Accounting methods tax provisions in "One Big Beautiful Bill Act"

KPMG analysis and observations

This report reflects the legislation signed into law by the president on July 4, 2025 (Pub. L. No. 119-21) and was last updated July 25, 2025.

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Introduction

The House of Representatives on May 22, 2025, passed H.R. 1 (House bill), the budget reconciliation bill known as the "One Big Beautiful Bill Act" (OBBBA) (read *TaxNewsFlash*). On July 1, 2025, the Senate passed its version of H.R. 1 (Senate bill), which made various amendments to the bill, including changes to the tax subtitle that was included in the House bill (read *TaxNewsFlash*). On July 3, 2025, the House passed the Senate bill without amendment, and the bill was signed into law by President Trump on July 4, 2025 (Pub. L. No. 119-21).[1]

This analysis of the legislation generally describes current law (meaning the law prior to enactment of the legislation), the House bill, and the amended Senate bill ultimately passed by the House and signed by the president.

Both the House and Senate bills would generally make permanent the tax provisions of the TCJA. Both bills also would temporarily provide for tax benefits promised by the president for tip income, overtime pay, and auto loan interest, and introduce a host of revenue-raising provisions. However, the enacted Senate bill differs from the House bill in several ways, as described below.

Among the important business provisions of the enacted Senate bill are provisions that:

- Reinstate and make permanent expensing of R&D costs, the higher EBITDA cap on the deduction for interest, and 100% bonus depreciation (the House bill would only extend these provisions for five years)
- Make permanent the section 199A deduction for passthrough business income (at the current 20% rate instead of the higher 23% rate of the House bill)
- Renew and reform the Opportunity Zone program
- Add a 100% first-year depreciation deduction for real property used in a production activity (the House bill included a similar proposal)

Note that the House bill included a proposed retaliatory tax on certain foreign corporations under new section 899 that was removed in the enacted Senate bill following the announcement of an agreement with the other G7 countries regarding the tax (read *TaxNewsFlash*).

The enacted Senate bill also includes revenue-raising provisions that:

- Repeal or phase out energy tax credits created by the Inflation Reduction Act (IRA) (though in some cases extending the credits further than the House bill)
- Make extensive reforms to the U.S. international tax regime, including to foreign-derived deduction eligible income (FDDEI), global intangible low-taxed income (GILT), and the base erosion anti-abuse tax (BEAT), and permanently extend the CFC look-through rule of 954(c)(6)

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[1] The Joint Committee on Taxation (JCT) has provided a number of documents estimating the revenue effects of the various versions of the bill:

- JCX-26-25R, which estimates the revenue effects of the provisions of the bill as passed by the House on May 22, 2025
- JCX-35-25, which estimates the Senate-approved bill using a present law baseline (the same baseline used for the estimates for the House bill provided above) that assumes that tax provisions of current law expire according to their terms
- JCX-34-25, which estimates the Senate-approved bill using a "current policy baseline" as adopted by the Senate, which assumes that tax policies currently in effect (such as the lower Tax Cuts and Jobs Act (TCJA) individual tax rates) are permanent and therefore extending those provisions has no revenue effect

- Temporarily increase the $10,000 cap on the state and local tax (SALT) deduction to $40,000, with no significant changes to the treatment of passthrough entity taxes
- Impose a 1% tax on remittances to a recipient outside the United States (would have been 3.5% under the House bill)
- Increase taxes on college endowments (but at lower rates than those of the House bill and omitting a provision on private foundations)
- Bar the IRS from making payment on certain employee retention credit claims filed after January 31, 2024

This report includes initial analysis and observations regarding the provisions in the bill related to accounting methods. This is one of a series of reports that KPMG has prepared on the bill, which can all be found here.

Extenders

Deduction of domestic research and experimental expenditures

Current law

Under current law (enacted by the TCJA), specified research and experimental (R&E) expenditures paid or incurred in connection with a taxpayer's trade or business in tax years beginning after 2021 must be capitalized and amortized ratably over a five-year period (15-year period if the research activities giving rise to the expenditures are performed outside of the United States), beginning with the midpoint of the tax year in which the costs are paid or incurred. R&E expenditures generally include all costs incident to the development or improvement of a product that are paid or incurred in an experimental or laboratory sense. For this purpose, all software development costs are included in the definition of R&E expenditures. R&E expenditures do not include the acquisition or improvement of land or property to be used in connection with research or experimentation that is of a character which is subject to the allowance for depreciation under section 167 or depletion under section 611. However, the allowances under sections 167 and 611 are considered R&E expenditures to the extent otherwise deductible in the tax year. Similarly, taxpayers may not claim as R&E expenditures any amounts paid or incurred related to mineral exploration (including oil, gas, etc.).

If any property with respect to which a taxpayer paid or incurred R&E expenditures is disposed, retired, or abandoned during the applicable section 174 amortization period, no deduction is generally allowed for the unamortized amount at the time of disposition and the taxpayer must generally continue to amortize such R&E expenditures over the remaining amortization period.

Under section 280C, taxpayers claiming a research credit under section 41 that exceeds the amount of the underlying expenses allowable as a deduction under section 174 for the same tax year must reduce the amount chargeable to the capital account by the amount of such excess. Alternatively, taxpayers may elect to reduce the credit by an amount equal to the highest tax rate under section 11(b) (i.e., the corporate tax rate, currently 21%).

House bill (sec. 111002)

The proposal would add a new temporary subsection (e) to section 174 that would suspend the requirement to capitalize and amortize domestic R&E expenditures paid or incurred in tax years beginning after December 31, 2024, and before January 1, 2030 (i.e., for five years). The treatment of foreign R&E expenditures would remain unchanged, and taxpayers would continue to be required to capitalize and

amortize such expenditures over a 15-year period beginning with the midpoint of the tax year in which the expenditures are paid or incurred.

The proposal would allow for full expensing of domestic R&E expenditures paid or incurred in tax years beginning after 2024 and before 2030, through new section 174A. Specifically, under that section, taxpayers incurring domestic R&E expenditures during the applicable tax years would have the option to (1) deduct the expenditures, or (2) elect to capitalize and amortize the expenditures ratably over a period selected by the taxpayer (but no less than 60 months) beginning with the midpoint of the tax year in which paid or incurred. The proposal would also allow taxpayers to elect under section 59(e) to capitalize otherwise deductible domestic R&E expenditures under new section 174A and deduct the expenditures ratably over a 10-year period, beginning in the tax year in which the expenditures are paid or incurred.

The changes made by the proposal would be treated as a change in accounting method that would be applied on a cut-off basis only for both (1) domestic R&E expenditures paid or incurred in tax years beginning after December, 31, 2024, with no adjustment made under section 481(a), that would be accounted for under proposed section 174A, and (2) domestic R&E expenditures paid or incurred in tax years beginning after December 31, 2029, with no adjustment made under section 481(a), that would be accounted for under section 174.

KPMG observation

This proposed framework essentially returns the treatment of domestic R&E expenditures to that of before the TCJA, while foreign R&E expenditures remain subject to the same, lengthy capitalization period. This disparity in treatment may encourage investment in domestic research in a way that the pre- and post-TCJA section 174 never did.

Regarding the change in accounting method treatment in the proposed rule, KPMG expects that if the proposal is enacted, the IRS will issue procedural guidance to effectuate the change similar to guidance issued following the TCJA, likely permitting a statement in lieu of the filing of a Form 3115. Because the proposal treats all amendments relating to R&E expenditures as a change in method of accounting, the IRS should also consider the need to allow late elections under proposed section 174A or section 59(e), including related procedures. Updated procedural guidance will also be needed to handle continuing changes to comply with the rules for pre-2025 expenditures. Additionally, taxpayers will still be looking to Treasury for guidance on the rules for pre-2025 domestic R&E expenditures and pre- and post-2025 software development and foreign R&E expenditures under the present capitalization rules.

For applicable corporations subject to the corporate alternative minimum tax (CAMT), the capitalization and amortization of R&E expenditures may be helpful in reducing or avoiding a CAMT liability. Under the proposal, the expensing of domestic R&E expenditures could result in taxable income being lower than adjusted financial statement income for CAMT purposes, depending on a taxpayer's other book and tax differences. Thus, applicable corporations may want to model the impact on CAMT of expensing domestic R&E expenditures versus electing to capitalize and amortize such amounts (over not less than 60 months).

The proposal would also amend the provisions affecting dispositions of property with respect to which R&E expenditures are paid or incurred. Under present law, section 174(d)) provides that no deduction is allowed for unamortized R&E expenditures in cases when a taxpayer disposes of any property developed with such expenditures. The proposal would also disallow reductions of amounts realized on dispositions of such property and instead require continued amortization of such amounts. This change would be effective for property disposed, retired, or abandoned after May 12, 2025.

KPMG observation

Under the temporary rules permitting capitalization of section 174 expenses, accelerated basis recovery would be allowed upon the sale or disposition of property even if it results in a deduction.

The addition of "reduction to amount realized" to section 174(d) for transactions entered into after May 12, 2025, adds credence to the view that in its current form section 174(d) only requires continued amortization upon the disposition of property at a loss, to the extent of the loss.

