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In this article, Santamaria and Palmer examine key provisions of the One Big Beautiful Bill Act concerning the new state and local tax regime and provide critical takeaways affecting passthroughs and partnerships that are paying or accruing taxes subject to the new SALT cap.

I. Background

On May 22 the House of Representatives passed the One Big Beautiful Bill Act (OBBB) on a 215-214-1 vote.[1] As the Senate now considers the OBBB, it may ultimately adopt tax provisions significantly different from the current OBBB tax title (which could again be changed if the chambers form a conference committee to reconcile bicameral differences on the legislation).

The OBBB's tax provisions, as passed by the House, would further extend or make permanent (and in some cases modify) certain expiring tax provisions of the Tax Cuts and Jobs Act, including lower rates for individuals, the international provisions of global intangible low-taxed income, foreign-derived intangible income, and the base erosion and antiabuse tax. The OBBB includes further taxpayer-favorable provisions, including an increase in the section 199A deduction for passthrough businesses (from 20 percent to 23 percent) and the restoration and extension of several expired business tax benefits from the TCJA through 2029, including the deductibility of research and development costs under section 174, 100 percent bonus depreciation, and the modified calculation of adjusted taxable income for purposes of the section 163(j) business interest deduction limitation. The OBBB also includes several new temporary tax benefits promised by President Trump during his campaign, such as 100 percent bonus depreciation for certain manufacturing facilities and new deductions for tips and overtime pay.

To partially offset the cost of these taxpayer-favorable provisions, the OBBB contains a host of revenue-raising provisions, including early sunsets and accelerated phaseouts of certain energy tax credits enacted by the Inflation Reduction Act of 2022, retaliatory measures on some non-U.S. corporations and individuals if their home jurisdiction has adopted taxes deemed to be discriminatory or extraterritorial, and increased tax rates on the net investment income of certain university endowments and private foundations.

Further, one of the largest revenue-raisers — and one of the most politically contentious in the House — is a collection of changes to the limitation on the individual deduction for certain state and local taxes. The proposed changes that

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[1]The vote was largely along party lines, with all Democrats and two Republicans voting against the bill, two Republicans abstaining from the vote, and one Republican voting present. *See* Office of the Clerk, U.S. House of Representatives, "Roll Call 145; Bill Number H.R. 1" (May 22, 2025). The tax title was first released by the House Ways and Means Committee on May 9, and a subsequent amendment in the nature of a substitute was released May 12. The bill was advanced out of the House Budget Committee on May 18 and further revised by the House Rules Committee in a May 21 manager's amendment, before its ultimate passage by the House the next day.

would be made to these SALT rules include both taxpayer-favorable changes (compared with present law) and taxpayer-unfavorable changes, including changes that would prevent some, but not all, passthrough entity tax (PTET) regimes and other related regimes. As the OBBB moves through the Senate, further changes to the SALT rules appear possible, if not likely, since the political dynamics in the Senate differ significantly from those in the House.[2]

As necessary background, current section 164(b)(6), enacted by the TCJA, generally caps an individual's itemized deductions for state, local, and foreign income; war profits; excess profits; real property taxes; and state and local personal property taxes at $10,000 ($5,000 for married taxpayers filing separately). This SALT cap sunsets for tax years beginning after 2025. In response to current section 164(b)(6), many states enacted PTET regimes through state-level legislation allowing a passthrough entity to elect to pay an entity-level state tax in return for a credit or deduction against a state tax imposed on the owner of that passthrough entity.[3] Those regimes have taken various forms and have imposed limitations on entities' eligibility to elect into the regime, including based on ownership composition.[4] PTET regimes have proliferated as the IRS has appeared to endorse their use via Notice 2020-75, 2020-49 IRB 1453, which stated the IRS's intent to issue proposed regulations "clarifying" that state and local income taxes paid by a partnership or an S corporation are allowed as a deduction by that entity in its non-separately stated taxable income or loss (though no such regulations have been issued).

For tax years beginning after 2024 (that is, the 2025 calendar year), the OBBB would temporarily quadruple the SALT cap provided by section 164(b)(6). The OBBB, however, also would provide a phasedown based on modified adjusted gross income.[5] Importantly, the OBBB leaves intact PTET regimes for the 2025 tax year.

For tax years beginning after 2025 (for example, the 2026 calendar year), the OBBB would provide an entirely reworked SALT regime.

This article provides an overview of the key OBBB provisions concerning the new SALT regime, along with five critical takeaways that would affect PTET regimes as well as partnerships and S corporations paying or accruing taxes subject to the new SALT cap. It highlights how the text of the OBBB leaves many basic questions unanswered about how exactly the new SALT regime would work. It also emphasizes how the OBBB would result in significant administrative burdens on a wide variety of taxpayers in a way that appears incongruous with the president's deregulatory agenda. It finally encourages taxpayers to carefully study the House-passed new SALT regime and changes made to it during the Senate's process and promptly provide feedback to policymakers — in hopes that extra cooks and taste testers may make the regime slightly less SALTy.

