

Speaker 1 ([00:00](#)):

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Shail Shah ([00:16](#)):

There are not a lot of state tax laws that are, I would say, taxpayer favorable, especially when they're sort of across the board. This is one of them.

Nikki Dobay ([00:26](#)):

Hello and welcome to GeTtin SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, shareholder in the Sacramento and Portland, Oregon offices recording live from Bend. I am super excited today to be joined by yet another one of my partners in crime Shail Shah shareholder in our San Francisco office. Shail, thank you for being here today.

Shail Shah ([00:53](#)):

Hey, Nikki, thanks for having me on.

Nikki Dobay ([00:56](#)):

So today we are going to talk about pass through entity taxes known to some by the SALT cap workaround. So we'll get into that. But as a newbie on the podcast, the first question I always ask my new guests is, how did you get into state and local tax?

Shail Shah ([01:19](#)):

I feel like my story is similar to a lot of other people who get into state and local tax. Nobody ever, well, at least in my generation, nobody actually sort of sets the course at a law school that they're going to be a state tax lawyer. You sort of just fall into it. So my story is, my first sort of foray into SALT was at EY. I was in their federal tax M&A practice and a very well known SALT luminary Steve Valtichek gave me a call my first day and explained to me how apportionment works, which I again, straight out of law school had no idea, asked if I would help him on a project. I said, sure. I guess I did a decent job on it. And he asked me again and again and about a year and a half later I realized I had done zero federal tax work and only state local tax work. And I figured at that point I was going to be a state tax lawyer for the rest of my career. So here we are.

Nikki Dobay ([02:14](#)):

So did Steve reference the pie in his discussion of apportionment during that first call?

Shail Shah ([02:20](#)):

No, the first call was about the Mississippi River in the 1800s and barges that went down the Mississippi River, and it was sort of what gave rise to the property factor. It was the second or third call where the pie for the pizza pie analogy came in. But it was a long history on the Mississippi River.

Nikki Dobay ([02:43](#)):

Well, it's hard to imagine a better mentor or SALT practitioner to learn from. So I think that those were some good formative years on your part. So we know who to go to when we need to talk about apportionment or the Mississippi River.

Shail Shah ([03:02](#)):

Got them both covered.

Nikki Dobay ([03:04](#)):

All right. So let's talk about these PTEs and Shail, we could spend hours talking about this subject. It is definitely an interesting one. We're going to try to keep it high level today. You and I presented on this, written on this, and so give us a little background on where the heck this concept came from and why there are so many people talking about PTEs these days.

Shail Shah ([03:35](#)):

Yeah, I'll start with there are not a lot of state tax laws that are, I would say, taxpayer favorable, especially when they're sort of across the board. This is one of them, but I'll sort of step back and talk a little bit about what gave rise to these PTEs. So the Tax Cuts and Jobs Act of 2017, this was during the Trump administration. One of the provisions in that act was to cap the state and local tax deduction for individuals on their federal return to \$10,000. And not surprisingly, that disproportionately impacts individuals who are in high tax states such as California, New Jersey, Connecticut, Illinois. Probably also not surprising, those states tend to be what we call blue states or democratic states. So there's likely a correlation between that the provision and the act and who it ends up impacting. So you had this cap on the deduction and then what a lot of states started thinking about, and I think Connecticut was probably the first state was well, how can we help our citizens effectively get around this sort of cap on the deduction? And states first tried to sue,

Nikki Dobay ([04:59](#)):

That didn't go well.

Shail Shah ([04:59](#)):

The federal government. That didn't go anywhere. And then states started introducing these pass through entity elections. And kind of one of the things that sort of blessed it and sort of accelerated a lot of this was IRS notice 2020-75, which basically told the states, yes, you can do this workaround and we'll get into the, sort of the details of the workaround a little bit. But that particular IRS notice is what accelerated the state's movement in this direction. And the sort of basic premise on how it works is that, again, the SALT cap only applies to individuals and it does not apply to entities.

([05:41](#)):

So the way most states have implemented this particular workaround is that they allow an entity to make an election. And that election is, there's an entity level tax. And for state purposes, we could talk about this a little bit later, but for state purposes, it's a wash. The state will either give you a deduction or a credit to make the individual taxpayers who are the pass through either the partners or the members of an S-corp or shareholders of an S-corp to make them whole. Right. And for the most part, what you get as an individual is whatever your sort of pass through deduction is, you take that on your federal return plus you get the \$10,000. So it's that benefit plus 10,000.

