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An Analysis of the 2025 Federal Tax Changes Under the “One Big Beautiful Bill” Legislation

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Key Takeaways

- President Donald Trump signed wide-ranging tax legislation, P.L. 119-21 (the Legislation) on July 4, 2025.
- The Legislation includes net tax cuts of $4.5 trillion and spending cuts of $1.2 trillion, for a cost compared with current law of approximately $3.3 trillion over the 10-year budget window.
- The Legislation will affect nearly every sector of the economy and every type of taxpayer, including individuals, corporations, pass-through entities and tax-exempt organizations.

Overview

The Legislation combines spending and policy priorities from 11 congressional committees and will reshape federal policy across nearly every sector of the U.S. economy.

Overview *(cont.)*

With respect to taxes, notable provisions include the following:

The Legislation makes permanent most of the expiring provisions of the TCJA; makes permanent changes to U.S. corporate international tax provisions; makes permanent the allowance for domestic research and development (R&D) expensing and bonus depreciation; allows immediate expensing for the cost of certain manufacturing facilities; phases out early or repeals certain Inflation Reduction Act of 2022 (IRA) renewable energy credits; modifies the excess business loss calculation; permanently renews and expands Qualified Opportunity Zones, the New Markets Tax Credits and low-income housing credits; increases the investment credit for semiconductor manufacturers for certain new facilities; restores Section 958(b)(4) prospectively and in a modified manner; allows oil and gas companies to exempt intangible drilling and development costs when calculating their corporate alternative minimum tax (AMT); increases the maximum of a real estate investment trust's (REIT's) assets that may be held through taxable subsidiary corporations; treats spaceports like airports for purposes of the exempt-facility bond rules;

Overview *(cont.)*

With respect to taxes, notable provisions include the following (continued):

Increases taxes on net investment income of certain private college and university endowments; makes permanent (with certain limited enhancements) the 37 percent individual top tax rate; increases and makes permanent the child tax credit; increases the state and local tax (SALT) deduction cap to $40,000 for certain taxpayers through 2029; increases and makes permanent the standard deduction and Section 199A; adds on a temporary basis various provisions promised by President Trump on the campaign trail, including eliminating taxes on certain tips and overtime, allowing for the deduction of auto loan interest for certain new cars, and providing a bonus standard deduction for seniors to help offset the cost of taxation of certain Social Security income; establishes Trump investment accounts for children; permanently increases the estate and gift tax exemption to $15 million; caps the value of itemized deductions at 35 percent and places a floor on itemized deductions of charitable contributions; adds a 1 percent floor on the corporate deduction of charitable contributions and a one percent remittance tax on certain transferors who send money abroad and tightens restrictions regarding the employee retention credit.

Overview *(cont.)*

The Legislation did NOT:

Make any changes to carried interest or the corporate or capital gains tax rates, did not reduce the corporate rate for U.S. manufacturing (but does allow full immediate expensing of certain manufacturing facilities), did not repeal the stock buyback tax or the corporate AMT, and contains no limitation on corporate deductions of state or local taxes. Unlike certain earlier drafts, the Legislation dropped the proposed Section 899 revenge tax, dropped the proposed attack on passthrough entity SALT deduction work-arounds, dropped the proposed 41 percent punitive tax on litigation funding, dropped the proposed excise tax on wind and solar projects that received certain assistance from foreign entities of concern (FEOC), dropped the proposed moratorium on states regulating artificial intelligence, dropped proposals relating to sales of public lands, and dropped a proposed amendment to Section 7213 to increase criminal penalties in cases of unauthorized disclosure of certain private tax return information. Public Law 86-272 modernization protections relating to taxation by states also were not included in the Legislation.

Overview *(cont.)*

There is a possibility for one or more additional reconciliation bills during late 2025 and 2026 and therefore additional opportunities for enactment of additional provisions, as well as changes and improvements to the Legislation. And the importance of engaging with the IRS and Treasury as they develop guidance to implement some of the more complex provisions cannot be overstated.

Bonus Depreciation

The Legislation permanently extends and modifies Section 168 first-year (bonus) depreciation, generally allowing 100 percent depreciation in the first year for certain property acquired and placed in service after Jan. 19, 2025. The Legislation also makes permanent the percentage of completion method for allocation of bonus depreciation to long-term contracts.

Immediate Expensing for Qualified Production Property

To encourage domestic manufacturing and production, the Legislation contains a special provision for qualified production property that allows for the immediate expensing of 100 percent of the adjusted basis of the qualified production property, including 39-year factory (manufacturing) property.

Qualified production property means the portion of any nonresidential real property (1) used as an integral part of a qualified production activity; (2) placed in service in the U.S.; and (3) whose original use begins with the taxpayer. The construction of the property must begin after Jan. 19, 2025, and before Jan. 1, 2029. The property must be placed in service after the date of enactment and before Jan. 1, 2031. Qualifying production activities include manufacturing, production or refining of tangible personal property and agricultural or chemical production.

Increased Dollar Limitations for Expensing of Certain Depreciable Business Assets

The Legislation allows for immediate expensing under Section 179 of the cost of qualifying property up to $2.5 million, with a phaseout threshold that begins to reduce the deductible amount when costs exceed $4 million for property placed in service after Dec. 31, 2024. Under current law, up to $1 million may be expensed and the phaseout threshold amount is $2.5 million.

In general, qualifying property is defined as depreciable tangible personal property, off-the-shelf computer software and qualified real property that is purchased for use in the active conduct of a trade or business.

Research and Development

Since 2022, taxpayers have been required to capitalize and amortize U.S.-based research or experimental expenditures ratably over a five-year period and non-U.S.-based research or experimental expenditures ratably over a 15-year period. These include costs to develop or improve a product, including software. Examples of costs are the salaries of the persons engaged in the research or experimentation efforts, overhead incurred to operate and maintain the facility, and materials and supplies that are consumed in the course of the research or experimental activities. The requirement to capitalize and amortize these costs has been a source of contention since 2022.

The Legislation permanently suspends the capitalization of domestic research or experimental expenditures for amounts paid or incurred in taxable years beginning after Dec. 31, 2024. However, a taxpayer may elect to capitalize and amortize the expenditures by filing an election with its tax return. This is an important election for some taxpayers, who benefit more from foreign-derived intangible income (FDII) -- which permanently lowers their tax rate -- when they capitalize (a mere timing issue) R&D expenditures. Foreign research or experimental expenditures still must be capitalized and amortized over a 15-year period.

Business Interest Deductibility

Under the TCJA, Section 163(j) generally limited the amount of business interest that a taxpayer may deduct to (1) business interest income, (2) 30 percent of its "adjusted taxable income" (ATI) and (3) certain interest associated with vehicle inventory financing. The TCJA initially defined ATI with reference to EBITDA, but for calendar years 2023 and beyond the TCJA essentially equated ATI with EBIT which had the impact of severely limiting interest deductibility (i.e., because depreciation and amortization deductions were required to be taken into account in determining the ATI number against which the 30% limitation was applied). For several years, taxpayers have been campaigning to "bring back the 'DA'," and the Legislation does just that by again equating ATI with EBITDA – this time on a permanent basis. The Legislation also extended vehicle inventory financing benefits to recreational vehicle dealers. These changes are effective for tax years beginning after Dec. 31, 2024.

The final bill also makes limited incremental adjustments to Section 163(j) by explicitly requiring the provision's coordination with interest capitalization rules and by statutorily mandating that ATI will be computed without considering amounts related to offshore operations (e.g., subpart F or GILTI inclusions). These changes are effective for tax years beginning after Dec. 31, 2025.

FDII (Renamed FDDEI)

The most substantive changes to FDII include (1) permanently modifying the FDII deduction rate to 33.34 percent (i.e., eliminating a scheduled reduction to a 21.875 percent deduction rate beginning in calendar year 2026), thereby making the effective rate of FDII approximately 14 percent, (2) eliminating the hurdle related to qualified business asset investment (QBAI) that taxpayers were required to overcome in order to enjoy FDII benefits, and (3) modifying the relevant computational rules so that interest and research expenditures are no longer allocated against FDII-qualified income. While the final bill modestly increases the overall rate applicable to FDII relative to the original House version, its targeting of certain key TCJA-related structural deficiencies that have plagued the FDII regime's operation is very taxpayer friendly and is certain to further enhance the attractiveness of the regime. These FDII changes are effective for tax years beginning after Dec. 31, 2025.