The proposal would amend section 280C(c) in several ways, including by requiring a reduction to the amount capitalized under section 174 for the tax year to the extent that year's research credit under section 41 exceeds the allowable amortization deduction for the qualified research expenditures for the year. The proposal would also add new section 280C(c)(4), requiring taxpayers to reduce the amount that would otherwise be taken into account under section 174A (i.e., domestic R&E expenditures paid or incurred in tax years beginning after 2024 and before 2030) by the amount of the research credit for such year. The proposal would continue to allow taxpayers to elect a reduced research credit in lieu of making such reductions.

KPMG observation

When the TCJA amended sections 174 and 280C(c), taxpayers were required to reduce their capitalized 174 expenditures only if their research credits (determined under section 41) for the same tax period exceeded the amount allowable as a deduction for those qualified research expenditures. For most taxpayers an excess did not occur, and consequently, taxpayers were able to claim the entirety of their research credits with no adjustment made to the total deductible amount (after the five-year capitalization period). The proposed changes to section 280C(c) may eliminate this opportunity for 2025 through 2029, but it is difficult to discern Congressional intent as the proposed changes to section 280C(c)(1)(B) would not be effective in accomplishing this result after 2029.

That said, the changes to section 280C(c) explicitly require taxpayers to reduce the amount taken into account under section 174A in an amount equal to the research credit. In certain situations where a U.S. taxpayer incurs qualified research expenses based on the controlled group test, but the related party's payments are not taken into account for U.S. tax purposes as section 174 or proposed section 174A expenditures, the revised section 280C(c) would seemingly have no effect on taxable income.

Finally, the proposal includes several coordination provisions to reflect the proposed changes to section 174 and the addition of proposed section 174A. Most notably, section 59(e) (providing an optional 10-year write-off of qualified expenditures) would be amended to treat proposed section 174A expenditures (rather than section 174(a) expenditures) as qualifying expenditures for purposes of the election such that the first-year amortization deduction under section 174 would no longer be eligible for a section 59(e) election for amounts paid or incurred in tax years beginning after 2024 (i.e., foreign R&E expenditures (and domestic R&E expenditures paid or incurred in tax years beginning after 2029) would be ineligible for a section 59(e) election).

JCT estimates that the proposal would decrease revenues by approximately $22.8 billion over the 10-year budget window (i.e., 2025 – 2034).

KPMG observation

By adding proposed section 174A and the coordination provisions, it is possible that some sections relying on section 174 were overlooked. Taxpayers are encouraged to review the coordination provisions to verify that their domestic R&E expenditures are treated appropriately in all situations. All

coordination provisions but one would replace references to "174" with references to "174 and 174A." The only provision that failed to make such a replacement was the coordination provision with section 59(e)(2)(B); as a result of this omission, as noted above, taxpayers would no longer be able to make a section 59(e) election for the amount of amortization allowable in the year the expenditures are paid or incurred.

While generally favorable, taxpayers considering expensing in 2025 should take into account the impact on other provisions such as BEAT, FDII and section 163(j), which may make the optional capitalization provisions in proposed section 174A (as well as section 59(e) elections) more attractive (for further discussion of the impact of R&E expensing on the business interest expense limitation under section 163(j), see KPMG observations under the "Increase in business interest limitation for depreciation, amortization, or depletion" section of this document). Alternatively, for taxpayers monitoring their base erosion percentage, the immediate expensing of domestic R&E could be beneficial as it may increase the total amount of deductions each year in the denominator of the calculation, having the effect of reducing the base erosion percentage.

Senate bill as enacted (sec. 70302)

While the Senate bill would also provide optionality between expensing or amortizing U.S. research expenses, the provisions differ from the House bill in a few key ways:

- Rather than temporarily allowing for the expensing of U.S. research expenditures, the Senate bill would make that treatment permanent. While the House's provision for expensing U.S research expenditures was set to expire after five years, no such expiration exists in the Senate bill.

- For taxpayers that elect to capitalize and amortize their U.S. research expenditures (for a period of not less than 60-months), under the Senate bill amortization would begin in the month in which the taxpayer first realizes benefits from the research expenditures. Conversely, amortization under the House bill would begin from the midpoint of the year in which the expenditures are incurred.

KPMG observation

While the House bill took a kick-the-can-down-the-road approach to the return of expensing for U.S. research expenditures, the Senate bill would settle the issue permanently. Interestingly, the time when amortization begins under the option to capitalize and amortize U.S. research expenditures would revert to the time when it began under old section 174(b) prior to amendment by the TCJA—the month in which the taxpayer first realizes benefits from such expenditures. In comparison to the House bill's use of a mid-year convention, this property-by-property placed in service date convention would add significant administrative complexity to the election. However, while section 174(b) (prior to amendment by the TCJA) explicitly provided that "such deferred expenses are expenditures properly chargeable to capital account for purposes of section 1016(a)(1) (related to adjustments to basis of property)," that language is missing from the Senate bill.

Next, both the House and Senate bills would insert into section 174(d) "or reduction to amount realized" after "no deduction." However, the Senate bill stipulates that "[t]he amendment by subsection (b)(1)(C)(ii) [regarding the insertion of "or reduction to amount realized"] shall not be construed to create any inference with respect to the proper application of section 174(d)... with respect to tax beginning before May 13, 2025."

KPMG observation

As was observed following the release of the House bill, the addition of language addressing

accelerated basis recovery upon the sale or disposition of research property seemed to add credence to the view that in its current form section 174(d) only requires continued amortization upon the disposition of property at a loss, to the extent of the loss.

Similar to the House bill, the Senate bill contains a number of coordination provisions to align the Internal Revenue Code with changes to section 174 and the addition of section 174A. Notable differences between the coordination provisions include:

- Changes to sections reflecting the permanence of section 174A rather than the temporary section 174A that would revert back to section 174 after five years under the House bill.

- A possibly significant revision to the requirements for expenditures to be credit eligible in section 41(d)(1)(A), changing the phrase "with respect to which expenditures *may be treated* as... research or experimental expenditures under section 174" to "with respect to which expenditures *are treated* as... research or experimental expenditures under section 174A." (emphasis added).

- Changes to section 280C(c)(1) that would clarify that domestic research or experimental expenditures as defined in section 174A(b) otherwise taken into account as a deduction or charged to capital account under Chapter 1 of the Code are reduced by the amount of the research credit under section 41(a) (unless the taxpayer elects a reduced research credit in lieu of making such a reduction).

KPMG observation

Historically the section 41 research credit has required that expenses be of a research or experimental nature, as described by section 174, to qualify for the credit. The use of "may" has implied that taxpayers need not necessarily recognize expenditures under section 174 for those expenditures to qualify for the credit. The change from "may be treated" to "are treated" seems to imply that for expenditures to qualify for the section 41 research credit, taxpayers must treat those amounts as section 174 (or section 174A) expenditures. This change coupled with corresponding changes the Senate bill makes to section 280C appear to eliminate the opportunity to claim a gross section 41 R&D credit without adjustment to the deduction for qualifying research expenditures.

Regarding transition rules, the House bill would provide that for tax years beginning after December 31, 2024, but ending before enactment of the bill, the Secretary may prescribe rules for changes in accounting method and other such applications of the changes to section 174. Alternatively, the Senate bill would explicitly provide that in such cases of a short tax year (beginning and ending in that timeframe) any changes in accounting method related to section 174A would be made on a modified cut-off basis taking into account under section 481(a) only amounts paid or incurred under section 174A for the tax year but not allowed as a deduction for that tax year.

Finally, the Senate bill includes retroactivity provisions that generally permit certain small businesses to apply new section 174A on a retroactive basis with amended returns or a cumulative section 481(a) adjustment, and all other taxpayers to apply the provisions retroactively but only with the cumulative section 481(a) adjustment and not on amended returns.

- Eligible taxpayers (which exclude certain tax shelters) that satisfy the gross receipts test under section 448(c) for their first tax year beginning after December 31, 2024, may elect to amend their returns for tax years subject to mandatory section 174 capitalization and apply the new rules under section 174A. Eligible taxpayers may also make the election by treating it as a change in accounting method. For tax years beginning in 2025, the section 448(c) gross receipts test is met if a taxpayer's prior three-year average annual gross receipts do not exceed $31 million (as determined by applying aggregation rules, as applicable). Additionally, such taxpayers may also make a section 280C(c) (as would be amended by the One Big Beautiful Bill) reduced credit election if they so choose. These elections would need to

be made within one year following the date of enactment of the bill and on an amended return, if applicable to an already-filed return, for an applicable tax year.

- Eligible taxpayers that choose not to amend their prior year returns or other taxpayers who are not eligible taxpayers, may elect to accelerate any unamortized domestic research expenditures (incurred in tax years beginning before January 1, 2025, but beginning after December 31, 2021) over a period of one or two years. The election is treated as an accounting method change.

KPMG observation

Though the gross receipts test described in section 448(c) applies to corporations and partnerships, the option to amend returns seems to apply to any taxpayer (including a sole proprietorship) that satisfies the gross receipts test for its first tax year beginning after December 31, 2024. For tax years beginning in 2025, the applicable gross receipts amount is inflation adjusted to $31 million. Additionally, this explicit statutory authority to amend returns would seem to supersede the rules for BBA partnerships requiring administrative adjustment requests in lieu of amended returns.