Nikki Dobay ([06:31](#)):

Yeah, and these have been, a couple things that I, just a few comments on that intro. One, this was incredibly politically motivated and the cap on the state and local tax deduction raised a significant amount of revenue that was necessary to offset a lot of other things in the TCJA. And to that point, that has always been a little curious to me as to why the IRS actually blessed what the states are doing in this area. Now, this is a limited subset because it's only the pass through entities. It's not every individual in every state that gets to work a SALT cap workaround, but they're kind of eating into all the revenues the cap was supposed to raise. And so it always makes me nervous that the IRS could, to change course. And we've put so much time and effort at the state level into these PTEs, but that's my political commentary.

Shail Shah ([07:40](#)):

Yeah, I thought it was interesting as well. And in a way, I think what it highlighted to me was maybe the IRS is a bit more apolitical than people think, because I think the way the IRS analyzed the issue is, okay, can a state implement a entity level tax on a pass through and states have the right to do that, and TCJA is limited to just individuals. And I thought that sort of gave a bit more credibility to the IRS, that they're not going to sort of foray into this sort of political arena with Congress.

Nikki Dobay ([08:17](#)):

Yeah. And apparently they aren't looking at this stuff through the lens that we often look through state statutes, which is you have to determine the intent of the legislature. But again, total aside on this. So these PTEs, they're designed for pass through entities to utilize so that the pass through entity is going to pay the tax and then the members or owners are going to get this credit in a couple states of deduction and really neutralizing or getting around the SALT cap workaround and providing a benefit to the individuals. So this sounds really great. So this is just working out super well. I think what we're up to 34 states that have now adopted this, they're all exactly the same. It just is smooth sailed if you're a multi-state business.

Shail Shah ([09:07](#)):

Nikki, in our world, nothing is smooth sailing when multiple states adopt something. So one of the challenges for a lot of multi-state businesses that have partnerships that operate in multiple jurisdictions is that the way the election works differs significantly from state to state. And oftentimes there are sort of very specific rules, whether it's elective or it's mandatory or there's kind of other little nuances that unfortunately everybody, if you're sort of analyzing this holistically, you have to look at all these different traps. Now in the bottom line is typically it's a good answer, but that may not be the case in every state. And there may be little sort of nuances that make that difference.

Nikki Dobay ([09:52](#)):

So the devil's in the details.

Shail Shah ([09:55](#)):

The devil's definitely in the details. Yeah.

Nikki Dobay ([09:57](#)):

All right. Let's chat about a few of those details. So again, I think 34 states have now enacted these. We may be up to 35. I think I saw Montana just passed one too. So Hawaii and Montana were the last two

that have enacted these. Again, this is another one of these concepts that have really kind of swept across the country very quickly, because to your point, this is really something that's state legislators can do to help their residents and it's revenue neutral at the state level. So one of the big kind of issues or things to consider with these is whether this is elective or mandatory. So what are your thoughts on that?

Shail Shah ([10:41](#)):

So for the most part, most states it is elective. The states in which it is mandatory are the states that already have a entity level tax on pass through. So for example, if you sort of think about Texas. Right. Texas doesn't differentiate for purposes of the Texas franchise tax on entity types. So if you're a corporation or if you're a partnership or an S-Corp, it doesn't matter. The tax applies in the same manner. So those are sort of, I would say, in air quotes, mandatory states because it's already in place, so you can effectively take the deduction on your federal return. But most states, for example, California, Oregon, kind of a handful of states, it is elective, but then there's a little bit of, within there, there's a little bit of detail. If the entity makes the election, do all the partners have to opt in or can each individual partner opt out? And that also varies state by state. Again, devil in the details.

Nikki Dobay ([11:40](#)):

Yeah, that's one that I find fascinating. We'll get into Oregon. We're going to dig in on Oregon and California a little later. But on this point, Oregon statute says all the owners or members have to agree to this. And I mean, I think that's a lot of reason why people are in partnerships or past serenities is because they want to disagree with their, they don't want to have to be told what to do. So that's always been a little bit of a head scratcher as to how these entities are dealing with that practically and can really impact folks if it is a state where if you're in, everybody's in because that can create a lot of challenges for non-residents. Most states use a dollar for dollar credit. There's a couple states that use a deduction. That one's not too crazy. But I think where we see some challenges is with respect to how some states are interpreting the credit for taxes paid to other states. And so any thoughts on that issue?

Shail Shah ([12:47](#)):

Yeah, again, it sort of varies state by state. Some states are only applying it if there's like reciprocity. Other states are sort of providing different ordering rules. So for example, you may not be able to even use the other state tax credit if you make the election kind of depending on the ordering rules. So again, I mean those vary across the different states.

