Passthroughs 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 June 29, 2025.

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Contents

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)

It is noteworthy a proposed retaliatory tax on certain foreign corporations under new section 899 in the House bill 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, estimates of the revenue effects of the bill as passed by the House on May 22, 2025
- JCX-35-25, estimates of the revenue effects of the Senate-approved bill using a present law baseline (the same baseline used for the estimates for the House bill provided above), which assumes that tax provisions of current law expire according to their terms
- JCX-34-25, estimates of 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 (reduced from 3.5% under the House bill)
- Increase taxes on college endowments (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 tax provisions in the bill related to passthroughs. This is one of a series of reports that KPMG has prepared on the bill, which can all be found here.

Limitation on individual deductions for certain state and local taxes

Summary of current law and overview

Current section 164(b)(6) (the "Current SALT Cap"), enacted by the TCJA, generally caps an individual's itemized deductions for state, local and foreign income, war profits, excess profits, and real property taxes, as well as state and local personal property taxes, at $10,000 ($5,000 for married taxpayers filing separately (MFS)). The Current SALT Cap sunsets for tax years beginning after 2025.

In response to the Current SALT Cap, many states enacted regimes through state-level legislation allowing a passthrough entity to elect to pay an entity-level state tax in return for a credit or deduction against a state tax imposed on the owner of such passthrough entity ("PTET Regimes"). The PTET Regimes have taken various forms and have imposed limitations on entities' eligibility to elect into the PTET Regime, including based on ownership composition. PTET Regimes have proliferated as the IRS has appeared to endorse their use in Notice 2020-75. Notice 2020-75 stated the IRS's intent to issue proposed regulations "clarifying" that state and local income taxes paid by a partnership or an S corporation are allowed as a deduction by such entity in its non-separately stated taxable income or loss (though no such regulations have been issued as of this writing). These PTET Regimes exist alongside pre-TCJA state and local income taxes imposed on passthrough entities ("Historic Passthrough SALT"), which generally do not allow for a partner or S corporation shareholder level credit (e.g., the Texas Franchise Tax or New York City UBT).

Both the Current SALT Cap and the treatment of state and local income taxes paid under PTET Regimes have been subject of significant debate through the current legislative process. Multiple regimes have been proposed.

Significant changes in approach were seen between the original Senate Finance Committee bill ("Original SFC bill") released June 16, 2025, and the final Senate bill passed by the Senate on July 1, 2025. Like the House bill, the Original SFC bill would have created a new limitation regime that would have meaningfully departed from the Current SALT Cap and the current-law treatment of PTET Regimes. The Original SFC bill, while similar in some ways to the House bill, departed in drastically different ways from the House bill, proposing entirely different criteria for the deductibility of taxes paid under PTET Regimes. However, the regime that ultimately passed the Senate is a continuation of the Current SALT Cap with modified dollar limitations and added income phasedowns and includes no changes to the existing treatment of PTET Regimes.

The Senate bill, which was signed into law, is described in detail below. For ease of reading, we have not included any discussion of the provisions in either the Original SFC bill or the House bill relating to changes to the SALT Cap or PTET Regimes.

Changes for tax year 2025

Senate bill enacted as OBBBA (sec. 70601)

The Senate bill as enacted quadrupled the state and local tax limitation on itemized deductions in current law section 164(b)(6), increasing the limitation from $10,000 (or $5,000 for MFS) (i.e., the Current SALT Cap) to $40,000 (or $20,000 for MFS).

The Senate bill also subjected the 2025 SALT Cap to a phasedown of 30% of the excess of the taxpayer's modified adjusted gross income (MAGI) over $500,000 (or $250,000 for MFS) (MAGI Phasedown). This MAGI Phasedown is capped to $30,000 (or $15,000 for MFS) allowing for a minimum itemized deduction related to state and local taxes of $10,000 (or $5,000 for MFS). At MAGI income of $600,000 ($300,000 for MFS) for 2025, the phasedown is at the $10,000 floor (MAGI Limitation).

The Senate bill defines MAGI as adjusted gross income increased by any amount excluded from gross income under sections 911 (foreign earned income and housing cost), 931 (income from sources within Guam, American Samoa, or the Northern Mariana Islands), or 933 (income from sources within certain U.S. possessions).