It is unclear whether a taxpayer which is not a corporation or partnership should apply section 448(c) for this purpose as if it were a corporation or partnership. In the case of the small business exceptions currently provided under other Code sections (e.g., sections 163(j)(3), 263A(i), 460(e) and 471(c)), a taxpayer other than a corporation or partnership is instructed to apply section 448(c) in the same manner as if such taxpayer were a corporation or partnership.

Modification of limitation on business interest

Current law

The deduction for business interest expense is limited to 30% of the sum of adjusted taxable income (ATI), business interest income and floor plan financing interest. Under present law, ATI is calculated in a manner similar to earnings before interest and taxes (generally referred to as “EBIT”).

The term “floor plan financing interest” means interest paid or accrued on indebtedness used to finance the acquisition of motor vehicles held for sale or lease and secured by the inventory so acquired. For this purpose, the term “motor vehicle” includes (1) a self-propelled vehicle designed for transporting persons or property on a public street, highway, or road, (2) a boat, or (3) farm machinery or equipment. Thus, under present law, towed trailers and campers that are not self-propelled vehicles do not qualify as a "motor vehicle."

Under present law, any taxpayer which meets the gross receipts test of section 448(c) (other than a tax shelter) is not subject to the interest expense limitation under section 163(j).

House bill (sec. 111003)

The proposal would reinstate the determination of ATI in a manner similar to earnings before interest, taxes, depreciation and amortization (generally referred to as “EBITDA”) (i.e., without regard to the allowance for depreciation, amortization, or depletion). The proposal would be applicable for tax years beginning after December 31, 2024, and before January 1, 2030.

KPMG observation

Capital intensive businesses were disproportionately impacted by the switch from an EBITDA to EBIT approach to calculating ATI for tax years beginning after 2021. Reverting to an EBITDA approach

would increase affected taxpayers' interest deductions for the years impacted. Coupled with the proposed extension of 100% bonus depreciation and the proposed special depreciation allowance for qualified production property, manufacturers and other taxpayers with large capital spend could see a significant increase in the amount of business interest allowed to be deducted while this proposal would be in effect.

Taxpayers who would benefit from the proposal but are subject to the base erosion tax under section 59A (BEAT) should model the potential interactions with their BEAT calculations. For example, an increase in the amount of interest deductible under section 163(j) could in turn increase a taxpayer's base erosion tax benefits under section 59A if such interest was paid or accrued to a foreign related party. In addition, lower regular tax liability because of increased deductions for interest could negatively impact a taxpayer's BEAT liability. For more information, read the International Tax report located on KPMG's dedicated webpage.

The definition of depreciation and amortization for purposes of section 163(j) is expansive and includes most types of cost recovery over time, including the amortization of various intangibles (e.g., under section 174 (or proposed section 174A), 167, 195, 197, 248, etc.). Thus, taxpayers should also model the impact of the proposed full expensing of domestic R&E expenditures on their ATI calculation. Amortization of R&E expenditures capitalized under section 174 and/or proposed section 174A(c) would be added back in calculating ATI while amounts that are fully deducted in the year paid or incurred would not. If the proposal is enacted, taxpayers with significant business interest and R&E expenditures may benefit by electively capitalizing domestic R&E expenditures under proposed section 174A.

Applicable corporations subject to CAMT who would be impacted by the proposal would also want to model the interactions of an increased interest expense deduction on any potential CAMT liability. Decreased taxable income as a result of the proposal may result in a CAMT liability for applicable corporations and, as a result, a CAMT credit that may or may not be useable in future tax years.

The proposal would also expand the definition of a motor vehicle for purposes of the floor plan financing interest addback to include any trailer or camper designed (1) to provide temporary living quarters for recreational, camping, or seasonal use and (2) to be towed by, or affixed to, a motor vehicle.

Another proposal in the bill (discussed below) would modify section 448(c) to raise the gross receipts threshold for certain manufacturing taxpayers from $25 million to $80 million for tax years beginning after 2025. Under both proposals, certain taxpayers that are presently limited under section 163(j) would potentially not be limited by section 163(j) after 2025. For a discussion of the higher gross receipts threshold, including what would constitute a manufacturing taxpayer under the proposal, see the "Increased gross receipts threshold for small manufacturing businesses" section of this document.

JCT estimates that the proposal would decrease revenues by approximately $39.6 billion over the 10-year budget window (i.e., 2025 – 2034).

KPMG observation

The new small manufacturing taxpayer exception under section 448(c), which would be effective for tax years beginning after December 31, 2025, lags behind many of the other proposals, which generally would be effective for tax years beginning after December 31, 2024, including the modification of the business interest expense limitation provision under section 163(j).

Senate bill as enacted (sec. 70303)

The Senate bill would similarly reinstate the determination of ATI in a manner similar to EBITDA (i.e., without regard to the allowance for depreciation, amortization, or depletion), but permanently (rather than temporarily like the House bill) for tax years beginning after December 31, 2024. There are no differences between the House bill and the Senate bill with respect to the proposed expansion of the definition of a motor vehicle to include certain trailers and campers.

Additional proposals with respect to section 163(j) under different sections of the Senate bill are discussed below under "New Items" (see discussion of sections 70341 and 70342 of the Senate bill).

Reinstatement of 100% bonus depreciation

Current law

The TCJA temporarily increased the section 168(k) first-year "bonus" depreciation deduction to 100%, allowing taxpayers to write off immediately the cost of qualified property when placed in service. The 100% bonus depreciation rate applied through 2022 and then started ratably phasing down over the succeeding five years. Thus, the bonus depreciation percentage under section 168(k) is generally 80% for property placed in service in 2023, 60% for property placed in service in 2024, and 40% for property placed in service in 2025. The percentage will continue to decrease to 20% for 2026 and expire in 2027. Similarly, section 168(k)(5) provides a special election to deduct the applicable bonus depreciation percentage of the costs of planting or grafting specified plants during such years (rather than in the year the specified plant is placed in service by the taxpayer).

While the bonus depreciation percentage generally decreased to 60% for assets placed in service in 2024 (and decreases to 40% for assets placed in service in 2025), certain qualified property placed in service in 2024 remains eligible for the 80% deduction (and if placed in service in 2025 will remain eligible for the 60% deduction). To be eligible for this extended placed-in-service date rule, an asset must meet all of the requirements of section 168(k)(2)(A)(i) and (ii), have a recovery period of at least 10 years or constitute transportation property, and constitute longer production period ("LPP") property. LPP property must have either (1) a production period in excess of two years; or (2) a cost in excess of $1 million and a production period in excess of one year. Examples of assets that may qualify include pipelines, barges and other vessels, and power generation facilities.

A corporate aircraft (i.e., an aircraft that is not used in the business of transporting people or freight) is also eligible for the extended placed-in-service date rule so long as the aircraft is acquired by purchase and the purchaser made a non-refundable deposit of the lesser of $100,000 or 10% of the purchase price. In addition, the aircraft must have a production period of more than four months and a cost in excess of $200,000.

House bill (sec. 111001)

The proposal would reinstate the 100% additional first-year depreciation deduction under section 168(k) (bonus depreciation) for property acquired and placed in service after January 19, 2025, and before 2030 (with an additional year for certain aircraft and qualified property with a longer production period). For property acquired before January 20, 2025, the current law percentages would continue to apply—i.e., generally 40% for property placed in service in 2025 and 20% for property placed in service in 2026. Any property acquired before January 20, 2025, and placed in service after 2026 (after 2027 for LPP property and certain aircraft) would not be eligible for a bonus depreciation deduction.

The proposal would modify the bonus depreciation deduction related to plants bearing fruits and nuts by suspending the current law phase-down percentages through 2026 and providing a 100% bonus

depreciation deduction for specified plants that are planted or grafted after January 19, 2025, and before 2030.

JCT estimates that the proposal would decrease revenues by approximately $36.6 billion over the 10-year budget window (i.e., 2025 – 2034).

KPMG observation

Because otherwise qualifying property acquired prior to January 20, 2025, would continue to be subject to the current-law, phased-down bonus percentages, taxpayers would benefit from evaluating acquisitions occurring in late 2024 and early 2025 to determine whether the acquisition may be treated as occurring after January 19, 2025. Even if an asset is determined to be acquired prior to January 20, 2025, taxpayers would presumably be able to apply the elective component rules under existing Treasury regulations to qualify components acquired after January 19, 2025, as eligible for the 100% bonus depreciation deduction.

Should the proposal pass as drafted, taxpayers may benefit from the administrative simplicity of the law given that this provision does not include phase-down percentages to plan around or a retroactive date that could burden taxpayers to amend previous tax returns or file accounting method changes.

Similarly to when the bonus depreciation rate was increased to 100% under the TCJA, this provision could have an important effect on M&A transactions. It would increase the incentive for buyers to structure taxable acquisitions as actual or deemed (e.g., pursuant to section 338) asset purchases, rather than stock acquisitions, by enabling the purchasing entity in an asset acquisition to immediately deduct a significant component of the purchase price, and potentially generate net operating losses in the year of acquisition that could be carried forward to shield future income.

