State income and federal excise tax implications of “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 31, 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)
- 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

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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

- 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 discusses the implications of the bill with respect to state corporation and individual income taxes. It begins with an overview of certain lessons learned or patterns that emerged in the state responses to the TCJA, followed by a discussion of the general manner in which states conform to the Internal Revenue Code (Code), and then examines the potential implications of the proposed changes. This is one of a series of reports that KPMG has prepared on the bill, which can all be found here.

Lessons from the TCJA

As taxpayers assess the potential impact of OBBBA on their state tax position and how states may respond to the new law, a great deal can be learned from the experience of states responding to enactment of the TCJA in December 2017. The TCJA was the most sweeping set of federal tax changes in 30 years, encompassing dramatic rate reductions, changes in the taxation of domestic enterprises, and a restructuring of the international tax regime, as well as major changes in the individual income tax. The varying responses of the states to the TCJA can be instructive in assessing possible state responses to OBBBA.

- It may well take a few years for states to formulate policies around, and enact laws conforming to, or decoupling from, the tax changes. Even now, almost eight years after enactment of the TCJA, states are still working through issues raised by the TCJA, especially with respect to the inclusion of global low taxed intangible income (GILTI) and section 163(j) interest limitations in the income base, among other matters.

- Even when a state adopts a federal change, guidance on the application of that change for state purposes, given differences, for example, in state and federal filing and reporting methods, may not be forthcoming in a particularly quick fashion, or perhaps not at all. A number of state tax authorities have not issued guidance, for example, on the computation of the section 163(j) interest expense limitation or the manner for including GILTI in the apportionment formula.

- For significant changes in the new tax law, taxpayers need to prepare for a period of nonconformity in the states that do not automatically adopt all federal tax changes. Roughly half of the states require legislative action to conform to federal law changes, and most state legislative sessions adjourn by July 1 each year. Depending on when a new federal law is enacted and the effective dates of the provisions, state legislatures may not be in a position to react to the changes legislatively in the near term.

- The experience with the TCJA has taught us there will likely be no uniformity in conformity, and enactment of these proposals will likely lead to substantial differences among the states as to what federal policies they adopt or decline to adopt. For example, well over half the states conform to some degree to section 163(j) interest limitation, while fewer than ten states follow federal rules with respect to including GILTI in state taxable income.

- Finally, the extent to which a particular state would conform to any federal change is likely to be heavily influenced by a number of state-specific factors, including (1) how the state generally conforms to the Code, (2) the political make-up of the state legislature and executive branch, (3) the current and projected fiscal condition of the state, and (4) the current state treatment, if any, of the Code section involved.

All of this is to say, that taxpayers should fully expect a significant period of fluctuation and uncertainty in the state tax landscape following the enactment of the additional federal tax changes in 2025. The complexity involved in properly complying with state tax obligations would be magnified. Accurately assessing one's state posture in this environment will require vigilant monitoring of state legislative actions and administrative guidance, careful analysis and modeling of the enacted changes, ensuring the required data is available for compliance, and devoting sufficient resources to compliance responsibilities.

Current landscape of state conformity to the Code

In computing taxable income for both corporations and individuals, almost all states conform in some manner to the Code. Conformity to the Code is the norm among states because it simplifies compliance for taxpayers and reduces the administrative burden facing state tax authorities.

Generally, states follow one of two approaches in conforming to the federal income tax rules. Rolling or current conformity states tie the state tax to the Code for the tax year in question, meaning they adopt all changes to the Code immediately as passed by Congress unless the state passes legislation to decouple from specific provisions. Static or fixed-date conformity states tie to the Code as of a particular date (e.g., December 31, 2024), meaning the state legislature must act to incorporate subsequent federal changes. States are roughly equally divided between rolling and static conformity.

A small number of states, notably California, adopt only selected Code provisions, rather than using the blanket approach employed by most states. Static conformity states generally update their conformity annually or at least regularly. California tends to be an exception and is somewhat irregular in its conformity updates, as it currently conforms to most provisions as of January 1, 2015. Interestingly, the California state legislature is currently considering a measure to update the conformity provision to the Code as of January 1, 2025, in most areas (California S.B. 711).

Some states that adopt a rolling conformity approach are seeking to hedge the uncertainty of potential federal legislation and its impact on the current budget cycle. The recently finalized budget in Virginia includes a pause on rolling conformity for 2025 and 2026, applicable to both corporate and individual taxpayers. Currently, Oregon is considering a pause on its rolling conformity to the definition of federal taxable income for 2025 for corporate and individual tax purposes. Note that Oregon already has fixed date conformity to the Code for items outside the definition of taxable income.

Additionally, states may adopt specific rules to mitigate the impact of certain federal changes. For example, in the wake of the TCJA, states adopted provisions to allow elective passthrough entity taxes, a portion of which was able to be taken as a credit against the individual state income tax by partners and owners of the passthrough, thus allowing those taxpayers to alleviate some of the $10,000 deduction limitation on state and local taxes at the individual level.

Corporate overview

For corporate income taxes, states generally begin the computation of state corporate taxable income with federal taxable income and therefore allow, for state tax purposes, many federal deductions. Most states start with line 28 of federal Form 1120 (taxable income before net operating losses and special deductions), while other states start with line 30, which includes net operating losses and special deductions. A few states take a hybrid approach of starting with Line 30 and adding back net operating losses, special deductions, or both. States establish their own tax rates and do not, for the most part, conform to various federal tax credits aimed at promoting certain activities, such as credits for investment in alternative energy sources. The research and development credit is an exception, as a number of states allow a counterpart credit based largely on the contours of the federal credit, to the extent that the expenses are incurred in that state.

Regardless of whether they use rolling or static conformity, states tend to pick and choose the federal items to which they will conform, often choosing not to conform to items that have major revenue loss consequences. For example, many states have decoupled from federal bonus depreciation for some or all tax years. Additionally, states are subject to constitutional limitations on taxing certain types of income, and they may decouple from provisions which tax income potentially outside the scope of state ability to tax or that they have traditionally chosen not to tax. After the passage of the TCJA, for example, many states allowed or adopted a modified state deduction to limit the amount of GILTI included in the state tax base and excluded the amount from the income apportionment formula as well.