II. Key Provisions in the New SALT Regime

The new SALT regime would limit, or in certain cases eliminate, the deductibility of certain foreign, state, and local taxes for individuals,[6] but

[2] *See* Tobias Burns, "'Donors' vs 'Takers': SALT Battle Stirs Debate Between Blue and Red States," *The Hill*, June 2, 2025 ("All the maneuvering the House has done on SALT and the last-minute agreement Republicans struck to raise the cap to $40,000 could be for nothing. Republicans in the Senate don't have a SALT caucus that is threatening to break from the rest of their party in the same way that the House does. Senate Majority Leader John Thune (R-S.D.) told The Hill that the SALT cap wasn't really an issue for the Senate, even though he recognized that the House had to make a deal. Investors say they expect changes on the bill could come from Senate moderates."). *See also* Al Weaver, "Senate GOP Weighs SALT Changes Despite 'Big, Beautiful Bill' Deal," *The Hill*, May 23, 2025.

[3] According to the American Institute of CPAs, 36 states and one locality have enacted a PTET regime since the TCJA. *See* AICPA and CIMA, "State Pass-Through Entity (PTE) Map" (May 9, 2025).

[4] For example, in Oregon, only partnerships and S corporations with individual or passthrough entity owners may elect into Oregon's PTET regime, while Minnesota prevents participation by any partnership or S corporation with an owner that is a partnership, non-disregarded limited liability company, or corporation. As another example, California requires election into its PTET regime to be made annually by consenting partners, while Alabama binds electing entities to the regime indefinitely until the entity files paperwork to revoke its election.

[5] For tax year 2025 the SALT deduction limitations are subject to a phasedown of 30 percent of the excess of a taxpayer's modified AGI over $500,000 (or $250,000 for married filing separately). This reduction is capped to $30,000 (or $15,000 for married filing separately) allowing for a minimum itemized deduction related to SALT of $10,000 (or $5,000 for married filing separately).

[6] The new SALT regime eliminates any deduction for "disallowed foreign real property taxes" (defined as foreign real property taxes other than those paid or accrued in carrying on a trade or business or an activity described in section 212). The treatment of disallowed foreign real property taxes is generally beyond the scope of this article.

would generally operate to increase the TCJA top-line limit for SALT deductions by individuals. While the increase in the top-line number has made headlines and will benefit some taxpayers,[7] there are many other wide-reaching and potentially taxpayer-adverse restrictions in the OBBB. Some of these changes will affect partnerships and S corporations, that is, passthrough businesses. Perhaps most importantly, the new SALT regime would allow for the continued viability of PTET regimes only in certain circumstances. However, PTET regimes would no longer be available in a variety of circumstances, and those circumstances are broader than an initial read might suggest. Further, when partnerships pay or accrue a tax subject to the new SALT cap, taxpayers would have to grapple with a top-up tax that would apply in cases of certain "mismatches." The new SALT regime would also alter core subchapter K (that is, partnership tax) rules[8] and impose a limit on the ability to capitalize certain amounts.[9] Finally, the OBBB would make changes to section 68, the former Pease limitation suspended by the TCJA. Under the proposed section 68 limitation, the SALT deduction for taxpayers in the 37 percent marginal income tax bracket would be subject to a 13.51 percent reduction.[10]

Compared with current law, the new SALT regime would incorporate increased top-line numbers that would apply to cap the individual deduction for certain taxes. In particular, proposed section 275(b)(1) would limit deductions for a new category of specified taxes to $40,400 ($20,200 for married taxpayers filing separately). Those amounts would be subject to phaseouts, which would reduce the deduction by 30 percent of the amount by which a taxpayer's modified AGI exceeds $505,000 ($202,500 for married individuals filing separately), as applicable (the "modified AGI limitation" and, together with the proposed deduction limitations, the new SALT cap). The modified AGI limitation would be inflation adjusted and would not reduce allowed deductions under the new SALT cap below a $10,000 set floor ($5,000 for married individuals filing separately).

To understand how the new SALT regime works to limit or eliminate the deductibility of various taxes, it is vital to understand a few of its newly defined terms, including:

- *Specified taxes.* Only specified taxes would be subject to the new SALT cap, and they would be defined to include (1) state and local and foreign real property taxes; (2) state and local personal property taxes; (3) state, local, and foreign income, war profits, excess profits; (4) sales taxes taken into account under section 164(b)(5) (relating to the election to deduct state and local general sales taxes in lieu of state and local income taxes); and (5) real estate taxes deductible under section 164 paid or incurred by a cooperative housing corporation tenant-stockholder.[11] However, taxes described in the previous sentence would not be specified taxes if the tax would qualify as either "disallowed foreign real property taxes" or "excepted taxes." Specified taxes would also include "substitute payments."[12]
- *Excepted taxes.* Excepted taxes would be excluded from specified taxes and would thus be deductible despite the new SALT cap. Excepted taxes would be defined to include (1) foreign income, war profits, and excess profits taxes; (2) "qualified trade or business (QTB) excepted taxes"; and (3)

[7] *See, e.g.*, Ashlea Ebeling and Richard Rubin, "How a New $40,000 SALT Cap Would Affect Your Tax Bill," *The Wall Street Journal*, May 22, 2025; Kate Dore, "House Republican Tax Bill Passes 'SALT' Deduction Cap of $40,000. Here's Who Would Benefit," NBC News, May 22, 2025; Hannah Ziegler et al., "What Republicans' New Tax Bill Would Mean for State and Local Tax Deductions," *The Washington Post*, May 23, 2025.