Increased bonus depreciation may have an impact on a corporation's future applicable corporation status for CAMT purposes. Although taxpayers are generally permitted to deduct tax depreciation in computing their adjusted financial statement income (AFSI), which yields a favorable result in years in which bonus depreciation is claimed, the inverse may be true in future tax years where property is fully depreciated and no tax depreciation deduction is available. Corporations that are not currently applicable corporations subject to CAMT but anticipate coming under the regime in a future year might want to model the effect on future tax years if 100% bonus depreciation is claimed in a year prior to being subject to CAMT, including modeling the effects of electing out of bonus depreciation for certain classes of property to extend tax depreciation deductions (and favorable CAMT adjustments) into future CAMT years. Further, when 100% bonus depreciation is coupled with the section 163(j) and section 174A proposals, the impact on taxable income (and any potential CAMT liability) could be material.

Senate bill as enacted (sec. 70301)

The Senate bill would permanently reinstate the 100% additional first-year depreciation deduction under section 168(k), instead of the temporary reinstatement proposed in the House bill, for qualified property acquired after January 19, 2025, and specified plants planted or grated after such date. For acquisition date determinations, the proposal would prohibit qualified property from being treated as acquired after the date on which a written binding contract is entered into for such acquisition.

As part of making 100% bonus depreciation permanent, the proposal would remove the limitation for self-constructed property under current law that requires self-constructed property to be manufactured, constructed, or produced before 2027. Similarly, the proposal would remove the requirement that qualified property be placed in service before 2027 (before 2028 in the case of LPP property and certain aircraft), as well as the requirement that specified plants be planted or grafted before 2027.

The proposal would provide a transitional election, whereby taxpayers can apply a reduced bonus depreciation percentage of 40% for qualified property (60% for LPP property and certain aircraft) placed in service by the taxpayer during the first tax year ending after January 19, 2025, in lieu of the 100% bonus depreciation percentage that would otherwise apply. Similarly, a transitional election would be available to apply a bonus depreciation percentage of 40% (in lieu of 100%) to specified plants planted or grafted by a taxpayer during its first tax year ending after January 19, 2025.

The proposal would generally apply to property acquired after January 19, 2025, and specified plants planted or grafted after such date. In the case of the transitional election of a reduced bonus depreciation percentage, the proposal would apply to tax years ending after January 19, 2025.

KPMG observation

For fiscal year taxpayers with tax years ending shortly after January 19, 2025, the transitional election outlined in the proposal would provide administrative ease by allowing the use of current bonus depreciation deduction percentages for taxpayers that might not want to recalculate depreciation for the first tax year ending after January 19, 2025. Presumably the election is meant to be limited to tax years ending after January 19, 2025, that include January 20, 2025, similar to what applied under current law to property placed in service during a taxpayer's first tax year ending after September 27, 2017, that included September 28, 2017 (see section 168(k)(10) and Treas. Reg. § 1.168(k)-2(f)(3), providing a transitional election to use the pre-TCJA 50% bonus depreciation rate for such tax year).

As discussed above, the proposed permanency of 100% bonus depreciation coupled with the section 163(j) EBITDA approach, and section 174A expensing for U.S. research expenditures would make modeling the impact of each of the provisions on taxable income and any potential CAMT liability, as well as the interaction with numerous international tax rules including the section 250 deduction for FDII and GILTI, and foreign tax credit capacity, even more important.

New items

Increased dollar limitations for expensing of certain depreciable business assets

Current law

Under current law, the maximum amount that may be deducted under the section 179 expensing election is $1 million (the dollar limit). The dollar limit is reduced dollar-for-dollar to the extent the total cost of section 179 property placed in service during the tax year exceeds $2.5 million (the phase-out amount). These limits are adjusted annually for inflation (e.g., for property placed in service in tax years beginning in 2025, the dollar limit is $1,250,000, and the phase-out threshold is $3,130,000).

The section 179 deduction for a sports utility vehicle is limited to $25,000, adjusted annually for inflation (e.g., $31,300 for 2025).

House bill (sec. 111103)

The House bill would modify the section 179 expensing election to increase the dollar limit from $1 million to $2.5 million and the phase-out amount from $2.5 million to $4 million, adjusted annually for inflation. Note, however, that a taxpayer's remaining basis in section 179 property for which an expense election is made may be eligible for bonus depreciation. The proposal would not change either the existing

requirements for what constitutes section 179 property or the $25,000 limitation (adjusted annually for inflation) on the section 179 deduction for a sports utility vehicle.

The proposal would be effective for property placed in service in tax years beginning after 2024.

JCT estimates that the proposal would decrease revenues by approximately $24.8 billion over the 10-year budget window (i.e., 2025 – 2034).

KPMG observation

The proposal would double the inflation-indexed dollar limit for tax years beginning in 2025 but would only increase the 2025 tax year phase-out amount by $870,000. As a result, the number of taxpayers that can elect expensing under section 179 would be unlikely to increase significantly, although the increased dollar limit would be meaningful to those taxpayers to which it applies.

Senate bill as enacted (sec. 70306)

The section 179 proposal in the Senate bill is identical to the one in the House bill.

KPMG observation

Since section 179 deductions reduce the basis of depreciable property before any applicable bonus depreciation is determined and section 179 elections may be made for a specified dollar amount of one or more assets placed in service during the year, the increase in the section 179 limitations coupled with the Senate bill's proposed permanency of 100% bonus depreciation provides a planning opportunity for taxpayers eligible to claim a section 179 deduction for bonus-depreciation-eligible property placed in service during 2025 where 40% bonus depreciation would only apply for qualified property acquired before January 20, 2025, and 100% bonus depreciation would apply for qualified property acquired after January 19, 2025.

Increased gross receipts threshold for small manufacturing businesses

Current law

Section 446 in general allows the overall cash and disbursements method ("cash method") as a permissible method of accounting. Section 448, however, places a limit (with some exceptions) on the use of the cash method for (1) C corporations, (2) partnerships with one or more C corporations as partners, and (3) tax shelters. This provision effectively requires such taxpayers to use an overall accrual method of accounting ("accrual method").

For C corporations and partnerships with a C corporation partner, an exception to the general limitation on the use of the cash method is provided if the taxpayer meets the gross receipts test of section 448(c) (a "small business taxpayer"). Under current law, section 448(c) permits C corporations and partnerships with a C corporation partner to use the cash method if average annual gross receipts for the prior three tax years are $25 million or less (the "gross receipts test"), indexed for inflation ($31 million for 2025). To determine whether gross receipts exceed the $25 million threshold, a taxpayer includes not only its own gross receipts but also those of any related party that is treated as a single employer with the taxpayer under section 52(a) or (b) or section 414(m) or (o). The gross receipts test is also applicable to determine the applicability of certain exceptions under other provisions of the Code, including the requirement to maintain inventories under section 471 and the requirement to apply the capitalization rules under section 263A for producers and resellers of property.

House bill (sec. 111109)

The proposal would amend section 448(c) by increasing the gross receipts threshold under the gross receipts test for certain manufacturing taxpayers from $25 million to $80 million. For purposes of the proposal, a manufacturing taxpayer would be defined as a corporation or partnership that derives substantially all of its gross receipts during the prior three tax years from the lease, rental, license, sale, exchange, or other disposition of qualified products. Qualified products would include tangible personal property that is produced or manufactured by the taxpayer to result in a substantial transformation (within the meaning of proposed section 168(n)(2)(D)) of the property comprising the product. Tangible personal property for this purpose would not include food or beverages prepared in the same building as a retail establishment where substantially similar property is sold to the public (e.g., food prepared on-site in a restaurant or retail store and sold to customers). The proposal would also require aggregating the gross receipts of certain, related passive trades or businesses (in addition to applying the general aggregation rules under current law) solely for purposes of determining whether a manufacturing taxpayer is eligible for the $80 million gross receipts threshold. The $80 million threshold would be indexed to inflation in the same manner as the $25 million threshold for non-manufacturing taxpayers.

The proposal would further incorporate, by reference, the gross receipts test of section 448(c) in two places: the determination of (1) a qualifying entity for purposes of proposed section 275(b), and (2) an eligible small business for purposes of proposed section 45F(b).

The proposal would be effective for tax years beginning after 2025.

JCT estimates the proposal would decrease revenues by approximately $14.6 billion over the 10-year budget window (i.e., 2025 – 2034).

KPMG observation

Section 448(c) not only applies to allow the use of the cash method by certain taxpayers but is also incorporated by reference in a number of other Code sections which would be impacted by an expansion of the exception to the gross receipts test. For example, a taxpayer (other than a tax shelter) who meets the gross receipts test of section 448(c) is generally eligible for an exception from the following provisions:

- The limitation on the deduction of business interest expense under section 163(j)
- The requirement to capitalize additional costs to real or tangible personal property produced or acquired for resale under section 263A
- The requirement for a farming corporation to use the accrual method of accounting under section 447
- The requirement to use the percentage of completion method (PCM) under section 460 if construction contracts are completed within a two-year period beginning with the contract commencement date
- The requirement to maintain inventories under section 471

While the increased threshold for small manufacturing businesses would generally allow some taxpayers who previously did not qualify as small business taxpayers to use the cash method and take advantage of the above simplifying provisions, the change in the gross receipts aggregation rule to include gross receipts from passive activities may have the opposite effect for some manufacturers. It is unclear whether a manufacturing taxpayer who does not qualify to apply the $80 million gross receipts test to be a small manufacturing business under the new aggregation rules but meets the $25 million gross receipts test for a small business taxpayer under existing law (*i.e.*, a manufacturing taxpayer with significant related party gross receipts from passive activities) would still qualify as a small business taxpayer. Manufacturing taxpayers who are currently treated as small business

taxpayers may need to recompute average annual gross receipts under the new aggregation rules to see if they still qualify as a small manufacturing business, once gross receipts from passive activities are taken into account. Rev. Proc. 2024-23 generally provides automatic consent for various changes in methods of accounting as a result of changes in small business taxpayer status.