Individual overview

On the personal income tax side, most states conform to the federal definition of adjusted gross income (AGI), but five states conform to federal taxable income (meaning they incorporate the federal standard deduction and personal exemption allowance in addition to the AGI provisions). As noted, states are about evenly divided between those that incorporate the federal changes automatically and those that require legislation to incorporate the changes. States that allow itemized deductions also usually conform to federal itemized deductions, with the most common model allowing all federal itemized deductions other than the deduction for state income taxes. There are about 10 states that do not provide any itemized deductions. As with the corporate income tax, states establish their own tax rates and tend not to conform to a wide range of federal income tax credits. The earned income credit is the most common exception to this general rule.

Given these relationships between federal and state income taxes, enactment of federal tax changes that affect the computation of the tax base by altering the income reflected or the deductions allowed, will have the most significant impact on state taxes. Changes to federal tax rates and tax credits will not, for the most part, have a direct impact on state taxes. With this as background, the state tax implications of certain of the potential and enacted federal tax changes contained in the bill are reviewed below.

TCJA individual income tax provisions

The TCJA contained a number of significant changes to the federal individual income tax. Largely to comply with the requirements of the budget reconciliation process, many of the provisions are set to expire as of December 31, 2025, at which time the law would revert to the language prior to enactment of the TCJA, unless otherwise modified in the intervening period. Both the House and Senate bills would make permanent many of the individual income tax changes enacted in the TCJA, often with some modifications that differ between the two bodies. They also propose additions to the individual income tax, including deductions for some tip income and overtime compensation, and certain modifications to provisions not affected by TCJA. The state income tax implications of the provisions put forth by the House and Senate and in the new law are reviewed below.

Tax rates and brackets

Current law

The TCJA restructured the income tax rate brackets somewhat and generally lowered the individual rates. For tax year 2025, the rates and brackets range from 10% on taxable income not over $11,925 for single taxpayers/$23,850 for married filing joint taxpayers to 37% for taxable income exceeding $626,350 single and head of household filers and $751,600 married taxpayers filing jointly.

House bill (sec. 110001)

The House bill makes permanent the seven individual income tax rates and brackets as adopted in the TCJA, along with continuing to index the brackets for inflation annually. In addition, the bill would add one year of indexing in 2026 for all but the 37% bracket by making the base year to measure the inflation adjustment 2016, instead of 2017.

Senate bill enacted as OBBBA (sec. 70101)

The enacted Senate bill mirrors the House bill and made the TCJA rate and bracket structure permanent, but it applied the additional year of indexing only to the 10% and 12% brackets.

> **KPMG observation**
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> The permanent extension of the rate and bracket provisions will not have a direct effect on states as they establish their own individual tax rate structures.

Standard deduction

Current law

The TCJA significantly increased the standard deduction for taxpayers who do not itemize deductions. For 2025, the base standard deduction ranges from $15,000 for single taxpayers to $30,000 for married filing joint returns; it is set to revert to $8,300 and $16,600, respectively in 2026 under the terms of the TCJA. There is also an additional standard deduction allowance for each taxpayer over age 65 or who is blind, with the amount dependent on filing status.

House bill (sec. 110002)

The bill strikes the expiration date for the increased standard deduction as enacted in the TCJA, as well as continuing the additional standard deductions for age and blindness. It also provides for an additional year of indexing for the base standard deduction by changing the base year for measuring the adjustment to 2016, instead of 2017. Finally, the bill would temporarily increase the base standard deduction by amounts from $1,000 to $2,000, based on filing status, for tax years beginning after December 31, 2024, and before January 1, 2029.

Senate bill enacted as OBBBA (sec. 70102)

The enacted Senate bill made the TCJA increases in the standard deduction permanent. The Senate bill contains no temporary increase in the base standard deduction amount. Instead, it increased the base amounts for tax years beginning after December 31, 2024, to $15,750 for a single filer, $23,625 for a head of household, and $31,500 for married taxpayers filing jointly. The standard deduction continues to be adjusted annually for inflation, and the additional deduction allowances for blindness and taxpayers over age 65 are continued.

> **KPMG observation**
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> There are about 10 states that have standard deductions set at the same level as the federal income tax. About half of these states conform to federal taxable income in its entirety, while the other half have independently set the standard deduction at the federal amount.

Personal exemptions and child credit

Current law

Along with increasing the standard deduction, the TCJA set the personal exemption allowance to zero and adopted a child credit for dependents under age 17 to adjust tax liabilities to reflect family size. The credit is $2,000 per qualifying child and phases out for incomes over $200,000 (single) and $400,000 (married, filing joint). There is also an additional child credit for certain income levels, and a portion of the additional credit is refundable.

House bill (secs. 110003-110004)

The measure makes permanent the personal exemption allowance of zero, as well as most of the child credit and additional child credit provisions. Further, the bill temporarily increases the maximum child credit to $2,500 for tax years beginning after December 31, 2024, and before December 31, 2028; it also requires the Social Security Number (SSN) of each parent and each qualifying child to appear on the return. Currently, only a child's SSN is required. To be eligible the SSN must be issued to a U.S. citizen, a person with permanent residence, or a person with legal employment status in the U.S.

Senate bill enacted as OBBBA (secs. 70103-70104)

The enacted Senate bill permanently reduced the personal exemption allowance to zero. The Senate bill also made permanent most of the provisions of the current child tax credit, including the $2,000 nonrefundable credit, the additional $1,400 refundable credit, and the increased income phase-out thresholds. It further increased the nonrefundable child tax credit to $2,200 beginning in tax year 2025 and permanently indexes the nonrefundable credit for inflation beginning in tax year 2026. It made permanent the requirement that the child's SSN be included on the return and extends the SSN requirement to the taxpayer (and spouse if a joint return).

KPMG observation

The Senate changes will have a limited impact on states as they generally establish their own personal exemption allowances (if any) and do not conform to most federal credits. The five states that conform to federal taxable income have adopted the zero personal exemption allowance as in current law. There are 10 states, however, that have set their standard deductions at the same level as the federal, five of which establish federal taxable income as their starting point for state tax calculations and would incorporate the additional standard deduction in the Senate bill, presuming continued conformity.