[8] For example, the OBBB would modify the section 702(a)(6) list of partnership items that must be separately stated. Proposed section 702(a)(6) would require the following to be separately stated: (1) foreign income, war profits, and excess profits taxes; (2) income, war profits, and excess profits taxes paid or accrued to U.S. possessions; (3) specified taxes (other than those paid or accrued to U.S. possessions), including substitute payments and disallowed foreign real property taxes. Under proposed section 703(a)(2)(B) those separately stated items would then be denied as a deduction to the partnership in computing its taxable income, thereby abrogating Notice 2020-75. The OBBB would also modify the section 704(d) basis limitation rules limiting a partner's ability to deduct its distributive share of deductions and losses allocated from a partnership.

[9] Proposed section 275(c) would prevent an individual from capitalizing specified taxes under chapter 1 of the code (*e.g.*, under section 266).

[10] This appears to be intended to place these taxpayers in a situation (measured in absolute dollar terms) analogous to taxpayers in the 32 percent marginal income tax bracket.

[11] Proposed section 275(b)(3).

[12] In contrast to section 901, possessions' taxes are treated as state taxes under these definitions. *See* section 164(b)(2).

state, local, and foreign real property taxes, state and local personal property taxes, or tenant-stockholder cooperative housing real estate taxes, if paid or accrued in carrying on a trade or business or section 212 activity.[13]

- *QTB excepted taxes.* QTB excepted taxes would be those (1) state, local, or foreign income, war profits, and excess profits taxes that are (2) paid or accrued (a) in carrying on a section 199A QTB and (b) by a "qualifying entity."
- *Qualifying entity.* A qualifying entity would be a (1) partnership or S corporation (2) if at least 75 percent of the gross receipts of all trades or businesses under common control with that partnership or S corporation were derived from QTBs (the 75 percent test). The OBBB's statutory language leaves many aspects of the 75 percent test uncertain — including which entities are aggregated, which years are counted, and which gross receipts are included in the denominator of the 75 percent test calculation.
- *Substitute payments.* Substitute payments would be included in the definition of specified taxes and thus would be subject to the new SALT cap. Substitute payments would be defined as an amount paid, incurred, or accrued to a state or local jurisdiction. However, if the amount is either a specified tax or a QTB excepted tax, it cannot be a substitute payment.[14] Further, for an amount to constitute a substitute payment, it must result in a specified tax benefit that meets a 25 percent test. The statutory language leaves many aspects of the 25 percent test uncertain.
- *Specified tax benefits.* Specified tax benefits would include any benefit that is (1) determined regarding the amount of the substitute payment to the state or local jurisdiction, and (2) allowed against, or determined by reference to, a specified tax or general sales tax (as defined in section 164(b)(5), for example, state and local sales taxes deducted by election in lieu of state and local income taxes).

Parsing these definitions reveals that whether the new SALT regime would limit or eliminate the deductibility of a tax would depend on a variety of factors, including:

- the type of tax (for example, real property taxes, income taxes, or sales taxes);
- the taxpayer's modified AGI and whether the taxpayer is a married individual filing separately;
- who pays the tax (for example, whether it is paid by a partnership or S corporation and whether that partnership or S corporation, along with any affiliated entities, meets certain criteria);
- whether the tax is paid or accrued in carrying on a trade or business or a section 212 activity;
- whether the tax is paid or accrued in carrying on a section 199A QTB or a section 199A specified service trade or business (SSTB);[15] and
- whether certain rules governing substitute payments — which appear to be intended to prevent the proliferation of new PTET regimes (or other regimes with similar effects) — apply.

These proposed definitions, even alongside the above factors, leave a reader without clear direction for how a particular tax would be treated under the new SALT regime. Thus, the table provides an overview of whether a certain type of tax would be nondeductible, subject to the new SALT cap deduction limitations, generally deductible without regard to the new limitations, or affirmatively deductible without regard to the proposed limitations.

III. PTET Regimes Under the New SALT Regime

The new SALT regime would allow for the continued viability of PTET regimes in limited circumstances, the contours of which are

[13] Proposed section 275(b)(4).

[14] Proposed section 275(b)(5).

[15] A section 199A QTB excludes SSTBs and the trade or business of performing services as an employee. SSTBs generally include trades or businesses involving the performance of services in the fields of health, law, accounting, actuarial science, consulting, financial and brokerage services, investing, investment management, and trading or dealing in securities. *See* section 199A(d)(1) and (2).