Further guidance will also be needed to define the terms "substantially all" and "substantial transformation" in the context of this proposal and to provide rules or guidelines for a taxpayer to determine whether they meet these requirements (e.g., whether a taxpayer who uses a contract manufacturer to produce its goods would qualify as a manufacturing taxpayer). Such a taxpayer is treated as a producer, rather than a reseller, for purposes of section 263A but the "substantial transformation" of the product may be viewed as being performed by the contract manufacturer. Should this proposal be enacted and until such guidance is published, taxpayers may seemingly take a reasonable interpretation of whether they are a manufacturing taxpayer based on existing authorities.

Senate bill

This proposal is unique to the House bill.

Exception to percentage of completion method of accounting for certain residential construction contracts

Current law

Section 460(a) generally requires taxpayers to use the percentage of completion method to account for taxable income from any long-term contract. This method essentially requires a taxpayer to recognize income and expenses as allocable costs are incurred under a contract. A long-term contract is generally a contract for the manufacture, building, installation, or construction of property that is not completed within the tax year during which the parties entered into the contract. See section 460(f)(1).

There are exceptions from this general rule for certain construction contracts, including home construction contracts and residential construction contracts. See section 460(e). Taxpayers that qualify for the home construction contract exception can use exempt contract methods, such as the completed contract method, which allow taxpayers to defer the recognition of income and expenses until the contract is completed. A home construction contract is any construction contract for which 80% of the estimated total contract costs, as of the close of the tax year during which the contract is entered into, are reasonably expected to be attributable to the building, construction, reconstruction, or rehabilitation of or the installation of any integral component to, or improvements of (i) dwelling units contained in buildings containing four or fewer dwelling units, and (ii) improvements to real property directly related to and located on the site of such dwelling units. See section 460(e)(6)(A). For this purpose, each townhouse or rowhouse is treated as a separate building. A home construction contract is generally not subject to section 263A if (i) it is estimated to be completed with the two-year period beginning on the contract commencement date, and (ii) the home builder meets the section 448(c) gross receipts test for the tax year in which such contract is entered into.

A partial exception from the required use of the percentage of completion method applies to residential construction contracts. Taxpayers who qualify may use the 70/30 percentage-of-completion/capitalized cost method (PCCM). Residential construction contracts are home construction contracts (as defined above), except that the building(s) being constructed contain more than four dwelling units. Under the 70/30 PCCM, 70% of a taxpayer's long-term contract income is required to be computed using the percentage of completion method, while the remaining 30% is exempt from such requirement but must be reported consistently using the taxpayer's exempt contract method.

House bill

This proposal is unique to the Senate bill.

Senate bill as enacted (sec. 70430)

The Senate bill would repeal the 70/30 PCCM for residential construction contracts and permit such contracts to be accounted for using any exempt contract method, such as the completed contract method. The Senate bill would also exempt a residential construction contract that is not a home construction contract from section 263A if (i) it is estimated to be completed with the three-year period beginning on the contract commencement date (instead of the two-year period that applies to home construction contracts), and (ii) the builder meets the section 448(c) gross receipts test for the tax year in which such contract is entered into. Additionally, the Senate bill includes a conforming amendment to section 56(a)(3) to allow the beneficial treatment for residential construction contracts to apply consistently for alternative minimum tax purposes in the case of noncorporate taxpayers.

The proposal would be effective for contracts entered into in tax years beginning after the date of enactment.

KPMG observation

The proposal would allow condominium developers and their contractors to qualify for the completed contract method instead of having to use the percentage of completion method or the 70/30 PCCM. The ability to use the completed contract method would permit the deferral of income until the year in which the residential construction contract is completed, consistent with the current law treatment of single-family home builders (as well as townhome and row house developers and contractors). It would also simplify the application of section 460 for condo developers that had previously preferred to obtain the partial deferral under the 70/30 PCCM.

Treatment of certain qualified sound recording productions

Current law

Under current law, for productions commencing prior to 2026, a taxpayer may elect under section 181 to deduct the cost of qualified film or television productions and qualified live theatrical productions in the tax year paid or incurred, up to $15 million per production ($20 million in the case of productions in certain geographic regions), rather than capitalizing the costs (generally under section 263A) and recovering them through depreciation once a production is placed in service. Production costs in excess of such limitation are generally eligible for bonus depreciation once the production is placed in service (i.e., at the time of initial release or broadcast or initial live-staged performance).

House bill (sec. 111107)

The proposal would create “qualified sound recording productions” as a new category of “qualified productions” eligible for elective expensing under section 181. Qualified sound recording productions would be required to be produced in the United States and would be defined as they are under U.S. copyright law, generally as any works that result from the fixation of sounds (whether musical, spoken, or other sounds), regardless of the nature of the material objects in which they are embodied, other than those accompanying motion pictures or other audiovisual works.

Under the proposal, up to $150,000 of the cost of a qualified sound recording production (or up to $150,000 of the aggregate costs of all qualified sound recording production paid or incurred during the tax year) would be allowed as a deduction in the tax year paid or incurred. Under current law, elective expensing under

section 181 is only available for productions commencing prior to 2026. The termination date of section 181 remains unchanged by the proposal.

The proposal would also incorporate qualified sound recording productions as qualified property eligible for bonus depreciation deductions under section 168(k) (similar to the category of qualified property added by TCJA that includes qualified film, television, and live theatrical productions, as defined under section 181). Under the proposal, a qualified sound recording production would be considered placed in service at the time of initial release or broadcast. Per the proposal, a 100% bonus depreciation deduction would be available for costs of qualified sound recording productions not expensed under section 181 if such productions are placed in service before 2029. The amendments relating to qualified sound recording productions would be effective for productions commencing in tax years ending after the date of enactment.

JCT estimates that the proposal will decrease revenues by approximately $153 million over the 10-year budget window (i.e., 2025 – 2034).

KPMG observation

The proper recovery of costs to produce sound recordings, such as podcasts, has historically been unclear, with taxpayers taking varying positions on how to determine the useful life of the property and whether an income forecast method may be used to recover production costs. Adding a category for qualified sound recording productions under sections 181 and 168(k) would provide methods of cost recovery that are in line with comparable types of property. However, since the deduction available under section 181 does not apply to productions commencing after 2025, the primary benefit under the proposal may be in the ability for qualified sound recording productions to be eligible for bonus depreciation through 2028. The proposal does not include provisions to depreciate the basis of such property after the expiration of bonus depreciation under the proposal (i.e., for property placed in service after 2028).

It is unclear why the proposal requires qualified sound recording productions to be placed in service before January 1, 2029, to be eligible for bonus depreciation when the bonus depreciation proposal (discussed above) generally extends 100% bonus depreciation for qualified property placed in service before January 1, 2030 (e.g., qualified film, television, and live theatrical productions would continue to be eligible for bonus depreciation through 2029, unlike qualified sound recording productions).

In addition, since taxpayers that meet the exception for certain small businesses under section 448(c) are generally exempt from the requirement to capitalize costs under section 263A (i.e., those whose average annual gross receipts do not exceed $25 million ($31 million for 2025)), the proposal seemingly benefits large producers.

Senate bill as enacted (sec. 70434)

The Senate proposal is generally the same as the proposal in the House bill with one main exception: the incorporation of qualified sound recording productions as qualified property eligible for bonus depreciation is no longer subject to the placed-in-service date requirement of the House bill, which would have required a qualified sound recording production to be placed in service before 2029 in order to be eligible for bonus depreciation. The absence of the placed-in-service date requirement in the Senate bill is consistent with the Senate bill's proposal that would make 100% bonus depreciation permanent for qualified property acquired after January 19, 2025.

KPMG observation

The permanent inclusion of qualified sound recording productions as qualified property that would be eligible for 100% bonus depreciation would be a significant development for taxpayers who produce sound recordings, particularly since under the proposal 100% bonus depreciation would

apply to qualified sound recording productions without any cost limitation as would otherwise apply under the section 181 proposal (i.e., the $150,000 dollar limitation under the section 181 proposal would not apply in determining the basis of qualified sound recording productions eligible for 100% bonus depreciation when placed in service). Similarly, for taxpayers who produce sound recordings and are subject to CAMT, bonus depreciation would provide a favorable adjustment for CAMT purposes once such productions are placed in service to the extent of any amounts not deducted under section 181.