The Senate bill continues this regime for tax years after December 31, 2025, with increased limitations and MAGI Phasedowns through tax year 2029, as discussed further below.

KPMG observation

Under the Senate bill, the current federal income tax treatment of certain state and local income taxes paid by passthrough entities ("Passthrough SALT") paid under PTET Regimes will be unchanged for all for tax years beginning in or after 2025.

Senate bill enacted as OBBBA: Continued SALT Cap regime for tax years 2026 and beyond

Under the Senate bill, the Current SALT Cap regime will continue with increased dollar limitations and MAGI Phasedowns until tax year 2030. Both the SALT Cap dollar limitation amounts and the MAGI thresholds before phasedown will increase by 101% per year through tax year 2029. For tax years 2030 and beyond, the SALT Cap will revert back to current levels (i.e. $10,000 (or $5,000 for MFS)) and there will be no MAGI Phasedown.

See the Appendix for tables providing the relevant annual Senate SALT Cap, Senate MAGI Limitation, and maximum MAGI an individual taxpayer can have before reaching the floor of $10,000 (or $5,000 for MFS).

KPMG observation

In total, the Senate bill serves as a simple, temporary five-year increase to the Current SALT Cap, and then reverts back to the Current SALT Cap limitation for all tax years beginning in tax year 2030 and subsequent tax years.

Under the Senate bill, the current federal income tax treatment of certain state and local income taxes paid by passthrough entities ("Passthrough SALT") paid under PTET Regimes will be unchanged.

For tax years beginning after December 31, 2029, the MAGI Phasedowns is unnecessary as the SALT Cap will already be at the floor.

Extension of the qualified business income deduction

Current law

Section 199A allows certain individuals, trusts, and estates to deduct 20% of their business income, qualified REIT dividends, and PTP income. The deduction, however, is subject to certain limitations and thresholds. For example, it is limited to 20% of taxable income reduced by net capital gain. Higher income taxpayers are also subject to a W-2 wage and capital investment limitation and are not allowed a deduction for income from specified service trades or businesses (SSTB), such as health, law, and accounting businesses. Section 199A is set to expire December 31, 2025.

House bill (sec. 110005)

The House bill would make several important changes to section 199A:

- Make the section 199A deduction permanent
- Increase the potential deduction percentage from 20% to 23%
- Replace the existing phase-in of W-2 wages, capital investment, and specified service trades or businesses limitations with a two-step process for taxpayers whose taxable income exceeds the threshold amount
- Include qualified business development company (BDC) interest dividends in the combined qualified business income amount (similar to qualified REIT dividends and qualified PTP income under the current law)
- Index the threshold amounts for inflation for tax years beginning after 2025

Senate bill enacted as OBBBA (sec. 70105)

The Senate bill as enacted, like the House proposal, made section 199A permanent and indexed the threshold amounts for inflation for tax years beginning after 2025.

Unlike the House proposal, the Senate bill as enacted did not increase the potential deduction percentage from 20% to 23%. It did, however, increase the phase-in limits from $50,000 to $75,000 ($100,000 to $150,000 for joint filers), in lieu of the two-step process proposed by the House bill.

The Senate bill also added a new minimum deduction of $400 for taxpayers who materially participate (within the meaning of section 469(h)) in a trade or business that has qualified business income of at least $1,000 (both the $400 and $1000 are increased by cost-of-living adjustments).

Unlike the House proposal, the Senate bill does not include a section 199A benefit for qualified BDC interest dividends.

KPMG observation

Making the section 199A permanent offers tax reductions to certain owners of qualifying pass-through businesses, maintaining the level of parity with the reduction of corporation tax rate established in 2017, when that rate was permanently lowered from 35% to 21%.

The Senate bill as enacted (and the House proposal) making section 199A permanent retains for certain higher-income taxpayers a W-2 and capital investment requirement to fully utilize the deduction, and for this same group of taxpayers also retains the disallowance of benefit against SSTB.