FDII (Renamed FDDEI) *(cont.)*

The Legislation also makes changes to FDII that seeks to limit a taxpayer's ability to benefit from the regime when offshoring intellectual property or other valuable assets. Historically, gains and royalties arising from outbound disposals of intellectual property to foreign affiliates (e.g., due to a sale or Section 367(d) contributions) could qualify for favorable FDII rates; however, this result arguably ran counter to FDII objectives aimed at encouraging U.S. multinationals to onshore intellectual property following the enactment of the TCJA. Accordingly, the Legislation eliminates the ability to claim FDII benefits for any disposals of intellectual property or other valuable assets to foreign affiliates, with effect for dispositions (including deemed dispositions) occurring after June 16, 2025. The Legislation does not include language contained in the earlier Senate version that would have made passive income – such as income of a type similar to foreign personal holding company income (for instance, certain royalties paid by a controlled foreign corporation (CFC) for local exploitation) – ineligible for FDII benefits. Such a limitation arguably would have been contrary to the objectives of FDII (e.g., to encourage holding intellectual property in the U.S.) and would have diminished the benefits of the FDII regime.

Finally, the Legislation changes the name of FDII to "Foreign-Derived Deduction-Eligible Income."

BEAT

The Legislation repeals the scheduled increase in the base erosion and anti-abuse tax (BEAT), which was scheduled to increase from 10 percent to 12.5 percent for tax years beginning after Dec. 31, 2025, and instead permanently adopts a slightly higher 10.5 percent rate that applies for tax years beginning after Dec. 31, 2025. The Legislation does not include “super” BEAT provisions – which would have increased the rate to 14 percent and made the provision applicable to more taxpayers – that were included in the Senate’s original legislative draft.

GILTI (Renamed Net CFC Tested Income)

The Legislation seeks to improve the operation of GILTI by making several modifications to the regime, including by addressing certain TCJA-related structural deficiencies that have plagued GILTI since its origin and by eliminating certain computational elements that might be perceived as incentivizing offshore (rather than onshore) manufacturing. The Legislation's most substantive changes to GILTI include (1) permanently modifying the GILTI deduction rate to 40 percent (i.e., eliminating a scheduled reduction to a 37.5 percent deduction rate beginning in calendar year 2026), thereby making GILTI's effective rate 12.6 percent (assuming GILTI earnings are not subject to foreign tax), (2) permanently reducing the GILTI haircut on deemed paid foreign taxes from 20 percent to 10 percent, with the result that GILTI-related earnings that bear a 14 percent effective rate of foreign tax should not be subject to residual federal income taxation, (3) eliminating the QBAI-related tax-free return that taxpayers had enjoyed following the TCJA, and (4) modifying the relevant foreign tax credit limitation provisions so that various expenses (particularly those associated with interest and research expenditures) are allocated and apportioned to U.S. source income rather than to income otherwise belonging to the GILTI basket. As with FDII, the Legislation operates to modestly increase the overall rate applicable to GILTI relative to the original House version; however, its targeting of various statutory deficiencies that have plagued the intended operation of GILTI generally is taxpayer friendly. While the elimination of the QBAI-related tax-free return may impact certain U.S. multinationals (e.g., energy companies where offshore CAPEX costs can be significant), many taxpayers may find the elimination of the QBAI benefit a relatively modest price to pay for the more significant improvements to the GILTI regime. These GILTI-related changes are effective for tax years beginning after Dec. 31, 2025.

Implications Regarding Pillar 1 and Pillar 2

The Legislation and related tariff actions make clear, as expected, that the U.S. Congress and the Trump administration believe Pillar 1 is dead and have no intention of aligning U.S. tax laws with Pillar 2. Treasury officials have stated that the U.S. tax system is robust enough that other countries should refrain from applying the 15 percent global minimum tax (Pillar 2) to any income that the U.S. taxes. To make these points explicit, earlier versions of the legislative text from both the House and the Senate included a new Code Section 899, which was aimed at discouraging foreign countries from enacting and applying discriminatory, extraterritorial or similar taxes that disproportionately had a direct or indirect impact on U.S. persons. This new statutory provision specifically would have targeted foreign countries that enact undertaxed profits rules (UTPRs), digital services taxes (DSTs), diverted profits taxes and similar measures. When applicable, the provision would generally modify the regular U.S. tax rates applicable to the governments of, and individuals and companies tax resident in, such "discriminatory foreign countries" by incrementally increasing the rate by 5 percentage points each year (but capping the overall increase at 15 or 20 percentage points). The provision garnered significant attention, and despite its similarity to a UTPR (i.e., an in terrorem tax rule designed to encourage other countries to adjust their local tax laws to avoid its application), many Europe-based stakeholders complained that new Section 899 would significantly impact historic investments in the U.S. and would possibly impede future direct investment.

Implications Regarding Pillar 1 and Pillar 2 *(cont.)*

In late June 2025, after holding a series of negotiations with other countries, the U.S. Treasury Secretary made a request that the Senate remove Section 899 from the bill due to a pending G-7 agreement to permit side-by-side co-existence of Pillar 2 and the U.S. tax system (including GILTI, as currently configured, without country-by-country application). On June 28, 2025, representatives of the G-7 countries issued a statement confirming their commitment to this side-by-side agreement, and while precise details are not yet fully known the stated objective is that U.S. multinationals will not be subject to Pillar 2's UTPRs or "income inclusion rules" in respect of U.S. and foreign source earnings. Given this agreement, the final bill does not include Section 899. While the side-by-side agreement must still be formalized and adopted by the OECD-led Inclusive Framework, the commitment made by the G-7 countries and the possibility for a second reconciliation bill in late 2025 should ensure that the agreement is made durable.

In late June 2025, Canada also agreed to rescind its DST in order to continue tariff negotiations with the U.S. After many delayed effective dates, Canada's DST was first due on June 30, 2025, covering revenues earned since January 1, 2022. Taxpayers who filed and made payments with the Canada Revenue Agency (CRA) before the June 30th deadline and before Canada's agreement to rescind the DST should receive refunds once Canada's Parliament returns from its summer break in mid-September and formally repeals the DST. CRA has stated that it lacks legal authority to refund DST payments absent legislation.

Other International Tax Changes

The Legislation includes a number of other changes to U.S. international tax rules that were not in the original House text. The most notable international tax changes in the final bill include:

- **More Favorable U.S.-Production Sourcing Rules**

  The Legislation seeks to enhance the sourcing rules for U.S. produced inventory, by permitting up to 50 percent of the income associated therewith to be treated as foreign source income for foreign tax credit purposes notwithstanding the final sentence of Section 863(b) (which sources entirely based on location of production).

Other International Tax Changes *(cont.)*

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- **Reinstatement of Section 958(b)(4) and Enactment of New Section 951B**

  The Legislation reinstates Section 958(b)(4) (which was repealed by the TCJA) on a prospective-only basis for taxable years beginning after Dec. 31, 2025, and with modifications to the manner it will apply going forward. Before the TCJA, that section functioned to block downward attributions of stock ownership in the context of determining which corporations were CFCs. The Legislation enacts new Section 951B to implement the new and targeted approach, again prospectively only for taxable years beginning after Dec. 31, 2025. There were various winners and losers associated with the TCJA's repeal of Section 958(b)(4) and Congress previously determined on numerous occasions not to reinstate Section 958(b)(4).

Other International Tax Changes *(cont.)*

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- **Elimination of the Section 898 One-Month Deferral Election**

  The Legislation eliminates the possibility of electing a one-month deferral for the required U.S. tax year of U.S.-owned foreign corporations (generally CFCs). The provision arguably seeks to eliminate on a going-forward basis tax year-end change planning that was prevalent following the adoption of the TCJA. It is effective for tax years of specified foreign corporations beginning after Nov. 30, 2025.

Other International Tax Changes *(cont.)*

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- **Permanent CFC "Look-Through" Under Section 954(c)(6)**
  The Legislation makes permanent the subpart F "look-through" rule for payments from related CFCs.