Special depreciation allowance for qualified production property

Current law

Under current law, nonresidential real property is generally depreciable over 39 years, and thus not eligible for bonus depreciation. However, certain real property such as qualified improvement property, non-building property used in designated manufacturing activities, and certain agricultural buildings and structures have a recovery period of 20 years or less and thus are generally eligible for bonus depreciation.

House bill (sec. 111101)

The proposal would create a new class of property, "qualified production property," which would be eligible for an elective 100% depreciation deduction, generally in the year the property is placed in service. Qualified production property would be defined as any portion of nonresidential real property used as an integral part of a qualified production activity for which construction begins after January 19, 2025, and before 2029, and which is placed in service before 2033. In addition, qualified production property would be required to be depreciable property under section 168 that is placed in service in the United States (or in a U.S. possession).

The proposal would define "qualified production activity" as the manufacturing, production, or refining of a qualified product that is tangible personal property. "Production" under the proposal would only include agricultural production and chemical production. Activities would not constitute manufacturing, production or refining unless they result in a substantial transformation of the property comprising the product.

Any portion of nonresidential real property that is not integral to a qualified production activity, such as space used for offices, administrative services, lodging, parking, sales activities, research activities, or software engineering activities, would not be qualified production property, and thus would not be eligible for the special depreciation allowance. The proposal would also exclude nonresidential real property for which use of the alternative depreciation system of section 168(g) is required, as well as nonresidential real property subject to other special depreciation provisions under section 168, such as property to which section 168(k) (bonus depreciation), section 168(l) (special allowance for qualified second-generation biofuel plant property), or section 168(m) (special allowance for qualified reuse and recycling property) . If a taxpayer elects out of section 168(k), 168(l), or 168(m) to instead elect the special depreciation allowance under proposed section 168(n) for qualified production property, the proposal would treat such property as a separate class of property for purposes of such election out.

The proposal would generally require qualified production property to be original-use property to the electing taxpayer and would provide a special rule for qualified production property that is acquired after January 19, 2025, and before 2029. For such property, the original use and beginning of construction requirements would be deemed met if the property was not used in a qualified production activity by any person at any point after 2020 and before May 13, 2025.

Qualified production property acquired pursuant to a written binding contract would be treated as acquired no earlier than the date such contract was entered into. For purposes of determining when original use commences, the proposal would apply syndication rules "similar to" those provided in

section168(k)(2)(E)(iii). The proposal would provide that, for purposes of the alternative minimum tax under section 55, no depreciation adjustment is required for qualified production property.

Under the proposal, the section 1245 recapture rules would apply if, within 10 years of the placed-in-service date, the qualified production property ceases to be used as an integral part of a qualified production activity. The adjusted basis of property subject to this special change-in-use recapture rule would be increased by the recapture amount. Additionally, the proposal would treat qualified production property as section 1245 property under the ordinary recapture rules, so that section 1245 recapture would be required when qualified production property is disposed of by sale.

Conforming amendments would be made to section 460(c)(6) to continue to permit taxpayers to disregard bonus depreciation in determining the percentage of completion of a long-term contract in the case of property with a recovery period of seven years or less.

The proposed rules relating to qualified production property would be effective for property placed in service after the date of enactment.

JCT estimates that the proposal would decrease revenues by approximately $147.9 billion over the 10-year budget window (i.e., 2025 – 2034).

KPMG observation

Under the proposal, the 100% bonus depreciation allowance under section 168(k) would generally sunset on December 31, 2029 (December 31, 2030, for longer production period property and certain aircraft), while the 100% depreciation deduction for qualified production property would be available through 2032 for property for which construction begins before 2029. This would create a three-year window (2030-2032) in which 100% depreciation would generally only be available for qualified production property under proposed section 168(n). During this window, taxpayers would likely consider not identifying tangible personal property (e.g., via a cost segregation study) that is no longer eligible for bonus depreciation.

It is unclear why a coordination rule with section 168(l) is provided under the proposal since the special depreciation allowance for second generation biofuel plant property under section 168(l) expired for property placed in service after 2020 (i.e., is deadwood).

The 10-year depreciation recapture rule that would be required if qualified production period property changes use in the hands of a taxpayer would be particularly unfavorable compared to other recapture provisions because it would require recapture of the entire amount of depreciation claimed, rather than recapture of the difference between the depreciation claimed and the depreciation that would have otherwise been claimed under the straight line method.

Senate bill as enacted (sec. 70307)

Under the Senate proposal, the election to claim the 100% deduction for qualified production property would require the property to be placed in service before January 1, 2031 (i.e., two years before the House bill's placed-in-service date requirement which would require the property to be placed in service before January 1, 2033), except in cases of acts of God that prevent the taxpayer from placing such property in service before such date, in which case the Secretary could provide an extension. For this purpose, the term "act of God" would mean "an unanticipated grave natural disaster or other natural phenomenon of an exceptional, inevitable, and irresistible character, the effects of which could not have been prevented or avoided by the exercise of due care or foresight" (see 42 U.S.C. sec. 9601(1)).

In the case of property with respect to which the taxpayer is a lessor, the proposal would not consider the use of such property in a qualified production activity by the lessee as used by the taxpayer as part of a qualified production activity.

The proposal would generally incorporate the same acquisition requirements as those that apply in determining whether used property is eligible for bonus depreciation under section 168(k)(2)(E)(ii). However, in addition to including the requirement in the House bill that the property be original-use property to the electing taxpayer, the proposal would exclude any property acquired through related party transactions from being considered qualified production property. Specifically, the property could not be acquired from a related person, from a decedent, or between controlled group members. Additionally, the basis of the property could not be determined by reference to the seller's basis in the property. The Senate bill also clarifies that the taxpayer must not have previously used acquired property for any purpose prior to the acquisition (i.e., a lessee who acquires leased property would not be eligible).

The proposal would revise the definition of a qualified product under the House bill by excluding any food or beverages prepared in the same building as a retail establishment in which such food or beverages are sold.

Under the proposal, electing taxpayers would be treated as having elected out of bonus depreciation for the separate class of qualified production property.

While the House bill did not specify how to make an election under the proposal, the Senate bill would require an electing taxpayer to specify the nonresidential real property and the portion of such property it is making the election for which it is electing the 100% deduction on its tax return for the tax year in which the property is placed in service. The election would be irrevocable and made in the manner provided by the Secretary in regulations or other guidance.

The proposal stipulates that regulations related to what constitutes substantial transformation of property would need to be consistent with guidance provided under section 954(d). Treas. Reg. § 1.954-3(a)(4)(ii) provides examples illustrating the meaning of substantial transformation for purposes of section 954(d), including, for example, the processing and conversion of wood pulp to paper, the transformation of steel rods to screws and bolts, and the processing of freshly caught fish into canned fish.

KPMG observation

Under the Senate proposal, the placed-in-service date cut off for the 100% depreciation deduction for qualified production property is two years earlier than in the House proposal. Because the Senate proposal would also make the 100% bonus depreciation allowance under section 168(k) permanent, if the Senate proposal were adopted without change for both types of property, there would not be a window of time in which only qualified production property would have a 100% deduction available. Therefore, taxpayers would likely want to continue to prioritize distinguishing tangible personal property from real property (e.g. via a cost segregation study) for purposes of claiming the 100% bonus depreciation allowance for non-building property placed in service after 2030.

The Senate proposal does not put a time limit on how long after January 1, 2031, the Secretary could extend the placed-in-service requirement for property that was not able to be placed in service timely due to an act of God. It is unclear whether a limit is intended (see, e.g., the Senate Finance Committee's Section-by-Section description of the Senate bill which indicates a two-year limit on an extension of the placed-in-service date by the Secretary).

The Senate proposal would seemingly reduce abuse of the 100% depreciation deduction for qualified production property by excluding related party acquisitions.

Limitation on amortization of certain sports franchises

Current law

Under current law, section 197 allows for the amortization of certain intangible assets (such as franchises). Prior to the enactment of section 197, many intangibles were not amortizable. In addition, section 197 did not apply to sports franchises acquired prior to October 23, 2004; however, other special rules applied to such intangibles under former section 1056. The American Jobs Creation Act of 2004 repealed the exception from section 197 for sports franchises and correspondingly repealed former section 1056, effective for sports franchises acquired after October 22, 2004 (note that the regulations under section 197 have not ever been updated to reflect this change). Since such time, professional sports franchises and any intangible asset acquired in connection with the acquisition of such a franchise (including player contracts), have generally been amortizable under section 197.

House bill (sec. 112017)

With respect to a "specified sports franchise intangible" acquired after the date of enactment, the proposal would limit the section 197 amortization deduction to only 50% of the adjusted basis in such assets. A specified sports franchise intangible is defined as any "amortizable section 197 intangible" which is a franchise engaged in professional football, basketball, baseball, hockey, soccer, or other professional sport, or any other amortizable section 197 intangible acquired in connection with such a franchise.

JCT estimates that the proposal would increase revenues by approximately $991 million over the 10-year budget window (i.e., 2025 – 2034).

KPMG observation

The proposal does not limit the amortization of separately acquired or self-created player contracts. Such contracts are generally amortizable over the limited life of the player contract if acquired separately from an acquisition of the professional sports team. An IRS safe harbor permits taxpayers to assign a value of zero in certain cases (see Rev. Proc. 2019-18, providing a safe harbor method for valuing sports recruiting and player trades if the contracts or draft picks are not section 197 intangibles).