Qualified business income deduction

Current law

The TCJA enacted a provision that allowed owners and shareholders of various passthrough entities a deduction against their individual income equal to 20% of the domestic qualified business income (QBI) received from the entity, subject to certain limitations. The deduction is allowed after the computation of AGI as part of the computation of taxable income on the return and is available to taxpayers regardless of whether they itemize deductions. (For a complete discussion of the limitations on and computation of the qualified business income deduction, Passthroughs report located on KPMG's dedicated webpage.)

House bill (sec. 110005)

The bill would make the QBI deduction permanent, with several modifications, the most significant of which is to increase the proportion of income eligible for deduction from 20% to 23%.

Senate bill enacted as OBBBA (sec. 70105)

The enacted Senate bill made the QBI deduction permanent, but it did not increase the rate of the QBI deduction as the House bill would have. It did, however, establish a new minimum deduction of $400 (indexed for inflation) for taxpayers having at least $1,000 of QBI. The bill also made several other changes to the QBI deduction. (For a complete discussion of the limitations on and computation of the qualified business income deduction, see the Passthroughs report located on KPMG's dedicated webpage.)

KPMG observation

As the deduction does not affect the computation of AGI, its direct impact is limited to the five states conforming to federal taxable income, presuming they have not otherwise made modifications to their law. Likewise, if other states have adopted provisions to incorporate the QBI deduction, they may be affected also, depending on the language of their law, or additional actions to conform.

Itemized deductions

Current law

Individual income taxpayers are allowed to deduct certain specified expenses from their adjusted gross income. The TCJA made several changes in the itemized deductions allowed to individuals in determining federal taxable income. For the large part, the changes restricted amounts of various deductions, including (a) limiting the amount of indebtedness on which mortgage interest payments could be deducted and eliminating the deductibility of home equity loan interest; (b) limiting the amount of personal casualty losses that may be deducted; (c) eliminating that ability to deduct "miscellaneous itemized deductions"; and (d) suspending a limitation on the total amount of itemized deductions that can deducted, based on the income of the taxpayer (known as the Pease limitation).

House bill (secs. 110008-110011)

The bill would make these TCJA provisions permanent, except for the Pease limitation. In place of the Pease limitation, the bill contains a revised overall limitation on the tax benefit of itemized deductions allowed, based on a formula involving taxes deducted under Code section 164, the taxpayer's amount of itemized deductions claimed, and the amount of taxable income subject to the 37% rate.

Senate bill enacted as OBBBA (secs. 70108-70111)

The enacted Senate bill generally follows the House version in making permanent many of the restrictions on allowable itemized deductions as contained in the TCJA, with a few exceptions: (a) certain mortgage insurance premiums are treated as qualified residence interest; (b) unreimbursed casualty losses from certain state-declared natural disasters are allowed as a deduction; and (c) certain unreimbursed employee expenses of K-12 educators are removed from the definition of restricted "miscellaneous deductions" (and thus allowed without restriction). As with the House bill, the measure repeals the "Pease limitation" on overall itemized deductions. The new limitation is structured so as to apply only to taxpayers with taxable income subject to the 37% rate and limits the value of the deductions as if they were in the 35% bracket.

KPMG observation

Most jurisdictions with a broad-based income tax allow itemized deductions at the state level, and they generally follow federal definitions and allowances, with some modifications. As such, most changes in federal itemized deductions as well as any revised overall limitation on itemized deductions that may be claimed are likely to be reflected in most states. All changes in itemized deductions will flow through to those states conforming to federal taxable income, absent other modifications they may have.

Limitation on individual deductions for certain state and local taxes

Current law

Historically, taxpayers were allowed an itemized deduction for state and local income taxes as well as real and personal property taxes. Generally, the TCJA temporarily limited the deduction of these state and local taxes (other than those incurred in the conduct of a trade or business) to an aggregate amount of $5,000 for married individuals filing separately and $10,000 for all other taxpayers.

House bill (sec. 112018)

The House bill makes significant changes to the limitation on the deductions for state and local taxes. For tax year 2025, no itemized deduction of state and local taxes for individual taxpayers that exceed an aggregate of $20,000 for married individuals filing separately, and $40,000 for all other taxpayers is allowed. The $20,000/$40,000 amount is phased down based on the modified AGI of the taxpayer (i.e., AGI increased by certain foreign exclusions) at the rate of 30% of the modified AGI exceeding $250,000 for married filing separate returns and $500,000 in the case of other taxpayers, but in no case may the deduction allowed fall below $5,000 for married filing separate taxpayers and $10,000 for all other taxpayers.

For tax years beginning after December 31, 2025, the bill would amend section 275 and would limit the deduction for certain state and local taxes. No deduction would be allowed for "any disallowed foreign real property taxes," and a deduction would not be allowed for "specified taxes" that exceed in the aggregate $20,200 for taxpayers married filing separate and $40,400 for all other taxpayers. The phasedown threshold for married filing separate taxpayers will be $252,500 of modified AGI for married filing separate and $505,000 for all other taxpayers. The limitation will phase down at a rate of 30% of modified AGI exceeding the threshold, but in no case will it be less than $5,000 for married taxpayers filing separately and $10,000 for all other taxpayers. For tax years beginning after December 31, 2026, and before January 1, 2034, the aggregate limitation and the phasedown threshold will be equal to 101% of the amount in the prior year. For tax years beginning after December 31, 2033, the limitation and the threshold amounts shall remain at the 2033 levels.

Under the House bill, "specified taxes" are subject to the limitation. Specified taxes generally would include sales taxes for which an itemized deduction is claimed, state and local real property taxes (including amounts paid by a cooperative housing corporation tenant-stockholder), personal property taxes, and income taxes. The bill excludes "excepted taxes" from the limitation, except for certain "substitute payments" that remain subject to the limitation. Excepted taxes are defined to include state and local real and personal property taxes and sales taxes paid in carrying on a trade or business or that would be deductible under section 212, the section allowing a deduction for expenses incurred in the production of income. Also included as excepted taxes are income taxes paid by a qualifying entity with respect to carrying on a qualified trade or business, as connected to Code section 199A. The bill also subjects "substitute payments" to the limitation; a substitute payment generally involves an amount paid to a state or locality if one or more persons are entitled to a "specified tax benefit" equal to or exceeding 25% of the payment. The type of "excepted taxes" that would not potentially qualify as a "substitute payment" are income taxes paid by a qualifying entity with respect to carrying on a qualified trade or business, as connected to section 199A. These provisions are effective for tax year 2026 and forward. For further discussion of specified taxes, excepted taxes, and substitute payments, read the Passthroughs report located on KPMG's dedicated webpage.