- **Modification of the Subpart F -- GILTI "Pro Rata" Rules**
  The Legislation makes significant changes to the subpart F and GILTI "pro rata" rules under Sections 951(a) and 951A. Most significantly, the revised rules no longer (1) trigger inclusions solely for U.S. shareholders that own a CFC on the last day of the CFC year, or (2) allow distributions to operate to reduce or eliminate taxable income. The changes arguably target Section 951(a)(2)(B) and similar planning techniques that were popular following the adoption of the TCJA, and because the changes are anti-abuse in nature there are transition rules relating to actual and deemed dividends that may have an immediate impact on current year tax results.

Other International Tax Changes *(cont.)*

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- **Foreign Tax Credit Limitations for Previously Taxed Earnings and Profits (PTEP) Distributions**

  The Legislation makes it clear that foreign taxes otherwise associated with the GILTI haircut (e.g., the 10 percent haircut applied to foreign taxes for deemed paid tax purposes) cannot be claimed on a subsequent distribution of PTEP. The changes arguably target foreign tax credit planning that may have been possible due to revisions to Section 960 made in connection with the enactment of the TCJA. Because the changes are anti-abuse in nature, they are effective for amounts distributed after June 28, 2025.

  Except as otherwise noted above, these changes are effective for tax years beginning after Dec. 31, 2025.

Modifications to Renewable Energy Provisions of the Inflation Reduction Act

The Legislation significantly modifies and in some instances repeals various renewable energy credits and provisions that were enacted as part of the IRA. These changes generated enormous amounts of revenue that were integral to offsetting the Legislation's deficit generating provisions. The modifications include the adoption of "prohibited foreign entity" rules that prevent certain entities that either are owned or have commercial ties with persons from covered nations (i.e., China, North Korea, Russia and Iran) from claiming renewable energy credits contained in the IRA. The modifications also include the adoption of "material assistance" rules that prevent eligibility for certain credits where a prohibited foreign entity materially assisted with manufacturing or construction. What follows is a summary of the most significant changes and portions of an executive Order issued by President Trump on July 7th.

Modifications to Renewable Energy Provisions of the Inflation Reduction Act *(cont.)*

- **Prohibited Foreign Entities and Material Assistance**

  The prohibited foreign entity rules are the culmination of prior legislative attempts to restrict and prevent certain foreign owned or controlled entities from benefiting from U.S. federal income tax credits. In many respects, however, the enacted rules go beyond prior attempts by targeting not just certain foreign-owned entities but also commercial transactions and ties with certain foreign-owned companies. The rules broadly apply to renewable energy credits in three situations.

  The first situation relates to "specified foreign entities," which is generally defined as an entity that is related to or controlled (through stock or equity) by the government, companies, or individuals of covered nations (as defined above).

  The second situation is for entities that are "foreign-influenced entities," which targets ownership (similar to the definition of a specified foreign entity) and commercial transactions and relationships with a prohibited foreign entity. The definition generally causes an entity to be considered a foreign-influenced entity (and in turn a prohibited foreign entity) if a separate prohibited foreign entity has the ability to direct or decide matters affecting management or operations of the entity. Whether an entity is a foreign-influenced entity is subjective and requires an analysis of the entity's capital structure (debt and equity), contracts for materials or manufactured goods, and other arrangements such as licensing agreements. The entity's contracts and other arrangements must be analyzed to determine whether a prohibited foreign entity has the ability to exercise "effective control" over aspects of the entity's management or certain business affairs.

Modifications to Renewable Energy Provisions of the Inflation Reduction Act *(cont.)*

- **Prohibited Foreign Entities and Material Assistance *(cont.)***

  The final situation involves whether an entity receives "material assistance" from a prohibited foreign entity. If an entity does receive "material assistance," either products it makes will not qualify as eligible components under Section 45X or the facility that is being constructed will not qualify as a qualified facility for purposes of production and investment tax credits.

  The Legislation adopted material assistance rules that analyze cost ratio thresholds for manufactured products and facilities. The cost ratio is calculated based on the total direct material costs paid or incurred by the manufacturer of an eligible component or developer of a facility to a prohibited foreign entity over the total amount of direct costs paid or incurred. If the ratio is above a statutorily defined threshold, the manufactured product or the facility are ineligible for certain renewable energy credits. The final legislation defines the relevant cost ratios and states that taxpayers may in the interim rely on existing IRS guidance relating to domestic content until additional guidance is issued.

  The prohibited foreign entity rules take effect in the taxable year beginning after the enactment of the Legislation. The material assistance rules apply to facilities the construction of which begins after Dec. 31, 2025 and to eligible components produced in the taxable year beginning after the date of enactment.

Modifications to Renewable Energy Provisions of the Inflation Reduction Act *(cont.)*

- **Clean Fuel Production Credit – Section 45Z**

  The clean fuel production credit under Section 45Z would be modified by the Legislation to require that feedstocks be produced or grown in the U.S., Mexico or Canada. Previously, there were no sourcing requirements with respect to feedstocks, and clean fuel producers were therefore able to import feedstocks such as sugar cane from abroad. The Legislation also contains amendments to the greenhouse gas emissions requirements for land use changes and emissions rates for animal manure used as a feedstock. Finally, the Legislation extends the clean fuel production credit to Dec. 31, 2029, which aligns it with the modified phaseout and expiration dates made to other credits.

Modifications to Renewable Energy Provisions of the Inflation Reduction Act *(cont.)*

- **Clean Electricity Production Credit and Investment Tax Credit – Sections 45Y and 48E**

  The Legislation terminates the clean electricity production credit and the clean electricity investment tax credit for all wind and solar energy property placed in service after Dec. 31, 2027. However, in a last minute change to the Legislation, the termination provision was amended to be effective for property the construction of which begins one-year after the enactment of the Legislation. Thus, projects that begin construction within the next year are not subject to the Dec. 31, 2027 placed-in service restriction. This provision generated enormous controversy when the Senate returned the Legislation to the House, and it remains to be seen how it will be implemented by Treasury and the IRS, including in light of the Executive Order discussed immediately below.

  As noted above, the prohibited foreign entity and material assistance rules apply to all types of facilities eligible for clean electricity production and investment tax credits (i.e., biogas, energy storage, geothermal, etc.).

Modifications to Renewable Energy Provisions of the Inflation Reduction Act *(cont.)*

- **President Trump issued an executive Order on July 7th stating, in Section 3 in relevant part:**

  "(a) Within 45 days following enactment…, the Secretary of the Treasury shall take all action as the Secretary of the Treasury deems necessary and appropriate to strictly enforce the termination of the clean electricity production and investment tax credits under sections 45Y and 48E of the Internal Revenue Code for wind and solar facilities. This includes issuing new and revised guidance as the Secretary of the Treasury deems appropriate and consistent with applicable law to ensure that policies concerning the "beginning of construction" are not circumvented, including by preventing the artificial acceleration or manipulation of eligibility and by restricting the use of broad safe harbors unless a substantial portion of a subject facility has been built," and

  "(b) Within 45 days following enactment…, the Secretary of the Treasury shall take prompt action as the Secretary of the Treasury deems appropriate and consistent with applicable law to implement the enhanced Foreign Entity of Concern restrictions…."

Modifications to Renewable Energy Provisions of the Inflation Reduction Act *(cont.)*

- **Advanced Manufacturing Production Tax Credit – Section 45X**

  The Legislation contains minor revisions to Section 45X, including amendments to the definition of "battery module," revisions to the rules for integrated components and the ability to "stack" Section 45X tax credits, and adding phaseouts to Section 45X tax credits for the production of critical minerals starting in 2031. As noted above, the prohibited foreign entity rules also apply to prohibit any manufacturer that meets the definition of a prohibited foreign entity from claiming a Section 45X credit. The material assistance rules also apply to prohibit any property manufactured with the material assistance of a prohibited foreign entity from qualifying as an eligible component for purposes of Section 45X.

