpayers.

The Joint Committee on Taxation estimates that over the next 10 years:

- Increasing the SALT cap from \$10,000 to \$40,000 would reduce tax revenue by \$565 billion.
- Increasing the Section 199A deduction from 20% to 23% would cost \$819 billion.
- Eliminating the deductibility of PTET would increase tax revenue by \$73 billion.

As a result, the minimal fiscal benefit of repealing the PTET deduction is significantly outweighed by the cost of expanded SALT and 199A deductions, raising questions about the rationale behind these provisions. Eliminating a widely used deduction with limited revenue impact, particularly while increasing others that are far more costly, appears counterintuitive and warrants questioning as the logic behind the potential increase in costs and exacerbating fiscal deficits is unclear.

Note, on June 16th, Senate Republicans released their own version of the bill that differs in many respects from the House version. Under that proposal, the SALT cap remains at the current \$10,000 limit. However, the PTET regimes would still be deductible up to the greater of \$40,000 plus the \$10,000 SALT cap, or 50% of the PTET. While the financial scoring of this proposal is not yet known, both the House and Senate Republican proposals create significant implications for many taxpayers and the states alike.

First, despite the proposed SALT cap increase under the House version the benefit may still be limited for taxpayers in high-tax states where SALT liabilities easily exceed even the updated cap, due to the inclusion of state income and property taxes. Residents of California, New York, and New Jersey, where property taxes

alone often exceed the proposed cap, would continue paying high state and local taxes with little federal benefit in return.

Additionally, since PTETs were introduced, state legislatures have seen a more predictable revenue stream for budgetary purposes. These systems push the tax payments onto businesses that are often required to make payments earlier in the year than individuals, and at the highest state rates for both residents and nonresidents. Meanwhile, individuals would not pay tax until income is achieved on an annualized basis. As such, the PTET regime facilitates a smoothing out of the state's cash flows.

Curtailing PTET deductibility, under the House proposal, could further reduce the amount of taxes collected upfront. For example, in New York a pass-through entity with income exceeding \$25 million is taxed at the top rate of 10.9%. However, partners of the entity would be taxed at the rate applicable to their income bracket, usually much lower than the highest rate. This structure enables New York to collect substantially more revenue upfront and retain those funds until the partners file their returns and claim credit and refunds for their share of the PTET.

States may need to adjust their revenue collection estimates to account for payment delays and reduced interest earnings on the deferred collections. PTETs allow states to collect substantial revenue at significantly higher rates earlier in the tax year. If eliminated as per the House, or the benefits curtailed under the Senate version leading to less elections, states would no longer receive those advance payments and instead would have to wait for individuals to pay estimated taxes as income is earned or when filing their returns. This shift could lead to temporary cash flow issues and diminished collections from the investment of early tax collections, forcing states to reconsider their budget forecasts.

Further, high-tax states already experienced large-scale migration by high earners. Eliminating or reducing the PTET deductibility would only add to the pressure by effectively increasing the federal tax burden on PTE owners. Without PTET, high-tax states become less attractive for residency and business operations, making it harder for states to retain professional firms and entrepreneurs. To prevent further erosion, states may need to consider reducing tax rates to offset the increased

federal tax to retain higher income taxpayers.

The House proposed also compounds the tax inequity by favoring capital-intensive businesses—such as manufacturing, tech, and retail—which would benefit from both the expanded Section 199A deduction and continued access to the PTET. Meanwhile, labor-intensive specified service trades or businesses, including professional service providers that don't qualify for Section 199A, would lose access to the PTET benefit. This change would move tax policy away from neutrality and disincentivize investment in professional services. The Senate version does not make this distinction and allows PTEs the PTET deduction subject to its limitation.

A foundation of the US tax system is to tax a business's net income. Allowing businesses to deduct ordinary and necessary business expenses, which has always included tax payments, is a cornerstone of the tax code to arrive at the tax base. PTET regimes function to restore the deductibility of SALT, shifting the tax burden on behalf of the partners onto the entity, which bears the full exposure, obligation and risk of the tax liabilities. Disallowing these business expenses represents a seismic shift in the tax code and undermines principals that have traditionally viewed taxes paid as deductible expenses.

Current estimates put the cost of the House tax bill between \$2.4 and \$3.0+ trillion. With the Senate revisions, we'll have to wait to see the negotiations unfold. The final legislation will potentially produce varying tax outcomes across industries and less uniform treatment for similarly situated taxpayers.

Watch the Replay: Big Beautiful Bill Breakdown

More than 1,220 professionals registered for our live webinar covering the most impactful provisions of the One Big Beautiful Bill. If you missed the session, the full recording is now available to watch on demand.

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