Nikki Dobay ([13:11](#)):

And then one of the other issues that I think is really important and often kind of an afterthought as people, because I know you're going to talk about how you got to get out your spreadsheet and do some math, so I won't steal your thunder there, but composite returns, because prior to these PTEs, the states had systems in place through withholding or composite returns that allowed non-residents to be part of generally composite returns. Some states call it something different, but to be part of a single return that the entity would file so that all of the non-residents wouldn't have to also file returns in multiple states. And what has happened, what we've seen is that some states have said, if you elect into one of these PTEs, you can no longer participate in a composite return filing or that entity can't file a composite return. I think that's a really unfortunate answer the states have gotten to and it has created a lot of additional complexity. But yeah. Any thoughts on this piece of this and how it could impact this analysis?

Shail Shah ([14:26](#)):

Yeah, it's a little head scratching. For example, in New York, if you make the PTE election, you cannot file a composite return. But if you go across the river in New Jersey, they carve out the PTE election as a sort of an exception. So you can still file a composite return. If the policy goal here is to help your residents, putting in these sort of hurdles or impediments, which oftentimes don't make a lot of sense seems to, you would think it's sort of frustrating, the goal of encouraging your residents to make the election. Because if you have hundreds and hundreds of partners, the inability to file a composite return, I mean, again, you alluded to the take out the spreadsheet. You have to look at what the administrative and compliance costs are for filing returns on behalf of all these different partners versus what the savings is on the federal side by making the election. And that's part of the math exercise.

Nikki Dobay ([15:26](#)):

Yeah. So talk about that math exercise.

Shail Shah ([15:29](#)):

Well, as I always say, everything we do in taxes comes down to numbers. Right. It's all numbers driven. And for a lot of these, again, when you have partnerships that operate in multi jurisdictions, taking out a spreadsheet and saying, if we make the election, here's what the federal benefit is, but here are all the additional costs. And then you have to look at and say, is it worth it? Right. And do we want to do it in certain states? Do we want to not do it in certain states? And you may have some small states where the compliance costs, for example, this composite return issue may outweigh the benefit, so you may want to skip it in that state and make it in another state.

Nikki Dobay ([16:13](#)):

Yeah, I think that's a really great point because on this one, I think for any pass through entity doing business wholly in one state, a California or Oregon or whatever state you're in that has these PTEs, it's going to be a no-brainer. It's really, you're not going to substantially increase your compliance costs because everybody's already filing a return in that state, and you're going to get this fairly significant benefit. But once you bring in operations in multiple jurisdictions, there's just layers of other things that need to be considered. And so I think, I guess it's been a little bit of a shock as how kind of prolific these have gotten and how many businesses are using them. So I'll talk a little bit about that when we get to Oregon, but I want to shift gears and have you kind of spend some time talking about the California, and yours is called the PTET. PTET, I like that.

Shail Shah ([17:22](#)):

I know, and not only does it vary state by state, the names all vary state by state, which makes it even more fun. So in California, California was a little late to the game, surprisingly, I think they waited a bit after there was a handful of states that had enacted this provision. And I think part of it too was the way the sort of regulatory and rulemaking process works in California, there's a lot of cooks in the kitchen, so things just take a lot longer to get enacted. But in California, it's a 9.3% entity level tax if you make the election. That is sort of the average individual rate in California. So that's sort of where they settled. There's sort of two components. There's the qualified entity, the entity that can actually make the election, and then the qualified taxpayer, so that's the taxpayer that gets the credit and can take the deduction on their federal return.

([18:26](#)):

Not surprisingly, a qualified entity has to be a flow through entity. It can be SB tax as a partnership, or it can be an S-corporation. It cannot be a single member LLC, so it cannot be a disregarded entity. So it has to be taxed as a partnership. A qualified taxpayer is really just an individual or trust, a single member LLC that's owned by an individual or a trust, not surprising because these are the individuals or people who can actually take the deduction on their federal return. So it's a pretty straightforward, in terms of qualification. There are two payments you have to make in California. So you make a payment, which is about a 50% estimated payment in the year in which you want to make the election, and then you make the rest of the payment when you file your return in the subsequent year.

[\(19:25\)](#):

And that does a couple of interesting things, right? Because the way the credit works in California is that you get the credit, so you're made whole for the tax year in which you make the election. So even though the payment, you make a partial payment, let's say 2022 is an example, right. You make a partial payment in 2022, you make the rest of it in 2023, you get the full credit in 2022. But some folks, a lot of folks may know that for federal purposes, the way the state tax deduction works, it's based off of taxes paid.