Modifications to Renewable Energy Provisions of the Inflation Reduction Act *(cont.)*

- **Other IRA Credits**

  The Legislation repealed the Section 25E credits for previously owned clean vehicles, the Section 30D clean vehicle credit, the Section 45W commercial clean vehicle credit, the Section 30C alternative fuel vehicle refueling property credit, the Section 25C energy efficient home improvement credit, the Section 25D residential clean energy credit, and the Section 45L new energy efficient home credit. The repeals have various effective dates of either Sept. 30, 2025 (25E credits, 30D credits, and 45W credits), Dec. 31, 2025 (25C credits and 25D credits), or June 30, 2026 (30C credits and 45L credits). The Legislation also moved the termination date for Section 45V clean hydrogen production tax credits from Jan. 1, 2033 to Jan. 1, 2028.

- **Credits for Semiconductor Manufacturers**

  The Legislation increases the advanced manufacturing tax credit, including for semiconductor manufacturers, from 25 percent to 35 percent for certain new facilities.

SALT Cap and Retreat from Attack on Most SALT Cap Work-Arounds

Prior to the changes made by the TCJA, individuals were permitted generally to take a deduction against their federal gross income for the full amount of state, local and foreign income taxes paid. Under the TCJA, an individual's itemized deductions for state, local and foreign income taxes were capped at $10,000 ($5,000 for married taxpayers filing separately), beginning in 2018. This so-called "SALT Cap" was scheduled to sunset at the end of 2025. During the years post the TCJA, 36 states enacted work arounds for individuals who are partners in partnerships or shareholders in S corporations. While each state's law is different, the general approach provides a pass-through entity tax (PTET) mechanism that allowed a pass-through entity to elect to pay an entity-level state income tax and pass the resulting tax benefit along to its partners and/or shareholders. The IRS approved of the PTET SALT Cap work-around when it issued Notice 2020-75, 2020-49 I.R.B. 1453, which provided that the IRS intended to issue regulations clarifying that state income taxes paid by a pass-through entity would be allowed as a deduction by the entity. No regulations were ever issued.

The Legislation raises the SALT Cap to $40,000 for tax years beginning in 2025 and does not limit or otherwise explicitly affect the deduction for partners or shareholders of pass-through entities who avail themselves of the PTET deduction. For tax year 2026, the SALT Cap will increase to $40,400 and for years after 2026 and before 2030, the SALT Cap will be 101% of the dollar amount for the taxable year in the preceding calendar year. For years after 2029, the SALT Cap will revert to $10,000.

SALT Cap and Retreat from Attack on Most SALT Cap Work-Arounds *(cont.)*

The SALT Cap is subject to a phase down by 30 percent of a taxpayer's modified adjusted gross income (MAGI) over $500,000 (or $250,000 for a married taxpayer filing separately) for tax year 2025. For taxable year 2026, the phase down begins at $505,000 and for years after 2026 and before 2030, the phase down begins at 101 percent of the dollar amount in effect for the taxable year of the preceding year. The SALT Cap will never go below $10,000.

Certain exclusions from gross income provided under the Code for U.S. citizens or residents living abroad, or for residents of Guam, American Samoa, the Northern Mariana Islands or Puerto Rico are added back to MAGI for purposes of computing the phase down.

State Income Tax Nexus Protection (Public Law 86-272)

Some were hoping that the Legislation would modernize and expand Public Law 86-272's protections from state income taxes, which have remained unchanged since 1959. In short, Public Law 86-272 prevents states from imposing net income taxes on businesses whose only contact with the state is the solicitation of orders for tangible personal property. An increasing number of states have taken the position that Public Law 86-272 does not protect companies operating a modern website and conducting other virtual activities. Public Law 86-272 modernization protections likely were left out of the Legislation.

Qualified Small Business Stock

The Legislation amends Code section 1202 in three taxpayer beneficial ways. First, a partial exclusion from the sale of Qualified Small Business Stock (QSBS) now starts after a three-year holding period. Second, the amount of eligible gain that may be excluded is increased. Third, the definition of "qualified small business" is broadened to include businesses with gross assets of up to $75 million.

Code Section 1202 now provides for a partial exclusion of gain from the sale of QSBS acquired after the date of enactment and held for three and four years of 50 percent and 75 percent of eligible gain, respectively. The exclusion for eligible gain from the sale of QSBS held for five years or more continues to be 100 percent. Prior law allowed for a 100 percent exclusion of eligible gain, but only if the taxpayer held the QSBS for five years (although rollovers were permitted).

The amount of eligible gain that may be excluded is increased from $10 million to $15 million and for years after 2026, the eligible gain amount is indexed for inflation.

Under prior law, to qualify as a "qualified small business" the aggregate gross assets of the corporation could not exceed $50 million. The new law increases the amount of gross assets to $75 million, which also is indexed for inflation.

Section 199A Qualified Business Income Deduction

The Legislation makes permanent Section 199A, which provides a non-corporate taxpayer a deduction for up to 20 percent of "qualified business income," including from passthrough entities, and certain other amounts. Prior to amendment, Section 199A was scheduled to expire on Dec. 31, 2025.

The Legislation makes two additional taxpayer-favorable changes:

- By way of background, qualified business income includes certain income, gain, deduction and loss with respect to a "qualified trade or business," but not a "specified service trade or business" (such as law, accounting, and consulting firms, as well as investment management and finance-related businesses). Also, the deduction cannot exceed certain thresholds based on the qualified trade or business's W-2 wages and certain basis determinations. The specified service trade or business, W-2 wages, and basis limitations do not apply if a taxpayer's income is below a specified income threshold adjusted annually for inflation ($197,300 for non-joint filers and $394,600 for joint filers in 2025), and they are phased-in if the taxpayer's income is less than the sum of (i) the income threshold and (ii) $50,000 in the case of non-joint filers and $100,000 in the case of joint filers (the Phase-in Amounts). The Legislation expands the phase-in range by increasing the Phase-in Amounts from $50,000 to $75,000 for non-joint filers and from $100,000 to $150,000 for joint filers.
- The Legislation provides a minimum (inflation-adjusted) $400 deduction for taxpayers having at least $1,000 of qualified business income from one or more "active qualifying trade[s] or business[es]" (generally any qualified trade or business in which the taxpayer materially participates within the meaning of Section 469(h)).

The amendments to Section 199A are effective for taxable years beginning after Dec. 31, 2025.

Section 461(l) Limitation on Excess Business Loss

The Legislation makes permanent Section 461(l), which disallows a non-corporate taxpayer's "excess business loss" (generally, net business loss exceeding a threshold amount adjusted for inflation; the threshold amount for 2025 is $313,000 for non-joint filers and $626,000 for joint filers). Disallowed loss generally is treated as a net operating loss and carried over to the succeeding taxable year. Prior to the Legislation, Section 461(l) was scheduled to expire on Dec. 31, 2028. An earlier version included language, ultimately dropped, that would have treated carried forward excess business loss as excess business loss subject to the Section 461(l) limitation.

This amendment to Section 461(l) is effective for taxable years beginning after Dec. 31, 2026.

Section 707(a)(2) Disguised Sale Rules

The Legislation amends the partnership “disguised sale” rules, apparently to clarify that they are self-executing.

By way of background, Section 707(a)(2) provides that certain transactions occurring between a partner and partnership may be recharacterized as occurring between (i) the partnership and a person who is not acting as a partner or (ii) two or more partners, none of whom is acting as a partner. The rules may apply when a partner performs services for the partnership or transfers property to the partnership and there is a related direct or indirect allocation and distribution from the partnership to the partner, and when a partner directly or indirectly transfers money or other property to the partnership and there is a related direct or indirect transfer of money or other property by the partnership to the partner. While final regulations on disguised sales of property are long-standing, Treasury and the IRS have not issued final regulations on disguised sales of partnership interests or on disguised payments for services.

Prior to amendment, Section 707(a)(2) began with the text “Under regulations prescribed by the Secretary.” The Legislation modifies that text to state, “Except as provided by the Secretary,” resolving any uncertainty about whether the disguised sale rules apply in the absence of final regulations. The amendment is effective for services performed and property transferred after July 4, 2025, and states that it shall not be construed as creating any inference with respect to services performed or property transferred on or before July 4, 2025.

