DEPARTMENT OF TAXATION
2026 Fiscal Impact Statement

1. **Patron** Joseph P. McNamara

2. **Bill Number** HB 33
House of Origin:
 X **Introduced**
___ **Substitute**
___ **Engrossed**

Second House:
___ **In Committee**
___ **Substitute**
___ **Enrolled**

3. **Committee** House Finance

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

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 2026.

If enacted during the regular session of the 2026 General Assembly, this bill would become effective July 1, 2026.

6. **Budget amendment necessary:** No.

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

8. **Fiscal implications:**

<u>Administrative Costs</u>

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

This legislation does not require any changes to the Department's systems and is not impacted by the Integrated Revenue Management System ("IRMS") replacement project. No resource constraints or implementation considerations are anticipated.

<u>Revenue Impact</u>

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:** Yes.

We believe that the intent of the Patron may be to make both the PTET under *Virginia Code* § 58.1-390.3 and the associated other state credit for PTET under § 58.1-332 permanent. If that is the intent of the Patron, then § 58.1-332 should be amended as well.

11. Other comments:

Cap on the Deduction for State and Local Taxes Paid

The federal Tax Cuts and Jobs Act ("TCJA") (Public Law 115-97) 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, many 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 itemized deduction limitation. Therefore, any individual owners would not be able to deduct their state tax in excess of the SALT cap amount. 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 would be beneficial because, unlike its individual owners, the PTE itself would not be subject to the SALT cap limitation and would be entitled to deduct an unlimited amount of state tax. Therefore, this tax planning technique allows the individual owners to avoid the SALT cap limitation on their federal returns.

H.R. 1 ("2025 H.R. 1") (Public Law 119-21), signed into law on July 4, 2025, makes the federal SALT cap permanent. 2025 H.R. 1 also temporarily increases the SALT cap from $10,000 to $40,000, indexed for inflation, for Taxable Years 2025 through 2029. This increased cap is phased out for taxpayers with a modified adjusted gross income over $500,000. The federal SALT cap is scheduled to return to $10,000 for Taxable Year 2030 and thereafter.

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.

The eleventh enactment clause of the 2025 Appropriations Act (House Bill 1600, Chapter 725) extends the sunset date for the elective PTET and the corresponding Refundable PTET Credit from January 1, 2026 to January 1, 2027.

Following passage of 2025 H.R. 1, the effect of PTET and corresponding refundable credit is to now offer taxpayers a workaround to the $40,000 federal SALT cap.

<u>Proposal</u>

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 2026.

If enacted during the regular session of the 2026 General Assembly, this bill would become effective July 1, 2026.

cc : Secretary of Finance

Date: 01/17/2026 ALS
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