The Senate bill as enacted does not include an increase in the deduction rate over 20% leaving a taxpayer who might be at the highest marginal federal tax rate with a potential effective tax rate at 29.6% (37% x 80%). When originally proposed in the House the increase in the section 199A deduction rate was to be 22% and then was increased to 23%. Under the House proposal, a taxpayer who might be at the highest marginal federal tax rate who might be able to fully utilize the benefit of the deduction, the revised effective tax rate against such qualifying income would have been 28.49% (37% x 77%).

Limitations on excess business losses of noncorporate taxpayers

Current law

In general, the section 461(l) excess business loss limitation limits the extent to which trade or business losses of a noncorporate taxpayer may be used to offset other income of the taxpayer. The excess business loss limitation is calculated by taking the aggregate deductions attributable to trades or businesses over the sum of aggregate gross income or gain attributable to trades or businesses, plus an annual threshold amount. Under current law, any excess business loss that is suspended is carried over to the taxpayer’s next tax year as a net operating loss (NOL) and is not retested under section 461(l). The current excess business loss limitation regime is set to sunset, such that losses will no longer be limited under section 461(l) after December 31, 2028.

House bill (sec. 112026)

The House bill would make the excess business loss limitation permanent. Significantly, the House bill would also change the manner in which the excess business loss is carried over to a subsequent year. Under the provision, excess business losses disallowed in tax years after December 31, 2024, would be included in the taxpayer’s calculation of aggregate deductions attributable to a taxpayer’s trade or business in the following tax year. However, any NOLs generated from excess business losses disallowed in tax years beginning before January 1, 2025, would not be included as an aggregate deduction attributable to the taxpayer’s trade or business. The proposal would be effective for tax years beginning after December 31, 2024.

Senate bill enacted as OBBBA (sec. 70602)

The Senate bill as enacted made the excess business loss limitation permanent but, unlike the House proposal, maintained the current manner in which the excess business loss is carried over to a subsequent year as a net operating loss. The Senate bill also slightly modified the overall section 461(l) calculation by updating the timing for the inflation adjustment provisions to apply to the annual threshold amount.

The Senate bill makes the current version of section 461(l) permanent effective for tax years beginning after 2026. The Senate bill's modification of the calculation for inflation adjustment timing applies to tax years beginning after 2025.

KPMG observation

The House proposal would have represented a substantial change to the manner in which the excess business loss regime currently operates. By modifying the provision to have excess business losses retested under section 461(l) in subsequent tax years—as compared with treating as an NOL carryover to the following year—a taxpayer's ability to claim trade or business deductions could be significantly limited. As background, NOL deductions for tax years beginning after December 31, 2020, are generally limited to 80% of taxable income and can generally offset any type of income. In contrast, if an excess business loss is required to be retested in the subsequent tax year, it may take many more years for the taxpayer to be able to utilize the benefit of such losses. Further, if a taxpayer has consecutive years of excess business losses, the modification may significantly compound the delay in utilization of such losses. In addition, the provision would create a new tax attribute for individuals to track.

Indeed, the House proposal may have resulted in the permanent elimination of the taxpayer's excess business losses. For example, if a taxpayer had a small business that generated significant losses and did not have any other sources of trade or business income before the business ceases, the taxpayer would have an excess business loss carryover. If the taxpayer then proceeded to earn only non-business income (including wage income as an employee), such cumulative excess business losses—in excess of the amount afforded to the taxpayer through the annual threshold construct—would be functionally lost to the taxpayer under this proposal. Furthermore, should the taxpayer die without using his or her cumulative excess business losses, then it would appear that the taxpayer's remaining excess business losses could be permanently lost after the year of death. The proposals would create an excess business loss limitation regime that would stand in stark contrast to other loss limitations (such as under section 469), which generally afford a taxpayer a mechanism to utilize losses before they are permanently eliminated.

The Senate bill as enacted does not contain the same modification as the House proposal, and instead, the Senate bill continues to treat any excess business loss that is suspended as a net operating loss to be carried over to the taxpayer's next tax year.

Change to the taxable REIT subsidiary asset test

House bill (sec. 111112)

The House bill proposal is identical to the Senate bill provision as enacted.

Senate bill enacted as OBBBA (sec. 70439)

The Senate bill as enacted increased the limitation of the percentage of a REIT's total assets that may be represented by securities of one or more taxable REIT subsidiaries from 20% to 25%.