Taxable REIT Subsidiaries

The Legislation amends the 75-percent asset value test in Section 856(c)(4), which an entity must satisfy to qualify as a REIT, to increase permitted ownership of taxable REIT subsidiary stock from 20 percent to 25 percent. The amendment applies to taxable years beginning after Dec. 31, 2025.

Oil and Gas Intangible Drilling Costs

The Legislation allows oil and gas companies to exempt intangible drilling and development costs from their adjusted financial statement income when calculating their corporate AMT.

Exclusion from Gross Income of Interest on Loans Secured by Rural or Agricultural Real Property

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The Legislation excludes from gross income 25 percent of interest income received from certain rural or agricultural real estate loans (including loans on certain farms, ranches and aquaculture facilities) made after the date of enactment of the Legislation by FDIC-insured banks and certain domestic entities owned by a bank holding company or insurance holding company, state or federally-regulated insurance companies or Farmer Mac. The Legislation includes a corresponding provision that operates to generally limit the ability of such lenders to deduct 25 percent of any interest on indebtedness incurred or continued to finance such rural or agricultural real estate loans. The exclusion from gross income (and related limitation on interest deductibility) is applicable for taxable years ending after the date of enactment of the Legislation.

Opportunity Zones

As background, the Opportunity Zone (OZ) program was created as part of the TCJA with the goal of increasing long-term investments in low-income communities. Under TCJA, the OZ program generally permits taxpayers to defer recognizing certain types of realized gains (and in some cases to permanently exclude from gross income a portion thereof) if they invest the amount of their gain into a qualified opportunity fund (QOF) within a 180-day period. The Legislation provides for the (OZ) program to become a permanent fixture of the Code.

Opportunity Zones (cont.)

- **New Opportunity Zone Designations**

  Beginning Jan. 1, 2027, there will be rolling 10-year OZ designations (i.e., every 10 years census tracts will be reviewed to determine if they still qualify for OZ designation, and the State governors will have the opportunity to re-designate OZs in their states based on the updated census tract information). The Legislation also narrows the eligibility criteria for designation as an OZ, including eliminating the ability to designate census tracts as OZs that by themselves do not qualify but that are “contiguous” to qualifying census tracts.

Opportunity Zones (cont.)

- **Modification of Current OZ Benefits**

  Under the current OZ program, if a taxpayer holds an investment in a QOF for at least five years, the taxpayer receives a basis step-up equal to 10 percent of the deferred gain (i.e., effectively providing the taxpayer with a permanent gain exclusion equal to 10 percent). If the investment is held for at least seven years, an additional 5 percent basis step-up is provided. The Legislation retains the ability of a taxpayer who makes an investment into a QOF after Dec. 31, 2026, to permanently exclude 10 percent of the deferred gain if the taxpayer holds his QOF investment for at least five years. The additional 5 percent basis step-up/ permanent exclusion for a seven-year hold included in the TCJA is not available for investments made after 2026.

  Also under the current OZ program, if a taxpayer holds an investment in a QOF for at least 10 years, the taxpayer gets a basis step-up to fair market value (FMV) on the date the investment is sold or exchanged (i.e., effectively providing the taxpayer with full tax-free appreciation on the investment). The Legislation modifies this benefit for taxpayers that hold on to their QOF investments for more than 30 years by limiting their basis step-up to the FMV of their investment on that 30-year anniversary date.

  The new “income recognition” date for investments made in QOFs after Dec. 31, 2026, is the earlier of (i) the date the investment is sold or exchanged, or (ii) the date that is five years after the investment in the QOF. Thus, unlike in the current statutory scheme where the “income recognition date” is a set Dec. 31, 2026 (unless the investment is sold earlier), every taxpayer investing in a QOF after 2026 will be able to defer its gain for a set five years as long as such investment is held for such 5-year period.

Opportunity Zones (cont.)

- **New Benefits for Investments in Rural Area OZs**

  If an investor holds an interest in a QOF that invests, directly or indirectly, in a sufficient amount of tangible property used in a "rural" OZ, the 10 percent exclusion attributable to a five-year holding period is increased to 30 percent. Additionally, the "substantial improvement" requirement for qualifying OZ property is relaxed for property located in a rural OZ.

- **New Reporting**

  The Legislation creates new annual reporting requirements for QOFs and qualifying entities in which QOFs invest (i.e., qualified opportunity zone businesses, or QOZBs) and institutes penalties for late filing. Among other items, information on the number of residential units held by, and full-time employees of, the QOF and/or QOZB will now be required to be reported annually. The Legislation also requires the Treasury to prepare publicly available reports summarizing information related to, among other things, the number and dollar value of investments in QOFs and the impact of such investments on the designated OZs.

Low-Income Housing Tax Credit

The Legislation makes the following changes to the low-income housing tax credit (LIHTC) under Section 42 of the Code:

- **State Housing Credit Ceiling Increase**

  The Legislation includes a permanent 12 percent increase to the annual 9 percent LIHTC allocation.

- **Expansion of Tax-Exempt Bond Financing Provision**

  Under the current LIHTC rules, if 50 percent or more of the aggregate basis of a building and land is financed with tax-exempt bonds that are subject to the state's volume cap, that entire building would be eligible for 4 percent credits without an allocation from the state (as opposed to just the portion of the building financed with the bonds). The Legislation generally expands that favorable rule to buildings, at least 25 percent of the aggregate basis of which are financed with tax-exempt bonds.

New Markets Tax Credit

The New Markets Tax Credit (NMTC) program was created as part of the Community Renewal Tax Relief Act of 2000, with the goal of encouraging investment in low-income communities (LICs). The program operates by having certified community development entities (CDEs) apply to the CDFI Fund for a NMTC allocation, which CDEs can then "award" to projects operating in LICs, generally based on each CDE's chosen "economic development" criteria. An investor will thereafter make an equity investment into an affiliate of the CDE (the Sub-CDE), which will be combined with other project funds in order to arrive at the amount of the NMTC allocation awarded to the project. These combined proceeds will then be used by the Sub-CDE to make loans, with favorable terms, to the project entity. The result of this structure is an aggregate NMTC equal to 39 percent X the NMTC allocation, which is available to the investor over a seven-year period.

For each of the years 2024 and 2025, the total amount of NMTC allocations available to be awarded to CDEs is $5 billion. Awards for this $10 billion "double round" are expected to be announced in the fall of 2025. The program has never been permanent, but has always been extended in annual increments prior to any expiration date, with the most recent five-year extension coming in 2020. Without a legislative extension, the awards to be announced this fall would have been the final round and the NMTC program would have expired at the end of 2025.

The Legislation provides for a permanent extension of the NMTC program with $5 billion of allocations available to be awarded to CDEs on an annual basis beginning in 2026.

Information Reporting and Form 1099K – Repeal of Revision to De Minimis Rules for Third-Party Network Transactions

Under current law, third-party settlement organizations (TPSOs), such as online marketplaces, are required to report certain payment transactions for goods and services that exceed a minimum threshold of $600 to the IRS and to the sellers using their platforms (“participating payees”) on Form 1099-K. A TPSO is the central organization that provides a third-party payment network and has the contractual obligation to make payments to participating payees.

The American Rescue Plan Act of 2021 (ARPA) lowered the threshold for Form 1099-K reporting applicable to third-party payment network transactions to $600, effective for calendar year 2022. However, the IRS has repeatedly delayed full implementation of the $600 threshold. Prior to the change, a de minimis exception only required reporting if the gross amount of the payment transactions with respect to a participating payee for the year exceeded $20,000 and the aggregate number of such transactions exceeded 200. Due to the delays in implementing the change in reporting thresholds, for calendar year 2024, TPSOs were required to file a Form 1099-K for participating payees receiving gross payments exceeding $5,000, regardless of the number of transactions. This threshold decreased to $2,500 for calendar year 2025 and then to $600, as originally mandated by the ARPA, for calendar years after 2025.

The Legislation reverts to the previous de minimis reporting exception for TPSOs so that a TPSO would not be required to report with respect to payment transactions of its participating payees unless the gross amount of the transactions exceeds $20,000 and the aggregate number of such transactions exceeds 200. The reinstatement of the de minimis exception applies as if included in the ARPA and thus applies to returns for calendar years beginning after Dec. 31, 2021.

