

**DEPARTMENT OF TAXATION
2025 Fiscal Impact Statement**

1. **Patron** Joseph P. McNamara

3. **Committee** House Finance

4. **Title** Pass-through Entity Tax: Sunset Date

2. **Bill Number** HB 1997

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would remove the sunset provision which currently applies to Virginia’s elective pass-through entity tax (“PTET”). As a result, the PTET would become permanent and not expire after Taxable Year 2025.

If enacted during the regular session of the 2025 General Assembly, this bill would become effective July 1, 2025.

6. Budget amendment necessary: No.

7. No Fiscal Impact: (See Line 8.)

8. Fiscal implications:

Administrative Costs

The Department of Taxation (“the Department”) considers implementation of this bill as routine and does not require additional funding.

Revenue Impact

Because the extension of the sunset date on the PTET is assumed in the official General Fund revenue forecast, this bill would have no impact on General Fund revenues.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Cap on the Deduction for State and Local Taxes Paid

The federal Tax Cuts and Jobs Act limited the itemized deduction for state and local taxes paid (“SALT”) to \$10,000 for taxable years beginning after December 31, 2017, and before January 1, 2026. Since then, several states, including Virginia have enacted laws to work around this limitation for owners of PTEs. These laws have become commonly known as “PTE SALT cap workarounds.”

A PTE is generally not taxed on its income. Instead, the PTE’s income is reported by its owners, which then pay federal and state income taxes on their share of such income. However, any state tax paid by individual owners would be subject to the new \$10,000 itemized deduction limitation. Therefore, any individual owners would not be able to deduct their state tax in excess of \$10,000. State PTE SALT workarounds generally:

- Allow a PTE to elect to pay state tax on its income; and
- Offer the individual owners of the PTE either a credit or a deduction, the effect of which is to exempt such owners from tax on the PTE’s income.

For federal income tax purposes, transferring the state tax burden from the individual owner to the PTE can be beneficial because, unlike its individual owners, the PTE itself is not subject to the \$10,000 limitation and is entitled to deduct an unlimited amount of state tax. Therefore, this tax planning technique allows the individual owners to avoid the \$10,000 limitation on their federal returns.

Virginia’s Pass-through Entity Tax

During the 2022 Session, the General Assembly enacted legislation to permit certain PTEs to make an annual election to pay an elective income tax at a rate of 5.75 percent at the entity level. The 2022 legislation also allowed a corresponding refundable income tax credit to certain PTE owners for income paid by a PTE if such PTE makes the election and pays the elective income tax imposed at the entity level. The effect of PTET and corresponding refundable credit is to offer taxpayers a workaround to the \$10,000 cap on the federal deduction for state and local taxes paid. During the 2023 Session, the General Assembly enacted legislation that expanded the number of PTEs that were eligible to make this election.

The PTET allows an individual to claim a credit for taxes paid to other states under laws that are substantially similar to Virginia’s PTET.

Proposal

This bill would remove the sunset provision which currently applies to Virginia’s PTET. As a result, the PTET would become permanent and not expire after Taxable Year 2025.

If enacted during the regular session of the 2025 General Assembly, this bill would become effective July 1, 2025.

Similar Bills

SB 951 would remove the sunset provisions for the enhanced standard deduction, the refundable earned income tax credit, and the PTET.

cc : Secretary of Finance

Date: 01/18/2025 JLOF
HB1997F161