Characterization of Certain Taxes Under the New SALT Regime

Deduction Disallowed	Deduction Subject to the New SALT Cap (as Specified Tax)	Deduction Not Subject to the SALT Cap (Unless Classified as Substitute Payment)	Deduction Not Subject to the New SALT Cap (as Excepted Tax)
Foreign real property taxes (described in section 164(a)(1)) not paid or accrued in carrying on a trade or business or section 212 activity.	State and local real property and personal property taxes (described in section 164(a)(1) and 164(a)(2) respectively), not paid or accrued in carrying on a trade or business or a section 212 activity. (Note: unlikely to exist for most partnerships.) State, local, and foreign income; war profits; and excess profits taxes (described in section 164(a)(3)) paid or accrued by a nonqualifying entity. (Note: could include taxes paid or accrued in carrying on a QTB.) State and local general sales taxes (described in section 164(b)(5)) that (1) are not paid or accrued in carrying on a trade or business or a section 212 activity and (2) for which the individual taxpayer makes the section 164(b)(5) election. Possessions' taxes of the types described above unless the taxpayer claims a foreign tax credit under section 901.	State and local real and personal property taxes (described in section 164(a)(1) and 164(a)(2) respectively), paid or accrued in carrying on a trade or business or a section 212 activity. (Note: does not depend on section 199A classification, SSTB vs. QTB.) Foreign real property taxes (described in section 164(a)(1)) if paid or accrued in carrying on a trade or business or a section 212 activity. (Note: does not depend on section 199A classification, SSTB vs. QTB.) Taxes that are not listed in proposed section 275(b)(3)(A)(i) (for example, taxes described in the flush language of section 164(a)), including general sales taxes and gross receipts taxes paid or accrued in carrying on a trade or business or a section 212 activity. (Note: does not depend on section 199A classification, SSTB vs. QTB.)	State, local, and foreign income, war profits, and excess profits taxes (described in section 164(a)(3)) paid or accrued by a qualifying entity in carrying on a QTB. (Note: treatment may depend on SSTB vs. QTB distinction.)

noteworthy. Three need-to-knows about the treatment of PTET regimes under the new SALT regime follow.

1. Viable PTET regimes require a QTB (that is, a 'good' section 199A business) but don't guarantee deductibility of SALT.

Under the OBBB, PTET deductions would be allowed in certain circumstances involving QTB activity.[16] This is because for a state or local income tax to be an excepted tax (and thus not subject to the new SALT cap), the income tax has to be paid or accrued by a partnership or S corporation in the carrying on of a QTB (the QTB requirement). However, paying a tax for the QTB is not enough to classify the income tax as an excepted tax. There are additional limitations that are wide-reaching.

First, the QTB requirement uses the term "carrying on" — a partnership or S corporation would need to carry on a QTB. This creates questions for structures with tiers of entities. In particular, if an upper-tier partnership (UTP) conducts a trade or business and receives a distributive share from a lower-tier partnership (LTP), which itself has a trade or business, one must query whether the tax paid by UTP on that distributive share from LTP is considered "paid or accrued in carrying on a trade or business" for purposes of the requirement. If the UTP itself does not conduct a trade or business, the question becomes more difficult. If not paid or accrued by the partnership or S corporation in carrying on the trade or business, those taxes would appear to constitute specified taxes, and the new SALT

[16] This article does not explore the rationale of the House's policy of allowing PTET regimes for certain QTB activities but not for SSTB activities.

regime would require those specified taxes to be separately stated and subject to the new SALT cap. Further, under general partnership tax principles, a partner is generally not considered engaged in the trade or business of the partnership.[17] To the extent disparate treatment of taxes paid by a UTP versus an LTP is undesirable to policymakers, the QTB requirement in proposed section 275(b)(4)(A) could simply be changed from "with respect to carrying on a qualified trade or business" to "with respect to a qualified trade or business."

Second, and perhaps more importantly, for a state or local income tax to be an excepted tax, it must be paid or accrued by a qualifying entity. This is in addition to the requirement that the tax is paid or accrued "with respect to carrying on" a QTB. A qualifying entity would be defined as a partnership or S corporation that meets the 75 percent test.[18] The 75 percent test requires that at least 75 percent of gross receipts for the tax year (within the meaning of section 448(c)) be derived from a QTB (as defined in section 199A(d), but without regard to the 199A taxable income threshold limitations provided in section 199A(b)(3)).[19] In making the 75 percent determination for purposes of the 75 percent test, gross receipts from all trades or businesses that are under common control, within the meaning of section 52(b), would be taken into account as gross receipts of the tested entity. This means that activities conducted by affiliated entities could preclude the deductibility of SALT paid or accrued for the QTB. For example, consider two brother-sister partnerships, A and B, under common control for purposes of section 52(b). Assume A and B have equal amounts of gross receipts. Further assume 100 percent of A's gross receipts are from QTB activities and 40 percent of B's gross receipts are from QTB activities. Though A would easily pass the 75 percent test as a qualifying entity on its own, when A's and B's gross receipts are aggregated for purposes of the 75 percent test, the resulting combined QTB percentage (here 70 percent) would cause A to fail to qualify as a qualifying entity. Therefore, any tax paid by A (or B) would not be treated as a QTB-excepted tax.

Thus, PTET regimes would generally be unavailable for taxpayers regarding SSTB and investment activities, and often also for QTB activities.

2. The definition of qualifying entity is unclear, administratively burdensome, and seems unnecessary.

The proposed definition of qualifying entity contains many ambiguities and uncertainties and would place many administrative burdens on taxpayers, even if some or all of the technical ambiguities were resolved. Perhaps most importantly, the qualifying entity definition does not appear to serve a clear policy purpose.

a. Technical questions.