Increase in Threshold for Requiring Information Reporting with Respect to Certain Payees

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The Legislation increases the information reporting threshold for certain payments made by persons engaged in a trade or business to another person (Code Section 6041(a)) and payments of remuneration for services (Code Section 6041A(a)) from $600 to $2,000 in a calendar year. The threshold amount would be adjusted for inflation in calendar years after 2026. No change is made to the information reporting threshold for direct sales (Code Section 6041A(b)). The increase in the information reporting threshold applies with respect to payments made after Dec. 31, 2025.

Employee Retention Tax Credit Provisions

The CARES Act created the Employee Retention Tax Credit ("ERTC") in March of 2021. The American Rescue Plan Act of 2021 also included ERTC provisions. The ERTC provided a refundable tax credit for portions of payroll taxes that were paid during the COVID-19 crisis. The Legislation changes several provisions regarding the administration and enforcement of the ERTC as follows:

- **Statute of Limitations**

  The Legislation disallows ERTC refund claims for the third and fourth quarters of 2021 filed after Jan. 31, 2024. The statute of limitations on assessments for those claims is extended to six years from several possible starting dates. Before passage of the Legislation, taxpayers had until April 15, 2024, to claim the ERTC for any applicable payroll taxes in 2020 and until April 15, 2025, for any applicable payroll taxes in 2021. The House version would have disallowed ERTC claims for all quarters filed after Jan. 31, 2024, but the Byrd rule prevents changes affecting Social Security from inclusion in reconciliation legislation. For the third and fourth quarters of 2021, ERTC claims were against Medicare taxes.

Employee Retention Tax Credit Provisions *(cont.)*

- **Enforcement Provisions Against Promoters**

  The Legislation imposes penalties and reporting requirements on "COVID-ERTC Promoters." A COVID-ERTC Promoter is any person providing "aid, assistance, or advice" to taxpayers in filing an ERTC claim and deriving a significant portion of their revenue from such assistance. Certified PEOs are explicitly excluded from qualifying as a COVID-ERTC Promoter. The Legislation requires COVID-ERTC Promoters to comply with certain due diligence requirements with respect to a taxpayer's eligibility for the ERTC and imposes a $1,000 penalty for each failure to comply with such due diligence requirements.

Individual Tax Changes

With respect to individual taxes, the Legislation, among other items:

- Makes TCJA individual tax rates and the standard deduction permanent, with some helpful adjustments; specifically, it permanently extends and increases individual tax bracket values and provides an additional year of inflation indexing;
- Makes the TCJA standard deduction increases permanent, retroactive to include tax year 2025;
- Continues elimination of personal exemptions by permanently setting the deduction amount to zero, except provides a temporary $6,000 deduction for seniors (discussed immediately below);
- Adds a temporary deduction of $6,000 under Section 151 (personal exemptions) for seniors for tax years 2025 through 2028 for those earning $75,000 or less ($150,000 for joint filers) with a phase-out for excess earnings up to $175,000 ($250,000 joint filers) to help offset taxation of Social Security income;
- Permanently repeals miscellaneous itemized deductions (but restores deductions of unreimbursed educator expenses for teachers);

Individual Tax Changes *(cont.)*

- Caps the value of itemized deductions at 35 percent and places a floor of .5% on itemized deductions of charitable contributions;
- Allows charitable contribution deduction for individuals who do not itemize deductions ($1,000 for single filers; $2,000 for joint filers);
- Makes permanent the Section 199A deduction at 20 percent with modest beneficial changes (discussed above in greater detail);
- Permanently increases the child tax credit by $200 to $2,200, effective for 2025 and indexes for inflation (also makes permanent the $1400 refundable child credit, indexed for inflation); subject to income phase-outs at $200,000 ($400,000 for joint filers); both taxpayers and dependents must have Social Security numbers in order to claim;
- Makes permanent the $500 nonrefundable credit for dependents other than a qualifying child;
- Establishes Trump investment accounts for children, which are eligible to receive contributions of up to $5,000 annually and also would receive $1,000 from the federal government for children born from 2025 through 2028 (more detail below);
- Eliminates tax on tips for tax years 2025-2028, capped at a $25,000 federal income tax deduction, with phase-outs for those earning more than $150,000 ($300,000 for joint filers);

Individual Tax Changes *(cont.)*

- Eliminates tax on overtime for tax years 2025-2028, generally limited to a federal income tax deduction of $12,500 ($25,000 for joint filers), with phase-outs for those earning more than $150,000 ($300,000 for joint filers);
- Allow a deduction for certain new car loan interest (only if the vehicle's final assembly occurs in the U.S.) of up to $10,000 for tax years 2025 through 2028 for those earning $100,000 or less ($200,000 for joint filers), with a phase-down thereafter;
- Makes TCJA's increased alternative minimum tax exemptions permanent at 2018 exemption phaseout levels of $500,000 ($1 million for joint filers) and indexes for inflation. Increases phaseout of the exemption amount to 50 percent (from 25 percent) of the amount by which a taxpayers AMT income exceeds the threshold amount;
- Makes permanent TCJA limits regarding deductions of mortgage interest ($750,000 of acquisition indebtedness and no deductions relating to home equity lines); adds provision treating certain mortgage insurance premiums on acquisition indebtedness as qualified residence interest;
- Extends and modifies limitations on wagering losses, limits the definition of annual wagering losses to 90 percent of actual losses and then allows deductions of those losses only to the extent of total annual wagering gains;

Individual Tax Changes *(cont.)*

- Eliminates Section 217 moving expense deduction except for members of the armed forces and certain members of the intelligence community;
- Allows tax-exempt distributions from Section 529 accounts to cover expenses of homeschooling and of elementary and secondary public and private school;
- Makes permanent exclusion from gross income of student loans discharged because of death or disability;
- Makes up to $5,000 of the adoption credit refundable and makes adjustable for inflation;
- Adds new Section 25F, providing a credit of up to $1,700 for charitable contributions to a scholarship-granting organization; and
- Makes permanent and modifies (to include state-declared disasters) limitations regarding personal casualty losses (generally requiring itemization to claim and subject to floor of 10 percent of AGI).

Trump Accounts

The Legislation establishes a new type of custodial account for minors. Trump accounts would be a form of Individual Retirement Account (but not a Roth IRA) and would generally be treated in the same manner as an IRA. Key features include:

- Eligibility and Characteristics: To be eligible for a Trump account, the account beneficiary must be below the age of 18 before the close of the calendar year in which the account is established and have a Social Security number. Trump account funds can grow tax-free until they are withdrawn but must be invested in mutual funds or ETFs that track the returns of a qualified index (such as the S&P 500 or other index funds that are primarily comprised of U.S. companies), do not use leverage, do not have annual fees and expenses of more than .1 percent of the balance of the fund investment and meet other criteria Treasury determines appropriate. Under the Legislation, Treasury could set up Trump accounts for individuals whom it identifies as eligible and for which no Trump account has already been established.

Trump Accounts (cont.)

- Contributions: The contribution limit for a taxable year is $5,000 (other than qualified rollover contributions) and is adjusted for inflation for taxable years after 2027. Contributions can only be made in calendar years before the beneficiary turns 18 and will not be accepted until 12 months after the date of enactment of the Legislation. U.S. federal, state, local, and tribal governments as well as charitable organizations could make “general funding contributions,” which would be contributions made to a specified qualified class of Trump account beneficiaries, and these contributions would not be subject to the $5,000 limit. No deduction is allowed for any contributions to a Trump account made before the first day of the calendar year in which the beneficiary turns 18.
- Employer Contributions: Employers may contribute up to $2,500 (adjusted for inflation for taxable years after 2027) to the Trump account of an employee or the employee’s dependent without it being taxable to the employee.
- Distributions: No distributions are permitted before the first day of the calendar year in which the beneficiary turns 18 (other than distributions of qualified rollover contributions). The rules applicable to distributions from IRAs generally apply.
- Pilot Program: Under a pilot program, Treasury will make a one-time contribution of $1,000 to the Trump account of each qualifying child born between Jan. 1, 2025, and Dec. 31, 2028, and who is a U.S. citizen and has a Social Security number.