Senate bill

This proposal is unique to the House bill.

Coordination of business interest limitation with interest capitalization provisions

Current law

Under current law, the Code provides no ordering rule for coordinating the interest limitation rules under section 163(j) with other provisions of the Code under which business interest expense may be capitalized. Regulations promulgated under section 163(j) provide a coordination rule indicating that business interest capitalized under a provision that subjects interest to capitalization is not subject to the section 163(j) limitation.

House bill

This proposal is unique to the Senate bill.

Senate bill as enacted (sec. 70341)

The Senate bill would provide an ordering rule that subjects interest that is capitalized under any provision other than section 263(g) or section 263A(f) to the limitation and would further provide that the amount of business interest expense allowable after the application of the business interest expense limitation would be applied to otherwise capitalized business interest expense before any other business interest expense.

The Senate bill would also provide that any business interest expense disallowed under section 163(j) in a prior year and subsequently carried forward shall not be treated as interest to which any interest capitalization provision applies.

Lastly, the Senate bill would invest the IRS with authority to issue regulations or other guidance as necessary, including regulations or guidance to determine which business interest is taken into account under sections 163(j) and 59A(c)(3). These proposals would be applicable for tax years beginning after December 31, 2025.

KPMG observation

The proposed ordering rule in the Senate bill would add additional complexity to the application of section 163(j) by adding another step in the determination of the taxpayer's current deduction for business interest expense and would not completely eliminate a potential circularity issue in cases where the amount of interest capitalized exceeds the amount of interest otherwise allowable after applying the limit.

This component of the overall Senate bill modifying the business interest limitation may disproportionately impact private equity structures, software developers, service companies, and businesses without significant capital expenditures.

Definition of adjusted taxable income for business interest limitation

Current law

Under section 163(j), business interest expense is only deductible up to the sum of (1) business interest income, (2) floor financing interest, and (3) 30% of adjusted taxable income (ATI) expense. Section 163(j)(8) defines ATI as the taxable income of the taxpayer computed without regard to:

1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business,
2) any business interest or business interest income,
3) the amount of any net operating loss deduction under section 172,
4) the amount of any deduction allowed under section 199A,
5) in the case of tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion, and
6) other adjustments as provided by the Secretary.

House bill

This proposal is unique to the Senate bill.

Senate bill as enacted (sec. 70342)

The Senate bill would amend the definition of ATI to exclude the amounts included in gross income under sections 951(a), 951A(a), and 78 (and the portion of the deductions allowed under sections 245A(a) (by reason of section 964(e)(4)) and 250(a)(1)(B) by reason of such inclusions), which generally relate to amounts required to be recognized in gross income by a U.S. shareholder of a foreign corporation. The proposal would be effective for tax years beginning after December 31, 2025.

KPMG observation

The proposal may have an adverse impact on taxpayers who have significant foreign operations by excluding many foreign sources of gross income from the 30% of ATI computation. For example, taxpayers who recognize significant tested income from CFCs for GILTI purposes may face a limit under section 163(j) for the first time, or a reduced limit.

Taxpayers should model the potential interactions between the relevant proposals on their ATI, BEAT, and CAMT calculations as discussed in greater detail above.

Expansion of qualified small business stock gain exclusion

Current law

Section 1202(a) provides for a gain exclusion on the sale or exchange of qualified small business stock (QSBS) held for more than five years. The percentage of gain that may be excluded depends on the date that the taxpayer acquired its stock:

- Stock acquired after September 27, 2010, is eligible for a 100% exclusion,
- Stock acquired after February 17, 2009, and before September 28, 2010, is eligible for a 75% exclusion, and
- Stock acquired after August 10, 1993, and before February 18, 2009, is eligible for a 50% exclusion.

The remaining 25% and 50% of gain for taxpayers subject to the 75% and 50% exclusion rules, respectively, are subject to tax at a maximum 28% rate (not taking into account the 3.8% net investment income tax). Moreover, 7% of the amount excluded from gross income under the 75% and 50% exclusion rules is treated as a tax preference item for purposes of the alternative minimum tax.

Taxpayers also are subject to a per-issuer limitation on eligible gain subject to the exclusion. This limitation is generally equal to the greater of (i) $10 million ($5 million for married taxpayers filing separate returns), reduced by gain taken into account by the taxpayer with respect to the same issuer in prior tax years, or (ii) ten times the taxpayer's basis in the qualifying stock of the issuer disposed of in the tax year.

Stock must meet various requirements to qualify as QSBS. One requirement is that, for a corporation to issue QSBS, the "aggregate gross assets" (as defined by section 1202(d)(2)) of the issuing corporation generally must not have exceeded $50 million at any point prior to, as of, and immediately after the stock issuance. Section 1202(d)(1).

House bill

This proposal is unique to the Senate bill.

Senate bill as enacted (sec. 70431)

The Senate bill would (i) provide for partial gain exclusion with respect to shares held for at least three but less than five years, (ii) increase the per issuer limitation on eligible gain, and (iii) increase the aggregate gross assets threshold of section 1202(d). In general, these provisions would be effective for shares acquired after the enactment date of the proposed legislation.

The Senate bill would add new section 1202(a)(5), which generally would provide for the exclusion of 50% of the gain on QSBS held for at least three years, and 75% of the gain on QSBS held for at least four years. Shares of QSBS held five years or more would qualify for the 100% exclusion, consistent with current law. The Senate bill would also provide that no amount of the gain excluded under section 1202 would be treated as a tax preference for alternative minimum tax purposes, consistent with current law treatment for shares issued after September 27, 2010.

KPMG observation

Under current law no gain exclusion is available for the disposition of QSBS that has not been held for more than five years (unless QSBS status "tacks" to new stock received in certain nonrecognition transactions). Thus, this provision would help taxpayers that dispose of QSBS "early" get at least a partial benefit from QSBS status. It appears that the maximum 28% rate would apply to the portion of the gain not excluded pursuant to section 1202(a)(5) on shares held for more than three but less than five years.

The Senate bill would amend section 1202(b) to increase the per issuer limitation from $10 million to $15 million, with the $15 million amount to be increased by an inflation adjustment for tax years beginning after 2026.

The Senate bill would also increase the aggregate gross assets threshold from $50 million to $75 million, with the $75 million amount increased by an inflation adjustment for tax years beginning after 2026.

KPMG observation

The $50 million threshold has existed since the QSBS rules were enacted in 1993, and thus, given inflation, businesses must effectively be "smaller" now than in 1993 to satisfy the current law requirement.

If this provision is enacted, shares issued after enactment generally (i) could benefit from a $15 million (rather than $10 million) per issuer limitation, (ii) could benefit from a partial gain exclusion if held for less than five (but more than three) years, and (iii) could potentially qualify based on the increased $75 million "aggregate gross assets" threshold even if the shares would not qualify under the current $50 million threshold. All these changes could potentially be a reason to delay closing a transaction if a taxpayer anticipates this legislation will be enacted in the near term.

Termination of energy efficient commercial buildings deduction

Current law

Section 179D provides a tax deduction for energy efficient commercial building property or energy efficient commercial building retrofit property located in the United States, subject to a deduction limitation computed based on an energy savings per square foot calculation (annually indexed for inflation). An increased

deduction may be available for increased energy savings or meeting certain prevailing wage and apprenticeship requirements.

The section 179D deduction is allowed in the year in which the property giving rise to such deduction is placed in service or, in the case of energy efficient building retrofit property, the year in which the qualifying final certification is made. For tax-exempt entities, section 179D offers the ability to allocate the deduction to the person primarily responsible for designing the property in lieu of the owner of the property (effectively giving the tax-exempt entity a discount).

Originally enacted as a temporary provision in 2005 for property placed in service prior to 2008, the provision has been enhanced and extended over the years. It was made permanent in 2020 and was most recently expanded by the Inflation Reduction Act of 2022, which increased the maximum amount of the deduction, favorably modified the efficiency standards, provided an alternative deduction for energy efficient retrofit building property, and expanded the assignment provisions to include additional tax-exempt entities.

House bill

This proposal is unique to the Senate bill.

Senate bill as enacted (sec. 70507)

This proposal would terminate the deduction under section 179D for property for which construction begins after June 30, 2026.

KPMG observation

Taxpayers in the planning and design stages for energy efficient commercial building property or energy efficient building retrofit property should carefully review their expected timelines and consider expediting the commencement of construction if the taxpayer would like to claim (or assign) the section 179D deduction.

For tax-exempt entities, the termination of section 179D will essentially eliminate the discount potentially obtained through allocation of the deduction to the primary designer of the property.

Termination of five-year cost recovery for energy property

Current law

Under current law, section 168(e)(3)(B) lists specific categories of assets that are five-year property for MACRS purposes. Under section 168(e)(3)(B)(vi)(I), this list includes any property described in section 48(a)(3)(A) (applied by substituting “solar or wind energy” for “solar energy” in section 48(a)(3)(A)(i) and disregarding the last sentence of section 48(a)(3)). Thus, for example, this five-year property class includes assets such as equipment using solar or wind energy to generate electricity (e.g., solar panels).