Many of the open questions center around the 75 percent test. These include which years, related entities, and items of income must be considered for purposes of the test. Many of these technical questions stem from the cross-reference to section 448(c) in the qualifying entity definition.[20]

First, regarding the relevant year or years of inclusion, the text appears unclear about whether taxpayers should look only to their current tax year for the 75 percent test or the previous three tax years (as required under section 448(c) itself). That interpretation appears to depend on whether the reference to section 448(c) modifies only the phrase "gross receipts" or also modifies the phrase "for the taxable year." Given this significant ambiguity, Congress should clarify the

[17] There is, however, some authority in the general partner context to attribute a trade or business to a general partner for certain purposes. *See*, *e.g.*, *Butler v. Commissioner*, 36 T.C. 1097 (1961); *see generally* William S. McKee et al., *Federal Taxation of Partnerships and Partners* para. 9.01 (2025) ("There is, however, some support for the view that a partnership's business can be attributed to its partners — a view that has more appeal when the partners are carrying on the partnership's business."). Moreover, limited partners are attributed the trade or business of the partnership for purposes of the effectively connected provisions of section 864(l). However, those provisions have a different purpose and may be viewed not to be applicable in the PTET context.

[18] Proposed section 275(b)(4)(B).

[19] This exclusion of section 199A(b)(3) appears to prevent taxpayers from asserting that some of their SSTB (or other non-QTB) activities would not negate excepted tax qualification to the extent the taxable income was below the threshold amount of section 199A(e)(2).

[20] One can query whether the reference to section 448(c) should instead be to section 448(c)(3). Further, by referencing section 448(c), it is unclear how taxpayers that are not corporations or partnerships are treated for purposes of the qualifying entity test. *See*, *e.g.*, section 163(j)(3).

issue even if broader changes to the qualifying entity definition are not made.

The ambiguity regarding the extent to which section 448(c)'s language applies to the 75 percent test via its reference to section 448(c) is also the source of the second ambiguity: Which entities must be aggregated for purposes of the 75 percent test? It is unclear from the language of proposed section 275(b)(4)(B) whether a taxpayer would only apply the aggregation rules of section 52(b) or instead must apply the rules of sections 52(a), 52(b), 414(o), and 414(m). The OBBB text itself only explicitly references section 52(b) so the former interpretation appears to be the better reading. The latter interpretation would read the reference to section 448(c) as incorporating section 448(c)'s own incorporation of other aggregation provisions (that is, also looking to sections 52(a), section 414(o) and section 414(m)). However, the latter interpretation appears inconsistent with the surplusage canon (*verba cum effectu sunt accipienda*), whereby every word and every provision is to be given effect, if possible.[21]

It also appears unclear whether gross receipts associated with investment income should be included in the denominator of the fraction analyzed by the 75 percent test, or whether the denominator should be limited to only gross receipts incurred in a trade or business. The first sentence of proposed section 275(b)(4)(B) refers generally to gross receipts, but the second sentence refers to "gross receipts of all trades or businesses which are under common control." Under the section 448 regulations, investment activity can generate gross receipts.[22] Here, however, it appears unclear whether the latter reference to trades or businesses modifies gross receipts so that investment income would be excluded — at least for section 52(b) group members other than the taxpayer. If investment income is included for the tested passthrough entity and excluded for section 52(b) group members other than the taxpayer, this seems to have the effect of having different percentages for each member of a single group. This result would create administrative complexities, both for taxpayers and the IRS. Perhaps more importantly, to the extent that investment income is, in fact, included for purposes of applying the 75 percent test, taxpayers with large amounts of investment income could have their qualifying entity status jeopardized for this reason alone.

b. Administrative burdens.

The definition of qualifying entity would place many administrative and compliance burdens on taxpayers, even if the issues discussed above are resolved. These difficulties stem from incorporating concepts from section 199A (namely the QTB versus SSTB distinction) and the use of aggregation rules, which would require many taxpayers to determine the proper amount of gross receipts allocable to QTB and SSTB activities. Taxpayers that would need to engage in this task include corporations and foreign entities without effectively connected income — both of which are not otherwise required to make those activity determinations (QTB or SSTB) under the code (as that activity does not give rise to section 199A benefits). Similarly, partnerships and S corporations are today only required to separate their income between their QTB and SSTB activities, but incorporation of the QTB concept into the 75 percent test would require this demarcation for receipts as well. Further, even if the 75 percent test only implicates section 52(b)'s aggregation rules, taxpayers would need to coordinate and communicate with members of their section 52(b) group, which could include foreign entities, individuals, and corporations. Complex information flows in multiple directions among the group (that is, up-reporting, down-reporting, and sideways reporting) would be required.

Assuming the 75 percent test looks to the current year, compliance uncertainty could be compounded since taxpayers would often not have the information to know if they would meet the definition of a qualifying entity until after the end of the tax year. That timeline would likely

[21] *See* Justice Antonin Scalia and Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 176 (2012) ("If possible, every word and every provision is to be given effect (*verba cum effectu sunt accipienda*). None should be ignored. None should needlessly be given an interpretation that causes it to duplicate another provision or to have no consequence.").