Estate and Gift Tax Exemption Changes

- Currently, the federal estate and gift tax exemption is an inflation-adjusted amount of $13.99 million per individual for 2025, though under prior law that amount was set to drop to an estimated inflation-adjusted amount of $7.14 million for tax year 2026. The Legislation permanently increases the estate and gift tax exemption to $15 million per individual for tax years 2026 and beyond. The $15 million exemption amount is indexed for inflation, meaning for tax years after 2026 the $15 million exemption amount will be increased based on inflation adjustments. The federal generation-skipping transfer tax exemption is permanently increased by the Legislation to an inflation-indexed amount of $15 million.

Premium Tax Credit Limitations

The Premium Tax Credit, which helps lower-income individuals afford health insurance through the federal exchange, would be restricted by the Legislation to a narrower group of lawfully present noncitizens. Eligible individuals must either be lawful permanent residents, Cuban nationals with approved petitions awaiting visa availability or individuals lawfully residing under a Compact of Free Association.

Excluded from eligibility would be asylum seekers, parolees, Temporary Protected Status recipients, individuals granted deferred action or enforced departure, and those granted withholding of removal. These individuals, though lawfully present, would no longer qualify for the credit. Additionally, the Legislation proposes to repeal the provision that allowed noncitizens with incomes below 100 percent of the federal poverty level to access the credit if they were ineligible for Medicaid due to immigration status. It also updates Affordable Care Act provisions to align with these new restrictions, including related subsidies and health program access.

New Excise Tax on Remittance Transfers

A new 1 percent excise tax would apply to certain international remittance transfers from the U.S. Such transfers would not include certain small-value transactions. If the excise tax is not paid by the sender, the provider would be required to collect and remit it. The Legislation provides two exceptions for U.S. citizens and nationals. Taxpayers may use a qualified provider that verifies citizenship (for example, by withdrawing funds from a bank account or charging the remittance to a credit or debit card) and also may claim a refundable tax credit by providing a Social Security number and proof of payment. Providers are required to report detailed remittance data, including sender information, amounts transferred, and taxes collected for credit-eligible individuals.

Social Security Number Requirement for Education Credits

The Legislation tightens requirements for claiming the American Opportunity and Lifetime Learning education credits. A valid Social Security Number would be required for the taxpayer, spouse (if applicable) and any student for whom education expenses are claimed, replacing the more flexible taxpayer identification number requirement.

Exempt Organization Changes

- **Increased University Endowment Tax (Section 4968)**

  The Legislation increases the tax on college and university net investment income from 1.4 percent to 8 percent for institutions with a "student adjusted endowment" above $2 million. Schools with student adjusted endowments of between $750,000 and $2 million per student will see their net investment income tax increase from 1.4 percent to 4 percent. The Legislation also expands which institutions are subject to the tax, but it excludes smaller schools with fewer than 3,000 tuition-paying students. Assets and net investment income of related organizations are generally included in the income calculation, as are student loan interest and royalty income. The changes are estimated to cost universities $761 million over 10 years.

  – Significant Tax Increases: Institutions with large endowments per student face dramatic increases in excise tax liability.
  – Broader Scope: Many institutions previously not subject to the tax may become subject to it due to the expanded definitions and inclusion of student loan interest and royalty income from intellectual property developed by students and faculty members using federal funding, as well as related organizations' assets and income.
  – New Compliance Burdens: Enhanced reporting and anti-avoidance rules will require careful review of endowment investments, royalty structures, and related entities.
  – Immediate Planning: Institutions should begin modeling the impact of these changes and consider how their endowment management, investment strategies and organizational structures may be affected and optimized.

Exempt Organization Changes (cont.)

- **Expansion of the Tax on Excess Compensation (Section 4960)**

  The Legislation expands the application of the tax paid by tax-exempt organizations on compensation over $1 million and certain severance payments. The definition of “covered employee” is broadened to include any employee (including any former employees employed on or after Jan. 1, 2017) of an applicable tax-exempt organization or any predecessor of such organization—not just the “high five” compensated individuals to which this section currently applies. This expansion significantly increases the number of individuals who will trigger the tax. The change is expected to cost tax-exempt organizations more than $3.8 billion over 10 years.

Exempt Organization Changes (cont.)

- **Modification to Charitable Contribution Deduction**

  The Legislation reinstates a partial charitable contribution deduction for individuals who do not itemize deductions ($1,000 for single filers; $2,000 for joint filers), at a cost to the federal government of $73.8 billion over 10 years. This cost is offset by a 0.5 percent floor on the deduction of contributions for those who do itemize, which is estimated to raise $63 billion. A similar 1 percent floor on corporate charitable deductions is estimated to raise $16.6 billion.

  All of these provisions apply to taxable years beginning after Dec. 31, 2025.

Employer-Provided Benefits

The Legislation includes a handful of provisions that affect benefits provided by employers as well as provisions related to compensation paid to certain employees.

- **Health Savings Account Changes**

  Current health savings account (HSA) rules disqualify individuals from making contributions to an HSA under certain circumstances, and the Legislation liberalizes a few of these rules.

Employer-Provided Benefits (cont.)

- **Telehealth**

  A COVID-era exemption previously allowed individuals to receive telehealth services without applying a deductible and maintain eligibility to make HSA contributions. The Legislation retroactively reinstates the exemption to when the original exemption expired and makes the exemption permanent.

- **Direct Primary Care Service Arrangements**

  The Legislation also allows an individual to remain eligible to make HSA contributions if the individual participates in a "direct primary care service arrangement," which generally means an arrangement whereby the individual receives primary care services from primary care providers in exchange for a fixed fee. This eligibility rule does not apply if the fixed fee exceeds $150 per month ($300 per month if the arrangement applies to multiple individuals), and such amounts will be adjusted annually. In addition, direct primary care service arrangement fees are treated as medical expenses that can be paid using an HSA.

  These direct primary care services arrangement changes apply to months beginning after Dec. 31, 2025.

Employer-Provided Benefits (cont.)

- **Educational Assistance**

  Code Section 127 allows employers to offer certain amounts of educational assistance tax-free to employees. The definition of "educational assistance" was previously expanded to include assistance related to an employee's student loans. The Legislation makes this expansion, which was set to expire at the end of 2025, permanent. The Legislation also adds language providing for an inflation adjustment with respect to the maximum tax exclusion (currently $5,250) for education assistance furnished in a calendar year.

Employer-Provided Benefits (cont.)

- **Dependent Care Flexible Spending Account Contribution Increased to $7,500 ($3,750 for Married Individuals Filing Separately)**

  Employers may offer employees dependent care flexible spending accounts (DCFSAs), which generally allow employees to contribute wages to a DCFSA pre-tax and then use the DCFSA to reimburse, on a tax-free basis, dependent care expenses incurred by the employee. For many years, the maximum DCFSA contribution amount has been $5,000 ($2,500 for married individuals filing separately). The Legislation increases those amounts to $7,500 and $3,750, respectively, for tax years beginning after Dec. 31, 2025.

Employer-Provided Benefits (cont.)

- **Commuter Benefit Programs**

  The ability to offer tax-free reimbursement for bicycle commuting expenses, sometimes called a "transportation fringe," has been permanently eliminated under the Legislation

Employer-Provided Benefits (cont.)

- **Executive Compensation in Excess of $1 Million**

  Currently, public companies cannot deduct more than $1 million with respect to compensation for a small number of top employees (technically called “covered employees”). For tax years beginning after Dec. 31, 2025, the Legislation modifies the rule to apply it to “specified covered employees” in the public company’s controlled group. Specifically, (i) a specified covered employee’s compensation from all controlled group members will be considered; and (ii) in determining who the specified covered employees are, identifying the five highest-paid employees would be determined by analyzing the entire controlled group’s employee population. Other than the criteria above, specified covered employees will be determined by the other three existing criteria used for identifying “covered employees,” which would still apply based solely on the public company’s employee population.

  The Code contains a corollary provision for nonexempt organizations in the form of an excise tax on compensation exceeding $1 million, which the Legislation modifies. This modification is addressed above, in the “Exempt Organization Proposed Changes” section.

Employer-Provided Benefits (cont.)