Senate bill enacted as OBBBA (sec. 70120)

The enacted Senate bill maintained the provisions in the House bill that increase the current limitation on the itemized deduction for state and local taxes to $20,000 for married individuals filing separately and $40,000 for all other taxpayers for tax years beginning 2025. The $20,000/$40,000 limitation amounts are phased down by the rate of 30% of the amount that the taxpayer's modified AGI (i.e., AGI increased by certain foreign exclusions) exceeds a threshold of $250,000 for married filing separate returns and $500,000 for all other taxpayers. For tax years beginning in 2026, the deduction limitation amounts increase to $20,200 for married individuals filing separately and $40,400 for all other taxpayers, with the 30% phasedown threshold level for married filing separate taxpayers beginning at $252,500 of modified AGI and at $505,000 for all other taxpayers. Starting with tax years beginning in 2027 and continuing through tax years beginning in 2029, the maximum deductible amounts and the phasedown thresholds are set at a level of 101% of the prior year's levels. During this period, the phasedown may not reduce the deduction permitted below $5,000 for married individuals filing separately and $10,000 for all other taxpayers. For tax years beginning in 2030 and after, the deduction limitation for all individual filers reverts to the current $5,000/$10,000 levels.

Unlike the House bill, however, the Senate bill did not add new limitations under Code section 275 for taxes paid by certain passthrough entities and does not include "substitute payment" limitations. Neither does the Senate bill contain language to address certain steps states had taken to "work around" the limitation through what were commonly referred to as "passthrough entity taxes" (PTETs).

KPMG observation

The modified limitation on individual deductions for state and local taxes will generally apply in those states that allow itemized deductions at the state level, presuming states maintain their current conformity to the code. In determining their itemized deduction allowances, states generally conform to federal definitions and allowances, but nearly all states with itemized deductions do not allow the deduction of individual income taxes. There are about 10 states with broad-based income taxes that do not allow itemized deductions. The impact will differ among states depending on whether they conform to the actual amount of federal deduction allowed or follow only the definitions of deductible taxes.

The TCJA limitation on deductions for state and local taxes had a significant impact on taxpayers, particularly those in states with relatively higher reliance on personal income taxes. As a result, states began to explore options to "work around" the limitation and enable taxpayers to ameliorate the impact of the limitation to some degree. One approach taken by many states was to allow a partnership to elect to pay a tax on the income of the partnership at the entity level, with the partners, in return, receiving a credit or deduction computed on the basis of the income taxed at the partnership level. While the House bill and the initial Senate Finance version of the Senate bill sought to curtail the work around nature of these passthrough entity taxes (PTETs), it appears that the updated Senate bill will preserve the deduction for taxes paid under PTET regimes, even though a state-level credit or deduction is allowed. For further discussion, read the Passthroughs report located on KPMG's dedicated webpage.

Moving expense adjustment

Current law

Under pre-TCJA law, certain household moving expenses were treated as an adjustment to income if the move met certain distance requirements and the taxpayer met certain employment requirements following the move. In addition, reimbursement of certain expenses by an employer was excluded from income for tax purposes. The TCJA temporarily repealed both the deductibility of moving expenses and the reimbursement exclusion, except in the case of members of the Armed Forces.

House bill (sec. 110013)

The House measure makes the TCJA provisions related to household moving expenses and reimbursements permanent.

Senate bill enacted as OBBBA (sec. 70113)

The enacted Senate bill made the TCJA repeal of the household moving expense and reimbursement exclusion permanent. In addition, it added expenses and reimbursement of moves required by members of the U.S. intelligence community as an exception to the general rule along with members of the Armed Forces.

KPMG observation

Changes to federal allowances for moving expenses will likely be emulated in state income taxes as they affect the computation of AGI which serves as the starting point for most state personal income taxes.

Bicycle commuting exclusion

Current law

Pre-TCJA law provided a $20 per month exclusion from gross income for employees that commuted to work by bicycle, subject to certain qualifications. The TCJA temporarily suspended this preference.

House bill (sec. 110012)

The House bill would repeal the bicycle commuting reimbursement permanently.

Senate bill enacted as OBBBA (sec. 70112)

The enacted Senate measure repealed the bicycle commuting reimbursement.

KPMG observation

As the bicycle commuting allowance is an exclusion from AGI, the change will flow through to most states.

Achieving a better life experience (ABLE) accounts

Current law

ABLE accounts are tax-favored savings programs intended to benefit disabled individuals and are maintained by a state government entity. The TCJA changes were generally designed to broaden the availability and utility of ABLE Accounts.

House bill (secs. 110015-110017)

The bill would make permanent a number of changes to the tax treatment of the amount contributed to and the use of ABLE Accounts that were enacted in the TCJA.

Senate bill enacted as OBBBA (secs. 70115-70117)

The Senate bill provisions enacted are identical to the House bill except that the Senate bill increased the credit allowed for individual retirement contributions by eligible individuals from $2,000 to $2,100, effective for tax years beginning after December 31, 2026.

KPMG observation

Most states operate ABLE Accounts, and the state income tax rules in those states generally conform to the preferences contained in federal law.

New individual tax provisions

No tax on tips

Current law

Current law treats reported income from tips as ordinary income.

House bill (sec. 110101)

The bill introduces an income tax deduction for qualified tips received by a taxpayer. The bill defines "qualified tips" as cash tips received by an individual in an occupation which traditionally and customarily receives tips. The Secretary is required to publish a list of qualifying occupations within 90 days of enactment. The deduction is limited to those amounts reported to the individual on Forms W-2, 1099-K, and 1099-NEC. The deduction would not be available for tips received for performing certain professional services, defined with reference to the specified service trade or business definition applicable to the QBI deduction. The deduction would also be unavailable for any designated "highly compensated employee." The deduction is available only if both the individual receiving the tip and their spouse (if applicable) have valid Social Security numbers. For federal purposes, the deduction for qualified tips may be taken in addition to the standard deduction for taxpayers who do not itemize deductions. The related FICA tip credit for businesses is also expanded to include social security taxes paid by an employer with respect to various beauty service businesses. Both the deduction and the expanded tip credit will be available for tax years beginning after December 31, 2024, and ending on or before December 31, 2028.