[22] Reg. section 1.448-1T(f)(2)(iv)(A) provides, "gross receipts include any income from investments, and from incidental or outside sources. For example, gross receipts include interest (including original issue discount and tax-exempt interest within the meaning of section 103), dividends, rents, royalties, and annuities, regardless of whether such amounts are derived in the ordinary course of the taxpayer's trade or business."

leave little time for taxpayers to coordinate with potential controlled group members, complete their 75 percent test analysis, and compute the relevant new SALT cap items, all in time to provide Schedules K-1 to partners or shareholders (as applicable) by the required date.

More globally, these administrative burdens seem incongruous with the current administration's deregulatory agenda generally, and in particular, Executive Order 14219, "Ensuring Lawful Governance and Implementing the President's 'Department of Government Efficiency' Deregulatory Initiative." EO 14219, issued on February 19, calls for the identification, followed by the repeal or modification, of regulations that impose significant costs on private parties that are not outweighed by public benefits or impose undue burdens on small business and impede private enterprise and entrepreneurship.[23]

c. Policy goals.

One potentially simple revision to this regime, which would remove those technical complexities and administrative burdens, would be to define a qualifying entity as any partnership or S corporation — without the 75 percent test qualifier. That revision would appear to adhere to Congress's policy objective of limiting the continued viability of PTET regimes to QTB activities given the QTB requirement (and the regulatory authority provided in the new SALT regime). Said more explicitly, the requirement that a state or local income tax be paid or accrued by a qualifying entity in order to fall outside of the new SALT cap is in addition to the requirement that the tax be paid or accrued in carrying on a QTB. Given that both requirements look to the presence (and quantum of) QTB activity, it is unclear what pressing policy objectives are served by having both requirements in the OBBB.[24]

[23]Proposed section 275(b)(6)(C) charges Treasury with promulgating regulations providing for the proper allocation of section 164(a)(3) taxes (state and local income taxes) between QTB and non-QTB activities.

[24]It is possible that some of the complexity in the definition of qualifying entity was intentionally included to reduce the revenue costs associated with allowing for the continued deductions of certain PTET regimes. As such, taxpayers should be aware that a revision to the qualifying entity definition to include all partnerships and S corporations may create revenue concerns as the change would appear to create a larger taxpayer base that would be expected to take advantage of the excepted tax rules.

3. The complex substitute payment regime appears intended to prevent states from proliferating new PTET regimes.

The substitute payment rules appear intended to prevent the proliferation of new PTET regimes inconsistent with the intent of the OBBB's authors. However, the rules will most likely beguile taxpayers and the IRS.

Under the OBBB, substitute payments are defined as payments to states or localities that are not specified taxes or QTB excepted taxes, that generate specified tax benefits (under certain assumptions) to one or more persons, which are related to specified taxes and of a certain quantum. Regarding the quantum of benefits, the rules would generally require one or more persons to receive in return specified tax benefits with aggregate dollar value equal to or exceeding 25 percent of the payment to the state or local jurisdiction. For determining the aggregate dollar value of the specified tax benefit, the rules provide several assumptions, including that, when the benefit is a deduction or exclusion, the aggregate dollar value to the recipient is 15 percent of the amount of that deduction or exclusion.

The primary target of the substitute payment rule appears to be the creation of new PTET regimes. An example of this was provided in the Joint Committee on Taxation report describing the provisions of the May 12 amendment in the nature of a substitute draft of the bill, in which a partnership not engaged in a QTB pays a state gross receipts tax or personal property tax imposed on the partnership, and by reason of that payment the partnership's partners receive credits against their state personal income tax liabilities.[25] The JCT report concludes that the payment by the partnership is a substitute payment. This is presumably because (1) the gross receipts tax is neither a specified tax nor an excepted tax, (2) the personal property tax paid is an excepted tax that is not a QTB excepted tax, and (3) the specified tax benefit of state income tax credits received is against a specified tax.

[25]*See* JCT, "Description of the Tax Provisions of the Chairman's Amendment in the Nature of a Substitute to the Budget Reconciliation Legislative Recommendations Related to Tax," JCX-21-25, at 312 (May 12, 2025).

The substitute payment rules appear intended to limit the ability of states to create PTET-like regimes to bypass the new SALT cap by making deductible payments at the partnership level in exchange for substitute deductions or credits at the partner level. By defining substitute payments made by taxpayers to state and local jurisdictions to include any payment (other than specified taxes or QTB excepted taxes), the rules appear to imply that the type of workaround that the substitute payment rules are intended to prevent is a payment by a taxpayer to a state in a nontraditional form (that is, not already a specified tax or similar) in exchange for a deduction or credit that is in a traditional form (that is, a specified tax or similar).

However, the substitute payment rules, because of their inherent complexity, seem likely to beguile both taxpayers and the IRS. There are many unanswered questions, including the reason for using a 15 percent assumed tax rate[26] and whether an increased rate for a QTB excepted tax (with a partner-level or shareholder-level specified tax benefit) could implicate these rules, including under one of the proposed regulatory grants.[27] There is also the practical question of whether and how a taxpayer would need to prove that a payment is not a substitute payment.