The increase in the limitation will be effective for tax years beginning after December 31, 2025.

Treatment of payments from partnerships to partners for property or services

Current law

In general, contributions by a partner to a partnership and distributions to a partner from a partnership, to the extent that distributed cash does not exceed a partner's basis, are not taxable. However, the Code also contains several exceptions to this general nonrecognition treatment, including the so-called "disguised sale" rules under section 707(a). Section 707(a)(2)(A) and (B) recharacterize certain transactions between a partner and a partnership as a transaction between the partnership and one who is not a partner, resulting in treatment as a disguised sale of property or of a partnership interest under section 707(a)(2)(B) or treatment as a disguised fee for services under section 707(a)(2)(A), as the case may be.

Current section 707(a)(2) prefaces the circumstances under which a recharacterization as a disguised sale or disguised fee for services might be appropriate with the language, "under regulations prescribed by the Secretary."

Treasury regulations prescribe rules relating to disguised sales of property to a partnership; however, no regulations currently exist addressing disguised sales of partnership interests. The Treasury Department and the IRS in 2004 issued proposed regulations addressing the treatment of disguised sales of partnership interests, but in 2009 withdrew these regulations. The Treasury Department and the IRS issued proposed regulations with respect to disguised fees for services under section 707(a)(2)(A) in 2015, however, these regulations have not been finalized.

House bill (sec. 112032)

The House bill proposal is identical to the Senate bill provision as enacted.

Senate bill enacted as OBBBA (sec. 70602)

The Senate bill as enacted strikes the language "Under regulations prescribed" and inserts in its place "except as provided."

KPMG observation

The change appears motivated by a desire to make clear that regulations are not necessary to implement the rules relating to disguised payments for services or disguised sales of partnership interests.

The IRS takes the position that section 707(a)(2)(B) is self-executing and does not require implementing regulations to recharacterize transactions as a disguised sale of a partnership interest, as evidenced by FSA 200024001 and TAM 200037005.

The Senate bill will apply to services performed, and property transferred, after the date of the enactment, July 4, 2025. The Senate bill also includes a provision stating that "nothing in this section or the amendments made by this section, shall be construed to create any inference with respect to the proper treatment under section 707(a) of the [Code] with respect to payments from a partnership to a partner for services performed, or property transferred, on or before the date of the enactment of this Act."

Expansion of the definition of qualifying income of certain publicly traded partnerships

Current law

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes. An exception from corporate treatment is provided for certain publicly traded partnerships, if 90% or more of the gross income of the publicly traded partnership is "qualifying income."

Qualifying income includes interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held to produce qualifying income. Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of any alcohol fuel mixture, biodiesel fuel mixture or alternative fuel described in subsection (b), (c), (d), or (e) of section 6426, or any alcohol fuel defined in section 6426(b)(4)(A) or any biodiesel fuel as defined in section 40A(d)(1). It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) in the case of a partnership, a principal activity of which is the buying and selling of such commodities, futures, options or forward contracts

House bill (sec. 112016)

The House proposal would expand the definition of qualifying income of a publicly traded partnership to include:

- Income and gains with respect to the transportation or storage of sustainable aviation fuel as described in section 40B(d)(1)
- Income and gains with respect to the transportation or storage of liquified hydrogen or compressed hydrogen
- Income and gains with respect to the generation, availability for such generation, or storage of electric power, or the capture of carbon dioxide by a "qualified facility" whose total carbon oxide production is at least 50% "qualified carbon oxide"

For this purpose, a qualified facility would be defined under section 45Q(d) but determined without regard to any date by which construction of the facility is required to begin. Qualified carbon oxide is defined in section 45Q(c).

The House proposal would apply to tax years beginning after 2025.

The JCT estimates that these changes would increase deficits by $2 billion over 10 years.

Senate bill enacted as OBBBA (sec. 70524)

The Senate bill as enacted includes the expansion of the definition of qualifying income of a publicly traded partnership from the House proposal and it further expands the definition to include:

- Income and gains with respect to the production of electricity from any advanced nuclear facility (as defined in section 45J(d)(2)),
- Income and gains with respect to the production of electricity or thermal energy exclusively using a geothermal energy resource or a qualified hydropower production resource as described in sections 45(c)(1)(D) or (H), and
- Income and gains with respect to the operation of geothermal energy property described in sections 48(a)(3)(A)(iii) or (vii) (determined without regard to any requirement under such section with respect to the date on which construction of property begins).