Senate bill enacted as OBBBA (sec. 70201)

The enacted Senate bill mirrors the House version closely with the exception that the amount of the tip deduction is limited. The Senate bill limits the amount of tip income that may be deducted to $25,000 per year regardless of filing status, and the deduction phases out by $100 for each $1,000 of modified AGI (AGI plus certain foreign income exclusions) exceeding $300,000 for married taxpayers filing jointly and $150,000 for all other taxpayers. The bill contains a transition provision to allow those persons responsible for reporting tips to employees to approximate a separate accounting of that amount for tax year 2025. The Senate bill extended the related FICA tip credit for beauty service businesses to include social security taxes paid by an employer with respect to various beauty service businesses, which was included in the House bill. As is the case in the House bill, the Senate provisions are applicable for tax years beginning after December 31, 2024, and ending on or before December 31, 2028. As with the House bill, the deduction is available to taxpayers even if they do not itemize deductions.

KPMG observation

The new deduction for tips in both versions will be included as a deduction in computing federal taxable income after the computation of AGI. The deduction will likely flow through to states that begin state tax computations with federal taxable income. States starting their income tax calculation with AGI could, of course, choose to conform to the tip deduction, and several states have independently considered state legislation to allow a state deduction for tip income.

No tax on overtime

Current law

Current law treats overtime pay as ordinary income.

House bill (sec. 110102)

The measure introduces a deduction for qualified overtime compensation. The bill defines “qualified overtime compensation” as overtime compensation paid to an individual required under the Fair Labor Standards Act of 1938 that exceeds the regular rate of pay at which the individual is employed. Overtime deductions for employees are allowed only if the amount of overtime is reported separately on Form W-2; currently, overtime pay is included with regular pay in Box 1 on Form W-2. Any qualified tip income (see “No Tax on Tips” above) is ineligible for the deduction. Like qualified tips, the deduction for qualified overtime compensation will also be unavailable for any “highly compensated employee” or individuals lacking SSNs. For federal purposes, the qualified overtime compensation deduction may be taken in addition to the standard deduction for taxpayers who do not itemize deductions. The deduction will be available for tax years beginning after December 31, 2024, and ending on or before December 31, 2028.

Senate bill enacted as OBBBA (sec. 70202)

The enacted Senate bill is the same as the House version except that the deduction for qualified overtime compensation is limited to $12,500 per year ($25,000 in the case of a joint return). In addition, the bill phases out the deduction by $100 for each $1,000 of modified AGI exceeding $300,000 for married taxpayers filing jointly and $150,000 for all other taxpayers. It is applicable to tax years beginning after December 31, 2024, and ending prior to January 1, 2029; the Senate version contains a transition provision to allow those persons responsible for reporting overtime pay to approximate a separate accounting of that amount for tax year 2025.

KPMG observation

Like the qualified tip deduction, the overtime deduction will be taken in computing federal taxable income after the calculation of AGI. As such, the deduction will likely flow through to states that begin state tax computations with federal taxable income, and other states could choose to conform to the overtime deduction. The Secretary is also required to modify withholding tables to account for the deduction; to the extent that a state bases its withholding requirements on federal withholding tables, this may result in under-withholding of state tax if the state does not conform to federal treatment of overtime compensation.

Enhanced deduction for seniors

Current law

As noted, current law provides an additional standard deduction allowance of $1,000 for each taxpayer over age 65.

House bill (sec. 110103)

The bill adds a deduction in section 63(f) of the Code for a bonus additional amount for all individuals aged 65 or more at the close of the tax year, for tax years beginning after December 31, 2024, and ending before January 1, 2029. The "senior bonus amount" will be $4,000 per eligible individual and will phase out at a rate of 4% of modified AGI exceeding $150,000 for married filing joint returns and over $75,000 for all other taxpayers. For this purpose, modified AGI is equal to AGI plus certain foreign income exclusions. The additional deduction for seniors will be treated much like the current additional standard deduction for those over age 65, but it will also be available to qualifying persons who itemize their deductions in the amount allowed after considering the phase-out.

Senate bill enacted as OBBBA (sec. 70103)

The enacted Senate bill added a similar additional deduction for taxpayers aged 65 or older at the end of the tax year in section 151(d)(5) of the Code. The additional deduction phases out over the same range as the House bill, but the phase-out rate is 6% of the modified AGI exceeding the threshold. As with the House version, the additional deduction is allowed for tax years beginning after December 31, 2024, and before January 1, 2029, and the taxpayer's SSN must be included on the return to qualify for the additional deduction.

KPMG observation

Despite the different placement in the Code, the impact of the provisions on state income taxes would seem to be similar. Presuming the states maintain their current conformity, the senior bonus amount appears to be available to all taxpayers meeting the age and income limits in states which start the state tax calculation with federal taxable income (five). There are about five additional states that choose to tie to the federal standard deduction amounts. Otherwise, states generally begin with federal AGI and establish their own standard deduction levels; as a result, the senior bonus amount will not flow through to most states without state legislation.

No tax on car loan interest

Current law

Present law does not allow the deduction of interest incurred on automobile purchases for individuals.

House bill (sec. 110104)

The House bill adds a new deduction of interest payments by individuals relating to the purchase of a qualified passenger vehicle. The deduction for qualified vehicle interest is allowed in computing AGI and is effective for tax years beginning after December 31, 2024, and ending prior to January 1, 2029. A qualified vehicle is limited to any vehicle designed for use on the public streets and roads, including all-terrain vehicles, trailers, and campers, provided that final assembly of the vehicle occurs in the U.S. A qualified passenger vehicle loan does not include loans for purchases of a fleet of vehicles, a commercial vehicle, any lease financing, and certain other vehicle-related loans not involving the purchase of a vehicle for use on public streets and roads. The deductible interest on a qualified loan is limited to $10,000 annually, and the $10,000 cap is reduced by 20% of the amount by which the taxpayer's modified AGI (as defined) exceeds $100,000 ($200,000 for married filing joint returns). Finally, the bill adds a new Code section (6050AA) providing that any person engaged in a trade or business who receives at least $600 on a specified passenger vehicle loan must file a report containing information required by Treasury to the individual making the payments, as well as the Secretary of Treasury.

