

PTE Tax Deduction Changes Under the Big Beautiful Bill: What Clients Need to Know

By Nathan Holaday

As part of the One Big Beautiful Bill Act, or "OBBA", major federal tax reform law passed by the United States House of Representatives on May 22, 2025, certain pass-through businesses will no longer be permitted to deduct Pass-Through Entity ("PTE") tax payments on their federal income tax returns. This provision represents a significant shift in tax policy and may require prompt attention from business owners, particularly those operating in high-tax jurisdictions or structured to take advantage of state-level state and local tax ("SALT") cap workarounds.

At Frost Law, we are closely monitoring the evolving tax landscape and advising clients on how best to respond to these developments.

Background: PTE Tax Workarounds and the SALT Deduction Cap

Since the enactment of the Tax Cuts and Jobs Act ("TCJA") in 2017, the \$10,000 cap on the federal deduction for state and local taxes has posed challenges for many individuals who are partners in partnership entities or shareholders in S-Corporations. The cap established by TCJA limits both the deductibility of state income taxes and property taxes. In response, over 30 states adopted elective PTE tax regimes allowing pass-through entities—such as partnerships and S corporations—to pay state income tax at the entity level. Each state took a slightly different approach when adopting a PTE election regime, however these payments were, until now, deductible at the federal level, effectively bypassing the SALT cap for individual partners and shareholders.

This strategy became a widely accepted workaround, endorsed by the IRS in Notice 2020-75. In practice, pass-through entities were able to take an ordinary deduction for state and local taxes paid, which then reduced the amount of net income subject to taxation at the partner or shareholder level. This deduction was not subject to the \$10,000 limitation, effectively bypassing the SALT cap for partners, members, and shareholders of electing entities.





However, the OBBB reverses course for many entities that used these elections primarily for tax avoidance purposes. If enacted as written, the House GOP's "One Big Beautiful Bill Act" would raise the federal deduction limit for state and local taxes to \$40,400 (\$20,200 for those using the married filing separately filing status), subject to a phase-out once a taxpayer's modified adjusted gross income exceeds \$505,000 (\$252,200 for married filing separately).

Key Change: No Deduction for Certain PTE Payments

Under the new legislation, pass-through entities will be disallowed from deducting PTE payments on their federal returns if the entity claiming the deduction is a "Specified Service Trade or Business" or "SSTB." Professions such as consulting, law, healthcare, performing arts, athletics, accounting, actuarial science, financial services, investment management, brokerage services, investing services, trading or dealing in securities, partnership interests, or commodities, and any business where the key asset is the reputation or skill of one or more employees are included. Typically, these businesses do not qualify for the Section 199A deduction and the bill aims to curb the perceived abuse of PTE elections. The bill requires that these tax payments be separately stated on a partner or shareholders Schedule K-1, and in so doing, abrogates Notice 2020-75, which effectively authorized the pass-through entity tax ("PTET") provisions enacted by various states.

If the House bill is enacted as written, SSTBs would be "unfairly economically disadvantaged", the AICPA wrote in a May 29 letter to the Senate.

Who Is Affected?

The change primarily impacts:

- **Pass-through entities:** medical practices, law firms, accounting firms, and financial advisor firms.
- **Entities that have made a PTE Election:** Pass-through entities that file tax returns in states with elective PTE tax regimes.

Legal and Tax Implications

This change adds complexity to federal tax compliance and may have downstream effects on partner/member distributions, state tax liabilities, and estimated tax obligations.

We strongly recommend that clients:

- **Review their current entity structure** to evaluate whether PTE elections remain beneficial;
- **Consult with legal and tax advisors** to assess compliance risk and identify potential exposure;
- **Plan ahead** for 2025 reporting obligations, including potential IRS guidance due by September 30, 2025.

While the Bill faces an uncertain future in the United States Senate, it is likely that a compromise bill will include some adjustment for PTE. The Senate is expected to review and address the Bill by July 4, 2025.





Our Perspective

While the One Big Beautiful Bill brings significant change, it also presents an opportunity to revisit and strengthen business tax planning strategies. Those with questions about how the pending tax reform may affect their tax situation should consult with a trusted tax professional. If you would like to discuss your case in detail, don't hesitate to reach out to us at (410) 261-4138 or schedule a confidential consultation with our team of tax and business attorneys.

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