The Senate bill provision will apply to tax years beginning after 2025.

Qualified Opportunity Zones (sec. 111102 of House bill and sec. 70421 of Senate bill)

Designation of QOZ

Current law

The Qualified Opportunity Zone program was designed to incentivize economic development and long-term equity investments in areas designated "Qualified Opportunity Zones (QOZs)" by providing certain tax benefits to investors, as discussed in further detail below.

As originally enacted, certain low-income communities and census tracts contiguous to low-income communities were designated as QOZs.[2] These initial QOZ designations expire on December 31, 2028.[3]

House bill

The House bill renews the QOZ program for 2027 through 2033 and provides certain enhancements to the program for low-income communities designated as QOZs that are comprised entirely of rural areas.

As passed by the House, the current designation of census tracts as QOZs would expire on December 31, 2026 (rather than December 31, 2028). A second round of QOZs would be designated and would be in effect from January 1, 2027, through December 31, 2033.

Under a revised definition of a low-income community in the bill, fewer census tracts would be eligible to be designated as QOZs in the second round. In addition, a census tract that is not a low-income community but is contiguous to a low-income community would not be eligible to be designated as a QOZ.

For the second round of QOZ designations, a minimum number (at least 33%) of the designated QOZs in each state must be low-income communities comprised entirely of a rural area ("Rural QOZs"). The

[2] Notice 2018-48, 2018-28 I.R.B. 9.
[3] Section 1400Z-1(f).

determination of whether a low-income community is comprised entirely of a rural area would be determined by the Treasury Department in consultation with the Secretary of Agriculture.

Senate bill enacted as OBBBA

The Senate bill as enacted created a permanent QOZ program that would allow the Secretary to designate new QOZs every 10 years. With the exception of QOZs in Puerto Rico, the Senate bill doesn't terminate the designation of QOZs prior to their expiration on December 31, 2028. Instead, the Senate bill provides a 90-day window every 10 years beginning July 2026 for a State to nominate census tracts to be designated as QOZs. The Senate bill, however, repeals the special rule under current law that designated each low-income community census tract in Puerto Rico as a QOZ.[4] This repeal is effective on December 31, 2026.

Like the House bill, the Senate bill revises the definition of "low-income community" to limit the tracts eligible for QOZ designation and provides that census tracts that are not low-income communities but are contiguous to a low-income community are ineligible to be designated as a QOZ. However, the Senate bill does not require a minimum number of QOZs to be comprised entirely of a rural area.

Gain deferral benefit

Current law

Under current law, taxpayers can elect to defer recognition of certain capital and section 1231 gains that have been invested in a "Qualified Opportunity Fund (QOF)" until December 31, 2026.[5] To qualify for deferral, a taxpayer must invest an amount equal to the deferred gain in a QOF generally during the 180-day period beginning on the date of the sale or exchange that generated the gain.[6] Taxpayers cannot elect to defer gain on any sales or exchanges that occur after December 31, 2026, and ordinary income may not be deferred.

House bill

Under the House bill, only amounts invested before January 1, 2027, would be taken into income on December 31, 2026. Amounts invested after December 31, 2026, but before January 1, 2034, would be taken into income on December 31, 2033.

Taxpayers can defer recognition of ordinary income of up to $10,000 in the aggregate over the life of the QOZ program. The initial tax basis of the taxpayer's QOF investment attributable to ordinary income would not be reduced to zero and, if held for at least 10 years, the taxpayer would be eligible to exclude gain realized on the sale of such QOF investment.

Senate bill enacted as OBBBA

Gains invested prior to December 31, 2026, are still taken into account in accordance with the current law. Recognition of gains realized after December 31, 2026, will be eligible for deferral under the QOZ program. Gains invested in a QOF after December 31, 2026, will be recognized on the date that is five years after the date of investment in the QOF.

Ordinary income would continue to be ineligible for a deferral election under the QOZ program.