House bill

This proposal is unique to the Senate bill.

Senate bill as enacted (sec. 70509)

The proposal would strike section 168(e)(3)(B)(vi)(I) from the Code, removing energy property from being five-year recovery property for purposes of section 168, unless such property is described in another

category of section 168(e)(3)(B) or properly included in an asset class of Rev. Proc. 87-56, 1987-2 C.B. 674, that has a five-year MACRS recovery period.

The proposal to remove energy property from the five-year property class in the statute would be effective for property the construction of which begins after December 31, 2024.

KPMG observation

The removal of wind and solar energy property from the statutory five-year property class will cause taxpayers engaged in such activities to need to determine which asset class would otherwise apply to such assets. Combined with the Senate bill's proposed permanent reinstatement of 100% bonus depreciation, this change might not have a significant impact on a taxpayer's depreciation deduction (e.g., if the otherwise applicable asset class would provide a MACRS recovery period of 20 years or less). However, depending on the activity in which an asset is used, some of these assets might no longer be eligible for bonus depreciation (e.g., if they would have a MACRS recovery period of more than 20 years). Further, since many states decouple from the federal bonus depreciation deduction, this change could impact taxpayers' state income tax liabilities. .

Intangible drilling and development costs taken into account for purposes of computing adjusted financial statement income

Current law

Section 55(b)(2) generally imposes a 15% minimum tax on the adjusted financial statement income (AFSI) of large corporations whose three-year average annual AFSI exceeds $1 billion ("applicable corporations"). An applicable corporation is generally liable for the Corporate AMT (CAMT) to the extent its "tentative minimum tax" exceeds its regular U.S. federal income tax liability (including the BEAT under section 59A). The tentative minimum tax is generally reduced by 75% of general business credits (GBCs) to determine net tax liability. Section 56A provides that a corporation's AFSI calculation generally starts with the net income or loss reported on its applicable financial statement (AFS), adjusted to account for certain adjustments prescribed by the statute and administrative guidance.

Under current law, AFSI is decreased for tax depreciation claimed with respect to property to which section 168 applies (i.e., i.e., depreciation deductions related to tangible and certain intangible property) in the tax year and increased for financial statement depreciation expense taken into account on the AFS with respect to such depreciable property. Additionally, the statute (under section 56A(c)(13)(B)(ii)) authorizes the Secretary to provide rules to make adjustments for any other item in order to provide that section 168 property is accounted for in the same manner as it is accounted for in determining regular taxable income. A similar substitution of tax amortization for financial statement amortization applies for certain qualified wireless spectrum acquired after December 31, 2007, and before August 16, 2022. However, current law does not include a reduction to AFSI for intangible drilling and development costs ("IDCs") which are generally deducted for regular tax purposes under section 263(c) and Treas. Reg. § 1.612-4 if incurred with respect to an oil, gas, or geothermal well located inside the United States.

Specifically, under section 263(c) and Treas. Reg. § 1.612-4, the holder of a working interest in a domestic oil and gas property may elect to deduct all expenditures made for wages, fuel, repairs, hauling, supplies, and other expenses incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and natural gas. Generally, IDCs do not include expenses for items which have a salvage value or items related to the acquisition of the property. Additionally, if a taxpayer does not elect to deduct IDCs under section 263(c), the taxpayer may instead capitalize IDCs, recovering them through depletion or

depreciation. Moreover, under section 59(e), a taxpayer who elects to deduct IDCs may elect to deduct a portion of its IDCs and capitalize and amortize the rest over a 60-month period.

Section 291(b) limits the current deduction for IDCs incurred by integrated oil and gas corporations to 70% of the amount otherwise allowable as a deduction for the year (see section 291(b)(1)), with the remainder allowable as a deduction ratably over a 60-month period (see section 291(b)(2)).

Under section 263(i), IDCs paid or incurred with respect to wells outside the United States are not currently deductible, but rather may either be capitalized into the depletable basis of the oil and gas property or amortized over a 10-year period.

House bill

This proposal is unique to the Senate bill.

Senate bill as enacted (sec. 70523)

The Senate bill proposes to amend section 56A(c)(13) for tax years beginning after December 31, 2025, to also provide for (1) a reduction to AFSI for any deduction allowed for IDCs under section 263(c) (including any deduction for such expenses under section 59(e) or 291(b)(2)) with respect to property described in section 263(c) to the extent of the amount allowed as deductions in computing taxable income for the year, and (2) an increase in AFSI to disregard any depletion expense which is taken into account on the taxpayer's AFS with respect to the intangible drilling and development costs of such property.

KPMG observation

The revision to the CAMT rules to allow AFSI to be adjusted to account for domestic IDCs is likely welcome by taxpayers in the oil and gas industry. The adjustment is made for both determining whether a taxpayer meets the $1 billion test for purposes of determining whether it is an applicable corporation (assuming the taxpayer does not use a scope safe harbor), as well as for purposes of determining the CAMT liability of an applicable corporation. Thus, presumably taxpayers in the oil and gas industry are less likely to be subject to CAMT and, if subject to CAMT, less likely a CAMT payor.

Although the proposed AFSI adjustment for domestic IDCs is expected to provide a favorable result for many taxpayers, the process of computing the adjustment may not be straight forward. For example, it may be difficult for a taxpayer to determine the amount of depletion expense in the AFS that relates to domestic IDCs capitalized into a property's basis for financial statement purposes.

Proposals dropped from the Senate bill as enacted

Third party litigation funding reform

Litigating financing is a fast-growing segment of the nontraditional credit market. In a typical litigation financing arrangement, an investor funds legal claims with either the plaintiff or the lawyers in exchange for a share of the litigation proceeds. Some taxpayers have taken the position that these arrangements give rise to capital gain on settlement, which results in a favorable capital gains tax rate for taxable investors,

an exemption from withholding tax for foreign investors, and an exclusion from UBTI for U.S. tax-exempt investors.

The June 28, 2025, draft of the Senate bill included a proposal that was struck prior to passage of the bill by the Senate that would impose a new tax on "qualified litigation proceeds" received by a "covered party." The tax would be equal to 31.8% and would apply at the entity level for passthrough entities. The tax imposed cannot be reduced or offset by ordinary or capital losses from other transactions. Qualified litigation proceeds would be excluded from gross income (such that they would not be subject to tax twice).

KPMG observation

The proposal is similar to legislation previously introduced by Representative Kevin Hern and Senator Thom Tillis. From a policy standpoint, the legislation is intended to reduce the number of lawsuits by limiting funding for speculative litigation.

In many cases, litigation financing agreements are speculative investments with significant yield that is commensurate with the level of litigation risk. The inability to net the income from profitable litigation financing agreements against losses on similar contracts would make the litigation financing industry, as currently structured, highly tax inefficient. The imposition of primary liability for federal income tax at the partnership level is highly unusual outside of the partnership audit regime. In addition, the rate of tax imposed at the passthrough entity level under the proposal would, in many cases, be higher than the amount of tax that would be imposed directly on the partners (i.e., the FDAP rate of 30% applicable to foreign investors and the UBTI rate for tax-exempt corporations of 21%).

The term "qualified litigation proceeds" is defined to include realized gains, net income, or other profit received by a covered party pursuant to a litigation financing agreement. The term "covered party" would be defined as any third party that receives funds pursuant to a litigation financing agreement, other than an attorney representing a party to the litigation. A "litigation financing agreement" would generally be defined broadly to include agreements which provide funding to law firms or parties to a litigation in exchange for a contingent payment based on the success of the litigation. This definition would include litigation financing arrangements structured as derivative instruments (including for example forward contracts). However, litigation financing arrangements would not include arrangements that qualify as indebtedness for U.S. federal income tax purposes and meet other requirements (including a cap on the amount of interest that can be charged equal to the greater of 7% or twice the average annual yield on 30-years Treasury securities). In addition, there is a *de minimis* exception, where the amount of funding is less than $10,000.

KPMG observation

The exemption for traditional indebtedness could potentially result in the industry shifting to traditional recourse loan financing rather than arrangements that are contingent upon the success of litigation. However, given the interest cap feature, it could well be that this exemption may not be that helpful to the industry (which generally seeks high yield investments).

The provision also includes a withholding regime under which persons having control of litigation proceeds would be required to withhold tax at a fixed 15.9% rate.

KPMG observation

The withholding tax is based on proceeds, rather than the amount of profit or gain. Because the withholding regime does not account for the amount initially funded, in many cases it could lead to over-withholding. In addition, no distinction appears to be made as between U.S. and non-U.S. parties.

Litigation financing agreements would also be excluded from the definition of a capital asset under section 1221.

KPMG observation

Some in this space have claimed long-term capital gain treatment of profits as well as on the sales of litigation financing agreements (prior to payout), including under section 1234A. It appears that this provision is intended to ensure that a covered party could not obtain capital gain treatment by selling a litigation financing agreement prior to payout.

The proposal would apply to tax years beginning after December 31, 2025. As currently drafted, there does not appear to be an exception for litigation financing agreements previously entered into.

KPMG observation

The lack of grandfathering for existing contracts would materially affect investors who entered into such arrangements using underwriting based on prior law.

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