IV. Specified Taxes Paid by Partnerships Under the New SALT Regime

The new SALT regime would encompass many circumstances in which specified taxes are paid or accrued by partnerships. In those cases, partnerships and their partners will have to navigate changes beyond the new SALT cap top-line limitation. Two need-to-knows about the treatment of specified taxes paid by partnerships under the new SALT regime follow.

1. Partnerships that pay specified taxes would need to grapple with proposed changes to subchapter K.

The OBBB modifies certain subchapter K (that is, partnership tax) rules to implement the new SALT regime. These include changes to section 704(d) and section 702.

Most notably, the OBBB modifies the section 704(d) basis limitation rules, which govern a partner's ability to deduct its distributive share of deductions and losses from a partnership. The OBBB would add a new rule through proposed section 704(d)(3) that would disallow the deduction for otherwise deductible, specified taxes in certain circumstances.

According to the JCT report, for purposes of the section 704(d) basis limitation, a partner's distributive share of partnership loss would generally only include that partner's distributive share of the partnership's specified taxes to the extent that the partner otherwise would be able to deduct that distributive share.[28] Therefore, if a partner does not have adequate basis to account for its full distributive share of otherwise deductible specified taxes, then some (or all) of its distributive share would be denied as a deduction in the current year and carried forward to future years. Thus, the explanation provided in the JCT report appears to indicate that there are two separate limitations regarding an individual partner's ability to deduct specified taxes allocated to it by a partnership — limitations from the new SALT cap, and, separately, the modified section 704(d) basis limitation rules. From the JCT report, it seems that the new rules under proposed section 704(d)(3) are intended to create a functional ordering rule in which a taxpayer compares its deductions arising from all items that are not specified taxes against its section 704(d) loss limitation, and then, to the extent the limit is not reached, takes additional deductions for its specified taxes. However, it is far from clear that the legislative text itself provides for these mechanics through its language.

Assuming the statutory rules are amended to reflect their apparent intent (as gleaned from the JCT report), there are still several unanswered,

[26]In determining the aggregate dollar value of the specified tax benefit, the rules incorporate several assumptions, including that, when the benefit is a deduction or exclusion, the aggregate dollar value to the recipient is 15 percent of the amount of the deduction or exclusion. That construction appears to be consistent with a 15 percent marginal tax rate for a state or local tax (or similar), which would generate a dollar benefit of 15 percent of any amount of deduction or exclusion from state or local taxable income. One possible reading, if state and local income taxes are combined and considered together as a single rate, is that the proposed 15 percent amount is a rounded approximation of New York City's highest combined state and local income tax rate (which reaches 14.78 percent on incomes over $25 million).

[27]*See supra* note 23, regarding proposed section 275(b)(6)(C).

[28]*See* JCT report, *supra* note 25, at 313.

but core questions. The new SALT regime would appear hard to apply (or administer) unless some of these issues were clarified. Taxpayers and the IRS would thus be well-served if amended language made clear how a partner's distributive share of specified taxes that are limited by the new SALT cap affect the basis limitation computation[29] and how those carryforward rules interact with the new SALT cap and other provisions of the OBBB regarding separately stated partnership items for specified taxes. Further, an ordering rule may be necessary if an individual has specified taxes from multiple partnerships or other sources.

Although unclear from the language of the bill itself, further issues arise with the proposed changes to subchapter K to implement the new SALT regime, including how to apply the modified loss limitation rules through tiers and the apparent incongruity of the proposed section 704(d)(3) loss limitation provisions with the corresponding basis determination rules of section 705. Because the new SALT cap is applied at the partner level, it cannot be determined whether any of the specified taxes allocated to a mid-tier partnership by an LTP will ultimately be deductible. The section 704(d) loss limitations apply to all partners, including mid-tier partnerships. It is therefore uncertain how to apply proposed section 704(d)(3) in those circumstances. Further, the proposed change only applies to section 704(d) loss limitations and does not mention the effect, if any, on the regular basis computations of section 705. Presumably, the partnership's payment of specified taxes reduces basis because it is an economic expenditure. It is unclear how to square this treatment with the changes to section 704(d), which seem to not reduce basis for purposes of the loss limitation for any specified taxes that are ultimately nondeductible.

Relatedly, distributive shares of specified taxes, which would be separately stated on Schedules K-1 under proposed section 702(a)(6) (requiring a separate statement of specified taxes by partnerships and S corporations[30]), raise an issue for corporate partners, in particular whether the corporate partner receiving those separately stated items on its Schedule K-1 would still need to apply the section 704(d) limitations and also whether the corporation can take a deduction for that specified tax. Proposed section 275(b) would apply to individuals, not corporations. Presumably, upon receiving a Schedule K-1 with a separately stated specified tax, a corporate partner would take a section 164(a) deduction for the item.

2. The overbroad mismatch rule appears intended to prevent partnerships from using special allocations to indifferent partners to mitigate the effect of the new SALT regime.