[\(19:58\)](#):

And so then what happens is you get a partial deduction in 2022 and you get a partial deduction in 2023. Now, of course, you can accelerate the payment for the one that you would make in 2023 and make it all in 2022 to get the full deduction, but you may have the sort of mismatch between the credit and the deduction. But that's pretty much it. It is a fairly straightforward election in California. And I will give credit to the franchise tax board. They're FAQs on their website is, they're pretty comprehensive and they're pretty informative. And even if you called the practitioner hotline, they're actually pretty knowledgeable about the mechanics of how the election works.

Nikki Dobay [\(20:44\)](#):

Yeah. And California's is set to run through when the SALT caps is in place under the TCJA. So I think we determined that was 2026.

Shail Shah [\(20:59\)](#):

January 1st, 2026. Right.

Nikki Dobay [\(21:01\)](#):

Yeah. So I will contrast this with Oregon in a minute. So this is kind of smooth sailing for the next couple years. I know there's one little hiccup in California with respect to the credits, which you and I have talked about.

Shail Shah [\(21:17\)](#):

So there is sort of an interesting hiccup that was fixed through a notice in California. The PTE credit does have a five-year carryover period. Your standard other state taxes paid credit does not have a carryover period. And what happened was, originally the way California had the credit mechanism work was that you had to use the PTE first and then you can use the OSTC. But the problem there was, well, the OSTC doesn't have a carryover period. So oftentimes you would use up the PTE credit and then you would not be able to use the other state tax credit. They ended up through a notice fixing that and they flipped it around. So you actually use the OSTC first, then the balance is used by the entity credit on the PTE, and then you can carry over whatever's left over into the subsequent years.

Nikki Dobay ([22:15](#)):

Okay. So it's not refundable but there's a carryover.

Shail Shah ([22:19](#)):

There's a carryover period. Exactly.

Nikki Dobay ([22:21](#)):

Okay. Okay. Yeah. So it sounds like I mean, California has really done a good job with their PTET. Oregon they call theirs the PTE-E. This is, I think one thing Oregon really kind of screwed up and is being perpetuated by the Republican boycott, which just ended here in Oregon, this legislative session, is when this thing was enacted, when our PTE-E was enacted, the legislature, I think what they were trying to figure out is how was this going to work? Would it really be revenue neutral? Were there going to be landmines that they weren't sure of? And so ours is set to expire at the end of the year, so it was only effective for the 22 and 2023 tax years. And our statutes are very light. I think this is a big difference between California and Oregon. California has very detailed statutes on this.

([23:26](#)):

Oregon statutes are very light and the Department of Revenue has had to fill in a lot of the blanks, but the big issue right now is this thing is going to go away. There was a bill SB 158, which would've extended this and made some other changes that I think I would say have been somewhat frustrating with respect to the Oregon PTE. One of them related to whether or not trusts could take advantage of this. And then the other had to deal with our election, which is it is an entity. You're all in or all out. So the entity makes the election and everybody's in is different than California where each individual owner can make the election. And so some of those items would have been fixed, but as many people know, we have been having this Republican boycott, it did just end last Friday.

([24:20](#)):

I guess that would've been, I don't know what the date was. It'll be a few weeks from the airing of this episode. But this bill is probably going to fall by the wayside. And it's very unclear whether or not the legislature will come back next year during our short session and fix this retroactively. So Oregon's could go away. The other real wrinkle is that they're still asserting that it's revenue neutral for purposes of revenues in revenues out, but the Department of Revenue is asking for four new full-time employees to administer this, which has a lot of us scratching our heads because they've kind of been doing it and now all of a sudden they're saying they need more manpower.

([25:07](#)):

So Oregon's is a little bit of a disaster right now. So we'll have to see if this is going to be the first one to implode, but all the drama in state taxes. So Shail, any final thoughts on these PTEs? If I'm crystal balling it, I'd like to say the SALT cap goes away, but I'm not that optimistic. So my sense is we're going to be dealing with these for a long time and maybe someday we'll get some uniformity. But I don't think, if kind of all of the other areas of state tax are any indication, it's going to be a really long time.

Shail Shah ([25:46](#)):

Yeah, it's hard to say what's going to happen with Congress, especially in this political climate. So I think you're right. This may be sort of something that's going to stick around for a while. And I think we're going to have to go through this sort of song and dance of taking a PTE election. Like we said, the sort of patchwork rules, it's frustrating, but as I said at the outset of the podcast, there are not a lot of multi-state tax law changes that are taxpayer favorable. So this may be one where we don't want to poke the

bear by trying to push states to do too much because they can easily take away this nice little benefit that they're giving their taxpayers.

