

Issue: California has made meaningful improvements to the Pass-Through Entity Tax (PTET), recognizing its importance for taxpayers navigating the federal limits on state and local tax (SALT) deductions. With greater clarity on federal tax rules, California is taking the right next steps by extending the PTET and adding flexibility to the payment deadline, giving taxpayers more certainty and making the program easier to use. However, one challenge remains: stranded PTET credits, which can lead taxpayers to opt out of the PTET altogether—undercutting the policy's effectiveness and potentially creating challenges for state revenue stability and budget planning.

Ask: Building on the state's earlier improvements, we encourage refinements to the PTET. In particular, extending the period during which PTET credits can be used or allowing refundability—approaches used by most states—which would give taxpayers more flexibility to manage stranded credits, make the PTET more practical and predictable, and preserve its revenue-neutral design.

Making the PTET Successful for the Long Term

PTET Supports Taxpayer Without Harming State Revenues

The PTET has been a win-win for the state. It gives taxpayers a practical way to manage their state income taxes and reduce the impact of federal SALT limits. This has provided significant taxpayer relief without any negative impact on state revenue.

Opportunities to Simplify Compliance & Add Flexibility

CalCPA members have worked closely with taxpayers of all sizes to apply the current PTET framework in real-world situations. That hands-on experience—combined with a deep understanding of the challenges facing California businesses—gives the CPA profession a practical perspective on how the PTET is working. It has also helped identify opportunities to streamline certain provisions so the PTET delivers the full benefit it was intended to provide.

Good Progress Has Been Made

Over the years, the Legislature has made meaningful improvements to the PTET, including extending the framework and fixing the rigid payment deadline that previously made it difficult to elect into the program. These changes have been well received by taxpayers and tax practitioners and have made the PTET more workable and predictable. While recent federal changes have eased the impact of SALT limitations, many California taxpayers are still affected, and the PTET remains an important tool for managing state tax compliance.

Recommendation: Address Stranded Tax Credits

While PTET credits can be carried forward, they are not refundable and expire after a set period. This creates uncertainty and makes tax planning more difficult, especially for taxpayers with fluctuating incomes. Over time, credits can accumulate resulting in stranded credits that risk expiring before they can be fully used. This added complexity can discourage participation, with some taxpayers opting out of the PTET or receiving only part of the intended benefit.

We recommend extending the period in which PTET credits can be used or allowing future credits to be refundable in the year the tax is paid. These options would make the PTET more practical and predictable for taxpayers, while remaining consistent with the program's revenue-neutral design by preventing overpayments beyond actual state tax liability.