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[4] Section 1400Z-1(b)(3).
[5] Section 1400Z-2(a); (b)(1).
[6] Section 1400Z-2(a).

Gain reduction benefit

Current law

If the taxpayer holds its QOF investment for at least five years before December 31, 2026, 10% of the deferred gain may be eliminated. An additional 5% of the deferred gain may be eliminated if the taxpayer holds the QOF investment for at least seven years before December 31, 2026.[7]

House bill

Under the House bill, if a taxpayer invests gain in a QOF after December 31, 2026, and holds that investment for at least five years by December 31, 2033, the taxpayer's basis in that investment would be increased by 10% of the deferred gain. If the taxpayer invests in a "Qualified Rural Opportunity Fund (QROF)" —a QOF in which 90% of its assets are (A) QOZ business property used within a QOZ comprised entirely of a rural area, or (B) stock or partnership interests in a "Qualified Opportunity Zone Business (QOZB)," substantially all of the tangible property of which is used within a QOZ comprised entirely of a rural area—then the basis increase would be 30% of the deferred gain.

Senate bill enacted as OBBBA

The Senate bill is consistent with the House Bill. The basis of any QOF investment held for at least five years will be increased by an amount equal to 10% of the deferred gain. The basis increase will be 30% of the deferred gain for investments in a QROF. The basis increase will be treated as occurring before the deferred gain is recognized.

Gain elimination benefit

Current law

A taxpayer who holds its QOF investment for at least 10 years would be able to elect, on the sale or exchange of that QOF investment, to adjust the tax basis of the disposed investment to its fair market value on the date of sale.[8] Under regulations, the ability to elect to adjust tax basis on a disposition expires on December 31, 2047.[9]

House bill

No change to current law.

Senate bill enacted as OBBBA

A taxpayer who holds its QOF investment for at least 10 years will be able to elect, on the sale or exchange of that QOF investment, to adjust the tax basis of the disposed investment to (a) its fair market value on the date of sale (in the case of QOF investments sold prior to the 30th anniversary of the investment date) or (b) the fair market value of such investment on the 30th anniversary of the investment date (in the case of QOF investments sold after the 30th anniversary of the investment date).

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[7] Section 1400Z-2(b)(2)(B)(iii) and (iv).
[8] Section 1400Z-2(c).
[9] Section 1.1400Z2(c)-1(c).

Substantial improvement of existing structures in a rural QOZ

Current law

Under current law, a certain percentage of property held by a QOZB, and some QOFs, must be QOZ business property. To be QOZ business property, the property must (among other things) be tangible property 1) the original use of which in a QOZ commences with the QOF or QOZB; or 2) that is substantially improved by the QOF or QOZB. Under current law, property is substantially improved if, during any 30-month period, the QOF or QOZB doubles the basis of the property, that is, there are additions to the basis of the property in an amount that exceeds the basis of the property at the beginning of the 30-month period.

House bill

Under the bill, tangible property located in a Rural QOZ would be considered substantially improved if additions to the basis of the property exceed only 50% of the adjusted basis of the property at the beginning of the 30-month period.

Senate bill enacted as OBBBA

The Senate bill as enacted is consistent with the House bill.

Enhanced QOF and QOZB reporting, including impact reporting

Current law

Current law does not subject QOFs or QOZBs to specific reporting requirements or require the Treasury Department to publish information related to the QOZ program.

House bill

Under the House bill, every QOF would be required to file electronically an annual return containing certain specified information. Much of the required information is already reported by a QOF on Form 8996, *Qualified Opportunity Fund.* However, under the bill, a QOF would also be required to provide 1) the name and address of its QOZBs, 2) each North American Industry Classification System (NAICS) code that applies to the trades or businesses conducted by the QOF and its QOZBs; 3) the approximate number of residential units, if any, for any real property held by the QOF or its QOZBs; and 4) the approximate average monthly number of full-time equivalent employees of the QOF or its QOZBs. Every QOZB would be required to provide each of its QOFs with a written statement providing information to be prescribed by Treasury for purposes of enabling a QOF to comply with its reporting requirements.