- **Deduction for Employer-Provided Meals**

  Effective for amounts paid or incurred after Dec. 31, 2025, the TCJA added a prohibition on deductions for certain expenses related to (1) meals provided to employees and their spouses and dependents by the employer on its premises, and (2) an employer's operation of an eating facility for employees (including food and beverage costs). The Legislation retains this deduction prohibition but adds a small carve-out. Specifically, the deduction prohibition will not apply if the expenses relate to (i) a good or service for which the employer receives adequate consideration in a bona fide transaction, or (ii) food or beverages provided on or at certain commercial vessels, oil or gas platforms, and fishing vessels or fish processing facilities.

  Unclear if snacks/coffee etc. are deductible.

Miscellaneous Items

- **Qualified Sound Recording Productions Eligible for Expensing and Bonus Depreciation**

  The Legislation adds a new category, “qualified sound recording productions” to the special expensing rules that already apply to qualified film, television and live theatrical productions under Section 181 of the Code. A qualified sound recording production is a sound recording (as defined under U.S. copyright law) produced and recorded in the U.S. Sound recording production costs of up to $150,000, in total, in the taxable year would be allowed as a deduction. However, as with qualified film, television and live theatrical productions, the Section 181 deduction only applies to qualified sound recording productions that commence before Jan. 1, 2026. Consequently, the Section 181 deduction will be of limited benefit since only sound recording productions commencing in taxable years ending after the date of enactment of the Legislation and before Jan. 1, 2026, will be eligible for the Section 181 deduction.

  The Legislation also makes qualified sound recording productions placed in service in a taxable year eligible for 100 percent bonus depreciation under Section 168(k) of the Code. A qualified sound recording production will be considered placed in service at the time of initial release or broadcast. The bonus depreciation amendments apply to qualified sound recording productions commencing in taxable years ending after the date of enactment of the Legislation.

Miscellaneous Items (cont.)

- **Reduction of Excise Tax on the Transfer or Manufacture of Certain Firearms**

  The National Firearms Act, codified in Chapter 53 of the Code, generally imposes a $200 excise tax on each transfer or manufacture of a firearm (the excise tax is $5 for weapons capable of being concealed). The Legislation eliminates the transfer tax and manufacture tax on most firearms (excise tax is reduced to zero) and imposes a $200 transfer tax and manufacture tax only on machine guns and destructive devices. The reduction in excise tax is effective for calendar quarters beginning more than 90 days after the date of enactment of the Legislation.

Conclusion

With this first Trump Administration budget reconciliation bill enacted, taxpayers should determine the expected impacts on their business plans, transaction pipelines, anticipated restructurings, operational affairs and estate plans and consider adjustments as appropriate.

Some of the proposed changes and spending cuts that were dropped solely because the Senate Parliamentarian ruled that inclusion would have violated the “Byrd Rule” that governs the reconciliation process may be revisited during the FY 2026 appropriations process and through standalone legislation during the remainder of the 119th Congress. With respect to provisions included in the Legislation, taxpayers should turn their focus toward offering input as the Treasury Department and the Internal Revenue Service develop and issue implementing regulations and related guidance.

There is likely to be one or more additional reconciliation bills during late 2025 and 2026 and therefore additional opportunities for enactment of additional provisions, as well as changes and improvements to the Legislation. BakerHostetler will continue to assist our clients with advancing their federal policy goals, challenging and, when necessary, litigating IRS enforcement mis-steps, and keeping our clients and friends updated on federal tax and budget-related developments.



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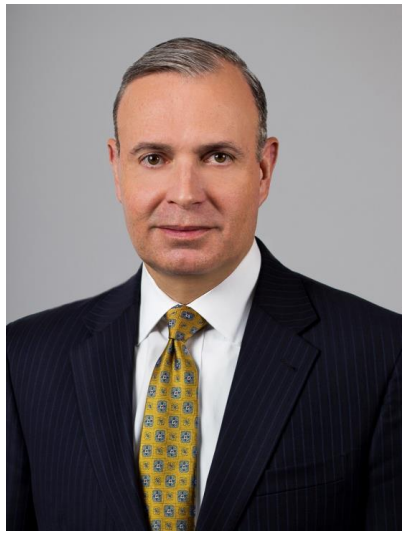
As leader of the Federal Policy team, Peter Roskam leverages the knowledge gained during six terms as a U.S. Representative from Illinois to analyze what is happening on Capitol Hill, anticipate the potential impact of proposed legislation and keep clients apprised of how their businesses can be affected. Peter serves as a client advocate, providing thoughtful, strategic advice and an insider's perspective to help mitigate potential roadblocks and maximize growth opportunities.

Prior to joining private practice, Peter held a number of noteworthy positions during his service in the U.S. House of Representatives (2007 to 2019), including serving in the House Leadership as Chief Deputy Whip. He also chaired three major subcommittees of the House Ways and Means Committee where, as Chairman of the Tax Policy Subcommittee, he was a chief architect of the 2017 overhaul of the U.S. tax code; as Chairman of the Oversight Subcommittee, he led the investigation into the I.R.S. which led to sweeping changes in civil asset forfeiture; and as Chairman of the Health Subcommittee, he led a series of hearings that addressed the opioid crisis and authored legislation making opioid addiction treatment more accessible.

Peter also served on the House Financial Services Committee, including the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee and the Domestic and International Monetary Policy, Trade and Technology Subcommittee; was a member of the Select Committee on Events surrounding the 2012 Terrorist Attack in Benghazi, Libya; chaired the U.S. House Democracy Partnership, a bipartisan commission supporting emerging democracies abroad; and co-chaired the Korea Caucus, the India Caucus, the Bipartisan Task Force to Combat Anti-Semitism and the Republican Israel Caucus.

Peter also served as a member of the Illinois House of Representatives and the Illinois State Senate for 13 years.



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Jeff Paravano has more than 30 years of experience handling tax controversies, tax litigation (including a U.S. Supreme Court tax case) and tax investigations, structuring transactions and restructuring global enterprises to help minimize worldwide tax rates. His prior government experience with the U.S. Department of Treasury's Office of Tax Policy is particularly useful when helping clients navigate complex tax planning issues and resolving major tax disputes.

Jeff has a broad-based practice involving tax controversies, tax litigation and tax investigations – including tax promoter investigations; structuring corporate, partnership, REIT and venture capital transactions; restructuring global enterprises to help minimize worldwide effective tax rates; bankruptcy taxation; and domestic and cross-border tax planning. He also represents clients' immediate and longer-term interests before government enforcement officials, federal policymakers and on Capitol Hill, has handled tax arbitrations and served as a mediator to help parties resolve contractual tax indemnity matters and post-transaction tax disputes.

Jeff also serves as firmwide Chair of BakerHostetler's Tax Group, which is among the largest law firm tax practices in the U.S., and as managing partner of the firm's Washington, D.C., office. Before returning to the firm in 2003, Jeff served as Senior Advisor to the Assistant Secretary, Tax Policy, at the U.S. Department of the Treasury. While at the Treasury, Jeff was responsible for providing advice on a wide range of tax policy and technical issues, including tax legislation and corporate, partnership, REIT and financial sector tax guidance. He also was one of the primary authors of the final tax shelter regulations, is author of the Tax Management Portfolio, *Tax Shelters*, T.M. 798, and co-author of the Tax Management Portfolio, *Reportable Transactions*, T.M. 648-2nd.

Jeff has assumed numerous positions of service in academia and to the legal profession. He is a fellow of the American College of Tax Counsel and a member of the American Bar Association, Section of Taxation, where he has served in various capacities, including as chair of the Affiliated and Related Corporations Committee and chair of the Committee on Government Submissions. He has been an adjunct professor in the LL.M. tax programs at Georgetown University Law Center and Case Western Reserve University School of Law, and has served on the editorial advisory boards of various tax publications. Jeff has written and lectured extensively on tax topics and has chaired numerous tax programs, panels and task forces. He is routinely among those named in Chambers USA: America's Leading Lawyers for Business, The Legal 500 United States, *The Best Lawyers in America*®, Lexology Index (formerly Who's Who Legal) and Super Lawyers, and was a past president of the Tax Club and editor-in-chief of The Tax Lawyer..

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