Senate bill enacted as OBBBA (sec. 70203)

The enacted Senate bill added a new deduction of interest payments by individuals relating to the purchase of a qualified passenger vehicle. The deduction for qualified vehicle interest is effective for tax years beginning after December 31, 2024, and ending prior to January 1, 2029. The deduction is limited to $10,000 and subject to a phase out, much like the House bill. The Senate version differs from the House version in several respects: (a) the definition of qualified passenger vehicle is limited to those for which the original use begins with the taxpayer; (b) the term qualified passenger vehicle is limited to vehicles with a gross vehicle weight of less than 14,000 pounds; and (c) there are no provisions for including all-terrain vehicles, trailers or campers. Additionally, unlike the House version, the Senate bill specifies the deduction is included after the computation of AGI in computing taxable income, like the QBI and proposed tip income and overtime compensation deductions. As with the House version, the Senate bill also imposed a reporting obligation on recipients of the interest payments.

KPMG observation

In the House version, the qualified vehicle interest is allowed as a deduction in computing adjusted gross income (AGI), and as such, would have flowed through to the large majority of states as most states start with AGI in computing state taxable income, presuming they do not require the addback of the deduction. The enacted Senate version, on the other hand, will flow through only to the five states conforming to federal taxable income, absent any independent state action to conform.

Non-itemized charitable deduction

Current law

Present law permits an income tax deduction for charitable contributions, subject to certain limitations based on the type of taxpayer, the property donated, and the recipient organization. The charitable contribution deduction is available only to taxpayers who elect to itemize their deductions. In tax year 2021, taxpayers who did not itemize deductions were allowed a limited charitable deduction of $600 or $300, depending on their filing status.

House bill (sec. 110112)

The House bill reinstates the policy in place for tax year 2021 for tax years beginning after December 31, 2024, and before January 1, 2029, but it reduces the dollar amounts to $300 for a married taxpayers filing jointly, and $150 for all other taxpayers. This deduction applies only to contributions made in cash and does not apply to a contribution to certain private foundations or any donor advised fund. The deduction is allowed even if a taxpayer chooses not to itemize their deductions.

Senate bill enacted as OBBBA (sec. 70424)

The enacted Senate bill also resurrects the charitable deduction for taxpayers that elect not to itemize their deductions, but it increases the amount of the deduction to $2,000 for married filing joint taxpayers and $1,000 for all other taxpayers. The bill also makes the deduction permanent effective for tax years beginning after December 31, 2025. Other restrictions regarding only cash contributions and allowable donations are the same as in the House bill.

KPMG observation

The deduction is applied after the calculation of AGI, like the current QBI deduction. As such, it will likely flow through to only the handful of states that begin their taxable income computations with federal taxable income, absent further state conformity changes to adopt a similar provision.

Changes to health savings accounts (HSAs)

Current law

Present law allows certain taxpayers to contribute amounts of a tax-preferred vehicle known as a Health Savings Allowance (HSA). Qualifying individuals may make deductible contributions to HSAs, and amounts contributed by employers on behalf of an employee are not includible in income. Earnings in the HSA and disbursements from the HSA for unreimbursed medical expenses are not taxable. There are limits on the individuals eligible to participate in HSAs as well as on the amounts of contributions as well as certain other restrictions.

House bill (secs. 110201-110214)

The House bill includes a variety of changes to expand eligibility for HSAs as well as the allowed use of funds in HSAs. The bill permits contributions from individuals who are currently ineligible (including Medicare-eligible individuals enrolled only in Medicare Part A, individuals with primary care service arrangements, individuals with bronze or catastrophic individual insurance plans, and individuals with access to on-site employee clinics); increases the cap on contributions to an HSA; permits amounts in an HSA to be spent on sports and fitness expenses paid for the purposes of participating in physical activity; and alters certain provisions affecting married spouses with HSAs and individuals with both HSAs and Flexible Spending Arrangements (FSAs).

Senate bill enacted as OBBBA (sec. 71304)

The enacted Senate bill contains two provisions from the House bill that expanded the types of arrangements in which HSAs may be used.

KPMG observation

In most cases, contributions to HSAs by individuals or employers as well as disbursements from HSAs are not subject to federal income tax. As such, the changes will likely flow through to states unless the state has adopted legislation to the contrary.

Child and dependent care tax credit

Current law

Taxpayers with one or more qualifying individuals are allowed a credit for certain employment-related expenses related to child and dependent care. The allowable qualifying expenses are limited to $3,000 for one qualifying individual and $6,000 for two or more qualifying individuals. The maximum rate of the credit is 35%, which declines as AGI increases to a level of 20% for AGI above $43,000 ($86,000 on joint returns).

House bill

The House bill does not contain changes to this credit.

Senate bill enacted as OBBBA (sec. 70405)

The enacted Senate bill increases the maximum credit rate to 50%, which is reduced by 1 percentage point for each $2,000 of AGI over $15,000 to a minimum of 35% at an AGI of $43,000 ($86,000 on joint returns). The rate of the credit remains at 35% until AGI reaches $75,000 ($150,000 on joint returns at which point it is further reduced at a rate of 1 percentage point for each $2,000 of AGI ($4,000 for joint returns) until it reaches a minimum level of 20% at $105,000 AGI ($210,000 AGI for joint returns). In no event will the credit be less than 20% of allowable expenses. The provision is effective for tax years beginning after December 31, 2025.

KPMG observation

About 30 states with a broad-based income tax also provide a child and dependent care credit, and it is commonly tied in some manner to the federal credit. In some cases, the state credit is a percentage of the federal credit allowed, and in other cases, it is based on the federally allowed expenses with a rate set independently by the state. The impact on state income taxes will depend on the manner in which they conform to the federal credit.

Charitable contributions made by individuals

Current law

Individuals who elect to itemize their deductions are allowed to deduct a portion of their qualified contributions, with the limitation based on the type of contribution made.

House bill

The House bill does not propose a similar change to charitable contributions.

Senate bill enacted as OBBBA (sec. 70425)

The enacted Senate bill amended Code section 170(b)(1) to permit an individual to claim a deduction for charitable contributions only if, and to the extent that, the aggregate of such contributions exceeds 0.5% of the individual's adjusted gross income. Total deductions for charitable contributions by an individual will continue to be subject to the current limitations (which depend upon the type of contribution and recipient), with the excess (as well as the contributions disallowed by the 0.5% floor) carried forward up to five years. However, if the individual's aggregate contributions do not result in carryover, there will be no carryover of contributions disallowed due to the 0.5% floor. The change will apply to tax years beginning after December 31, 2025.