Nikki Dobay ([26:35](#)):

All right. Well thanks for that conversation. I'm sure like I think we both said we don't think this is going away, so probably more to come on this topic. Before we shift gears to the real fund, your favorite SALT update of the week and we're going to, you're a California guy, so we'll be California focused. So what else has been happening in California?

Shail Shah ([26:58](#)):

Well, we've had this sort of in fight between Democrats and Democrats and my colleague or our colleague, Brad Marsh, actually gave a extensive podcast on ACA 11. And that is the bill that was introduced to abolish the board of equalization. And I think Brad gave a really in depth discussion about how the BOE works here in California. Last I heard there are very few people supporting that bill, and it looks like it is on its way to what call suspense file. So it's probably going to be dead. But it was a very interesting political environment of just Democrats just fighting amongst each other over this bill. So it was a lot of sitting back and having a popcorn out and watching the fireworks as they fought about it.

Nikki Dobay ([27:48](#)):

Well, I always when the BOE was stripped of a lot of its powers back in 2017. I mean, how many new taxing agencies did you all get? So maybe you'll get some more.

Shail Shah ([28:01](#)):

I know. I think we're up to what five? Who knows? We just keep adding them on at this point.

Nikki Dobay ([28:08](#)):

Yeah. Just every new thing gets its own agency. So that's how California rolls so. So speaking of agencies, we are now at this prize non-tax question. So I'm going to ask this question. It's got a little bit of setup and then I will answer to give you time to collect your thoughts. So I had to go to the US Postal Service office today to pick up some keys for a postal box. And I haven't really thought about the post office in a long time. As a kid, I collected stamps and so I really enjoyed it. So the question is, what is your thoughts about the post office and going to the post office?

([28:51](#)):

And again, I hadn't thought about it for a long time, but it is thriving here in Bend, Oregon. You couldn't even get in the parking lot. There were so many people there. People are doing stuff at the post office. It was kind of, I guess really nice to see that this federal agency that's been around forever that still will deliver your mail for 50 some or 60 some cents is thriving. In Portland, I don't know who went to the post office. I always went to a place called the Postal Annex, which I loved. So what are your thoughts on the post office? I'm happy to see it thriving here in Bend, Oregon.

Shail Shah ([29:34](#)):

So I love the postal service and I know there was talks about how do we maybe get rid of the postal service or do we privatize it? I love the postal service. Having said that, I avoid the post office like a plague. I'm one of those people that I will go online and just guesstimate, but I'll over guesstimate what the sort of weight of a box is, just so I don't have to go to the post office and stand in line and pay the

accurate amount. I am willing to pay more money to not go to the post office. So that is sort of my view on sort of brick and mortar at post office. It'd be great if they can move a lot more stuff online, but I sort of get the fact that that may not happen.

Nikki Dobay ([30:19](#)):

Well, it's just so busy in your area too. Is that the thing? If you have to go to the post office, it's just a long wait.

Shail Shah ([30:29](#)):

Well, it's a long wait. I wouldn't say it's busy. I think it's more, there's a few people in line and generally one person working there and about an hour goes by, by the time you get to the front, so.

Nikki Dobay ([30:39](#)):

Okay. So you would like to see some additional funding for the post office.

Shail Shah ([30:46](#)):

If there's a way they could figure out to sort of speed things up, I think there are certain people who need more help with their packages and there should be maybe an express line for those who just, kind of like self-checkout. Right.

Nikki Dobay ([30:57](#)):

Right.

Shail Shah ([30:57](#)):

Just kind of get in and get out and you're out the door.

Nikki Dobay ([31:00](#)):

Well, yeah, I will agree with you on that because I actually, we went to the post office on Saturday to try to do what I did today and that person wasn't there, so you had to come back and it's only between nine and 1:00 AM or 1:00 PM and then like 3:30 PM and 5:00 PM. So I'm like, what? So those are their hours so. So yes, could the post office benefit from some maybe improvements? Yeah, but it's great to see it thriving, but I'm glad you love it too.

Shail Shah ([31:36](#)):

Totally agree.

Nikki Dobay ([31:38](#)):

All right, well I'm glad we chatted about the postal service. So Shail, thank you for joining me today and chatting about PTEs. I'm sure we're going to be talking about these, although sometimes I just get sick of talking about them. We'll find a lot of other great California topics to talk about as well. And thank you for the listeners for tuning in. Please check out the show notes for more information about Shail and me and PTEs, and I look forward to being with you again on the next episode of GeTin SALTY.