If a QOF fails to file timely a complete and correct return, the QOF would be subject to a penalty of $500 for each day the failure continues. The maximum penalty under this provision would be $50,000 for a large QOF and $10,000 for all other QOFs. A large QOF would be defined as one whose gross assets (determined on the last day of the tax year) exceed $10 million. The penalties would increase if the failure were due to an intentional disregard. The penalty amounts would be adjusted for inflation and would be subject to relief for a reasonable cause.

Additionally, the Treasury Department would be required annually to publish a report on QOFs and a separate report on QROFs. The report is required to include statistical metrics designed to show the impact of the QOZ designation on census tracts and the efficacy of the QOZ program.

Senate bill enacted as OBBBA

The Senate bill as enacted is identical in all material respects to the information reporting provisions in the House bill.

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 enacted as OBBBA (sec. 70431)

The Senate bill as enacted (i) provides for partial gain exclusion with respect to shares held for at least three but less than five years, (ii) increases the per issuer limitation on eligible gain, and (iii) increases the aggregate gross assets threshold of section 1202(d). In general, these provisions will be effective for shares acquired after the enactment date, July 4, 2025.

The Senate bill added new section 1202(a)(5), which generally provides for the exclusion of 50% of the gain on QSBS held for at least 3 years, and 75% of the gain on QSBS held for at least 4 years. Shares of QSBS held five years or more will qualify for the 100% exclusion, consistent with current law. The Senate bill also provides that no amount of the gain excluded under section 1202 will 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 will 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 amended 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 also increased 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.

Under this new law, 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.

Appendix

Annual Senate MAGI Limitations for tax years beginning after December 31, 2025

All Individual Taxpayers Except MFS			
Tax Year	**MAGI Limitation**	**House Specified Tax Limitation**	**MAGI at Max Phase Out**
2026	$505,000	$40,400	$606,333
2027	$510,050	$40,804	$612,730
2028	$515,151	$41,212	$619,191
2029	$520,302	$41,624	$625,716
2030 (and after)	N/A	$10,000	N/A

Married Individuals Filing Separately (MFS)			
Tax Year	**MAGI Limitation**	**House Specified Tax Limitation**	**MAGI at Max Phase Out**
2026	$252,500	$20,200	$303,167
2027	$255,025	$20,402	$306,365
2028	$257,575	$20,606	$309,595
2029	$260,151	$20,812	$312,858
2030 (and after)	N/A	$5,000	N/A

Contact us

For more information on the content of this report, contact a professional in the Passthroughs group of KPMG Washington National Tax:

Deborah Fields
T: +1 (202) 533-4580
E: dafields@kpmg.com

Sarah Staudenraus
T: +1 (202) 533-4574
E: sarahstaudenraus@kpmg.com

Robert Keller
T: +1 (504) 584-1030
E: rkeller@kpmg.com

Sabrina Stimel
T: +1 (415) 490-4514
E: sabrinastimel@kpmg.com

Monisha Santamaria
T: +1 (202) 533-3800
E: monishasantamaria@kpmg.com

Holly Belanger
T: +1 (202) 533-4096
E: hbelanger@kpmg.com

John Finkelstein
T: +1 (202) 533-3724
E: jfinkelstein@kpmg.com

Beverly Katz
T: +1 (202) 533-3820
E: beverlykatz@kpmg.com

Anna Holtsman
T: +1 (202) 533 4334
E: aholtsman@kpmg.com

Ossie Borosh
T: +1 (202-533-3983)
E: oborosh@kpmg.com

Or contact a professional in the SALT group of KPMG Washington National Tax:

Bradley Wilhelmson
T: +1 (312) 665-2076
E: bwilhelmson@kpmg.com

Marianne Evans
T: +1 (202) 533 4188
E: mevans@kpmg.com

For questions on legislative matters, contact a professional in the Federal Legislative and Regulatory Services group of KPMG Washington National Tax:

John Gimigliano
T: +1 (202) 533-4022
E: jgimigliano@kpmg.com

Jennifer Acuña
T: +1 (202) 533-7064
E: jenniferacuna@kpmg.com

Tom Stout
T: +1 (202) 533-4148
E: tstoutjr@kpmg.com

Jennifer Bonar Gray
T: +1 (202) 533-3489
E: jennifergray@kpmg.com

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