KPMG observation

About 30 states with a broad-based income tax allow itemized deductions, and in most cases, the deductions are tied to federal definitions used on the federal return. In most cases, the state deduction is tied to the amount allowed on the federal return, but in some cases, the link is only to the definition of what may be claimed as a deduction. Thus, the impact of the charitable contribution limit will depend on the language in the state code.

Business tax provisions

The provisions in both the House and Senate bills that potentially have significant state tax implications are the changes to the provisions originally enacted as part of the TCJA, including the expensing of certain assets, the deduction of certain research and experimental (R&E) expenses, and modifications to the limitation on the deductibility of interest expense. The House bill would make temporary taxpayer-favorable changes to each of these provisions; the Senate bill, for the large part, proposes to make similar taxpayer-favorable changes permanent. In addition, both the House and Senate measures would amend the deductions associated with global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII) and revise aspects of base erosion and anti-abuse tax (BEAT) regime. Each of these changes, as enacted, will have direct consequences for state corporate income taxes as well as corporate taxpayers, as noted below.

Expensing certain assets

Current law

Under current law, the federal bonus depreciation deduction codified in Code section 168(k) is phasing out for most assets by 20 percentage points each year, until it phases out for property placed in service after December 31, 2026.

House bill (secs. 111001 and 111101)

The House bill would reinstate 100% bonus depreciation (i.e., a first-year depreciation deduction equal to 100% of the basis in the asset) for most eligible assets acquired after January 19, 2025, and placed in service after that date and prior to January 1, 2030 (January 1, 2031, for certain longer production property and certain aircraft). The bill also increases the availability of expensing for certain small businesses under Code section 179. The bill would also create a new category of assets eligible for immediate expensing. This deduction would be added to the Code as new section 168(n) and would apply to "qualified production property" placed in service before January 1, 2033. Qualified production property consists of nonresidential real property used in the production of tangible property in the United States and not otherwise eligible for bonus depreciation.

Senate bill enacted as OBBBA (secs. 70301, 70306, and 70307)

In contrast to the temporary extension of bonus depreciation in the House bill, the enacted Senate bill made 100% bonus depreciation permanent for eligible assets acquired after January 19, 2025. The bill also increased the small business expensing provisions found in Code section 179 in a manner identical to the House bill. Additionally, it added new section 168(n) to the Code to allow immediate expensing for these assets, like the House provisions, but it requires that the qualified production property be placed in service prior to January 1, 2031, and added certain technical requirements on previous ownership of the property.

KPMG observation

The increased expensing allowances will flow through to the state corporate income tax base in rolling conformity states unless the state acts to decouple or has already decoupled from bonus depreciation or section 179 expensing. There will be no impact in static conformity states unless the state acts to adopt the change.

Approximately 30 states have chosen not to conform to the existing bonus depreciation regime, largely because of the negative revenue impact. The revenue implications of the reinstated 100% federal expensing provisions could be substantial for states that choose to conform. The full expensing system is accomplished by amending Code section 168(k), meaning there are likely to be minimal compliance-related issues emanating from the change beyond those experienced currently in states that do not conform to bonus depreciation.

The new deduction for qualified production property comes through the enactment of a new subsection within Code section 168, meaning those states that decouple from federal bonus depreciation by decoupling from Code section 168(k) may not automatically decouple and may require state legislative action to maintain their nonconformity. Conversely, states that have in some manner conformed specifically to section 168(k) may need further legislative action to deal with the new section 168(n).

Treatment of R&E expenses

Current law

For tax years prior to January 1, 2022, taxpayers were generally allowed to deduct R&E expenditures immediately rather than requiring that they be capitalized and amortized over a period of years under section 174 of the Code. Beginning in 2022, taxpayers were required to capitalize and amortize their domestic R&E expenditures over five years and foreign R&E expenditures over 15 years.

House bill (sec. 111002)

The House proposal would temporarily reinstate the treatment of these expenses that was in place prior to 2022 by allowing immediate expensing of qualified expenditures for expenses incurred in tax years beginning after December 31, 2024, and before January 1, 2030. However, the proposed legislation would continue to require the capitalization of non-U.S. R&E expenditures and the amortization of those expenses over 15 years.

Senate bill enacted as OBBBA (sec. 70302)

The enacted Senate bill made immediate expensing of domestic R&E permanent, effective for tax years beginning after December 31, 2024. Like the House bill, the Senate bill also retains the requirements to capitalize non-U.S. R&E expenditures and amortize these expenditures over 15 years.

KPMG observation

State conformity to this change (whether temporary or permanent) depends on whether states automatically conform to changes to the Code enacted by Congress. A handful of states have enacted state-specific rules independent of section 174 allowing or requiring taxpayers to immediately deduct all R&E expenditures (domestic and non-U.S.). In those states, the proposed legislation may have little or no effect. Note that the proposed change only provides preferential treatment of *domestic* R&E expenditures. The combination of varied conformity and state-specific rules may create administrative burdens for taxpayers, including state-specific tracking of R&E amortization.

In addition to the administrative complexities, the preferential treatment granted to only domestic R&E expenditures may raise questions about whether state conformity could violate the Commerce Clause of the U.S. Constitution. In *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, 505 U.S. 71 (1992), the U.S. Supreme Court held that Iowa's corporate income tax unconstitutionally discriminated against non-U.S. commerce because it "impose[d] a burden on non-U.S. subsidiaries that it [did] not impose on domestic subsidiaries." Specifically, through its conformity to the Code, Iowa disallowed a deduction for dividends received from *non-U.S.* subsidiaries but allowed a deduction for dividends received from similarly-situated *domestic* subsidiaries. State conformity to preferential treatment of domestic R&E activities could be found to have a similar discriminatory effect.