Proposed section 6659 would provide a "mismatch rule" requiring an addition to federal income tax for covered individuals that have a state and local tax allocation mismatch (a SALT allocation mismatch) for a specified tax payment paid, incurred, or accrued by a partnership. The mismatch rule would apply in cases in which the dollar value of the "specified tax benefit," as determined under certain stated assumptions, to a covered individual exceeds the individual's distributive share of the deduction for the SALT payment. For these purposes, a covered individual would be an individual, estate, or trust that is entitled to a specified tax benefit and that takes into account, directly or indirectly, any item of income, gain, loss, deduction, or credit of the payer partnership.

It appears that the primary intent of the mismatch rule is to prevent disproportionate special allocations of specified taxes to partners most able to deduct them (for example, corporate partners that would not be subject to the new SALT cap). The JCT report contains an example in which a corporate partner is specially allocated all the partnership's specified tax payments, implying a situation in which the section 704(b) regulations would respect that allocation.[31] Under

[29]The explanation in the JCT report suggests that a partner's distributive share would not include specified taxes that are limited by the new SALT cap for purposes of the section 704(d) basis limitation. But the effect of excluding those limited specified taxes is unclear. Query whether those amounts are permanently excluded from the section 704(d) loss limitation calculus (potentially allowing other losses to be deducted) and whether those amounts included in the partner's distributive share in a future year (inferring there is an unlimited carryforward that can occur).

[30]The bill would apply corresponding provisions to S corporations under sections 1366(a)(1) and 1363(b)(2).

[31]*See* JCT report, *supra* note 25, at 314.

the example, an individual partner receives a credit against their personal state income tax liability that relates to a tax paid by the partnership. Because the state credit exceeds the individual's allocation of the tax expense, a SALT allocation mismatch exists. Under the example, the individual is required to increase their federal income tax liability because of this mismatch.

Other situations could implicate the mismatch rule as well. For example, the elective PTET regimes of certain states include in the relevant tax base income before sourcing for a resident partner but sourced income for a nonresident partner, with a tax credit allocable to each partner in accordance with the passthrough-level tax attributable to that partner's income included in the tax base. For this type of PTET regime, structurally, it appears that a SALT allocation mismatch may exist for partnerships with resident and nonresident partners of the state. This would seem possible in the absence of a special allocation of the expenses in accordance with each partner's contribution to the PTET tax base. In that case, for example, if the nonresident partner's apportionment to the state is less than 100 percent, the partner's determined contribution to the state's tax base for PTET purposes would not be pro rata compared with the resident partner's contribution to the state tax base, and each partner's state tax credit would follow that split. However, in that situation, if an expense is allocated pro rata under the partnership agreement, the resident partner may receive a specified tax benefit from the state tax credit they receive that is greater than their share of the corresponding tax deduction allocated to them. There does not seem to be a pressing reason that this situation should result in the application of the mismatch rule, since it does not even implicate a special allocation.[32]

Situations exist that arguably suggest the rule is also underinclusive. For example, it appears that certain partners receiving guaranteed payments (within the meaning of section 707(c)), and no distributive share (guaranteed payment only partners), may not be subject to the mismatch rule — whatever the economic arrangement is. This is because the mismatch rule requires a benefit to a covered individual, and a covered individual must take into account an "item of income, gain, loss, deduction, or credit." Thus, query whether the definition of covered individual includes a "guaranteed payment only partner," since a section 707(c) guaranteed payment would generally not be considered an item of income, gain, loss, deduction, or credit. This, however, is uncertain since section 707(c) treats the income as recognized by one who is not a partner for certain enumerated purposes, but for purposes of other provisions of the internal revenue laws, guaranteed payments are regarded as a partner's distributive share of ordinary income.

V. Conclusion

The new SALT regime raises many questions for current PTET regimes and the operation of certain core subchapter K principles. It was substantially modified through the House OBBB process — the new SALT regime, as passed by the House, is meaningfully different from the Ways and Means print and the Budget print. Further, Congress may ultimately enact a SALT regime with significant differences from the one in the current House-passed OBBB tax title. The political dynamics in the Senate differ substantially from the political dynamics in the House, particularly regarding the SALT cap.

Therefore, taxpayers should carefully study the new SALT regime in the House-passed OBBB and promptly provide feedback to policymakers. Further, as revisions to the tax title are made by the Senate (whether at committee markup, on the Senate floor, or otherwise), taxpayers should carefully parse the revised language — including changes affecting the treatment of PTET regimes and proposed changes to subchapter K. Once

[32] In particular, before the manager's amendment, the substitute payments provisions of the OBBB could be read to generally preclude the use of all current PTET regimes. *See* Miles Johnson and Michael Kaercher, "Ways and Means Bill Curtails SALT Cap Workarounds for All Passthrough Entities," New York University Tax Law Center (May 19, 2025). This is because the language suggested that a QTB excepted tax could be a substitute payment under the prior language. However, the manager's amendment changed the definition of substitute payment to clarify that a substitute payment could not exist regarding a QTB excepted tax. This change generally came as welcome news to some taxpayers.

again, prompt feedback to policymakers is vital — extra cooks and taste testers may make the regime slightly less SALTy.[33] ■

[33] The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG LLP. KPMG LLP is a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Ltd., a private English company limited by guarantee.