Interest deductibility

Current law

Under current law, section 163(j) disallows the deduction of net interest expense (excluding floor plan financing interest) to the extent it exceeds 30% of a taxpayer's adjusted taxable income (ATI). Interest amounts subject to the limitation can be carried forward indefinitely. There is an exception from the limitation for taxpayers with an average of $25 million or less in gross receipts over the three prior years, certain real property businesses, farming businesses, regulated public utilities, and electric cooperatives. ATI is as the taxable income of the taxpayer computed without regard to any business interest expense or business interest income, the qualified business income deduction for certain passthrough entities, and net operating losses. For tax years beginning before January 1, 2022, ATI was also determined before any deduction for depreciation, amortization or depletion, but for tax years beginning on or after January 1, 2022, the calculation of ATI includes deductions for those items.

House bill (sec. 111003)

The bill would temporarily reinstate the addback of depreciation, amortization and depletion to the computation of ATI, effectively reducing the amount of interest not allowed to be deducted under section 163(j). This change would apply to tax years beginning after December 31, 2024, and before January 1, 2030

Senate bill enacted as OBBBA (secs. 70341-70342)

The enacted Senate bill permanently reinstated the addback of depreciation, amortization, and depletion to the computation of ATI for tax years beginning after December 31, 2024. A new provision of the Senate bill also applies the section 163(j) limitation first to capitalized interest and then to other interest, effective for tax years beginning after December 31, 2025. Additionally, the Senate bill makes clear that the definition of "adjusted taxable income" excludes amounts included in gross income under sections 951(a), 951A(a), and 78.

KPMG observation

Currently, most states conform to the interest limitation. Notwithstanding conformity with section 163(j), there could be certain complexities—which have existed since the initial enactment of the interest limitations rules—because of the different filing methods at the state and federal level. The federal limitation would generally be determined at the consolidated group level. Many states, however, do not follow the consolidated group method of filing and require taxpayers to file separate entity returns or as a member of a state unitary combined group. To deal with the different composition of the “taxpayer” at the state level, states often require individual consolidated group members to recompute federal taxable income as if the member had filed separately, rather than consolidated, at the federal level. In addition, over 20 states currently have rules that disallow the deduction of interest or intangible-related interest paid to related parties. Coordinating the state and federal rules in these states often presents complications. While taxpayers have adapted to these differences between the federal and state applications of section 163(j), the changes to the calculation of ATI and application of the limitation first to capitalized interest these measures could create complications in states that do not immediately conform (e.g., those states could have different limitation amounts and different carryforward amounts than they have for federal purposes). The provision in the Senate bill coordinating the section 163(j) limitation with capitalized interest may prevent taxpayers from shielding some interest from the 163(j) limitation by capitalizing such interest. To the extent states do not conform to this provision, there may be state opportunities to deduct additional interest not allowed for federal purposes.

Global low-taxed intangible income (GILTI) or net CFC tested income (NCTI)

Current law

Under Code section 951A, U.S. shareholders of controlled foreign corporations (CFCs) must include in federal taxable income an amount computed by reference to the activities of their CFCs. This income inclusion, referred to as GILTI, is computed by taking the taxable income of the CFC determined using rules similar to those applicable to domestic corporate taxpayers less an amount based on 10% of the CFC’s adjusted basis in its tangible assets – termed Qualified Business Asset Income (QBAI). The income included under this provision by the U.S. Shareholder (i.e., the domestic parent) is eligible for a potential deduction under section 250 equal to 50% (37.5% for tax years beginning after December 31, 2025) of the U.S. Shareholder’s GILTI inclusion (subject to limitation when GILTI exceeds the U.S. Shareholder’s taxable income). The section 250 deduction limits the effective U.S. income tax rate on GILTI to 10.5% (13.125% in tax year 2026 and beyond). Certain foreign tax credits are allowed at the federal level, but there is no similar benefit at the state level because states do not have a foreign tax credit equivalent.

House bill (sec. 111004)

The bill would replace the scheduled reduction of the section 250 deduction from 50% to 37.5% of GILTI with a permanent reduction to 49.2% and exclude certain income generated from services performed in the U.S. Virgin Islands from the computation of a taxpayer’s GILTI inclusion amount.

Senate bill enacted as OBBBA (secs. 70321-70323)

Like the House bill, the enacted Senate bill also makes the section 250 deduction permanent but changes the deduction percentage to 40%. The Senate bill also changes the computation of GILTI by removing a reduction for net deemed tangible income return (NDTIR), potentially increasing the amount of GILTI and correspondingly increasing the amount subject to the section 250 deduction. Once the NDTIR deduction is removed, GILTI becomes equal to Net CFC Tested Income (NCTI), and the bill removes references to

GILTI and replaces them with references to NCTI. Additional international provisions unique to the Senate Finance bill include provisions to change the computation of the foreign tax credit with respect to NCTI. The changes are effective for tax years beginning after December 31, 2025.

KPMG observation

A substantial majority of states currently, either through legislative enactment or rolling conformity, include some portion of GILTI in their state taxable income base. Only about 10 of these, however, follow the federal approach of including the full amount of GILTI in gross income and allowing the 50% deduction under section 250. The remainder have taken different approaches. Several treat GILTI as a foreign dividend and extend the state dividends-received deduction to GILTI. Others exclude GILTI from income, but disallow expenses related to the generation of GILTI as a deduction or include a relatively small portion of GILTI (e.g., 5%) in income as a proxy for expenses related to otherwise excluded income. In a few states, section 951A is simply not adopted or is not operational.

Given that most states have established their own statutory regime for the treatment of GILTI or NCTI, the direct impact of the proposed change should be modest. Rolling conformity states that follow the federal approach to GILTI inclusion will see some reduction in revenues from what would have occurred if the current law reduction in the section 250 deduction had taken place. In static conformity states that follow the federal approach to GILTI, there will be a mismatch with the federal rules for the Code section 250 deduction if the state does not update its conformity. Because the Senate bill was adopted, taxpayers will also need to navigate additional complexities in determining whether a state follows the updated approach to computing NCTI. The changes to the computation of the foreign tax credit will have a minimal impact on the states, as states do not generally allow a foreign tax credit. This variance among the states could create compliance difficulties for taxpayers with significant operations in a mixture of rolling and static conformity states.

Foreign-derived intangible income (FDII) or foreign-derived eligible income (FIDDEI)

Current law

The TCJA included a new deduction for certain types of foreign-source income under Code section 250 (the same section containing the deduction for GILTI). This provision allows a U.S. corporation a deduction equal to 37.5% of its FDII. Starting in 2026, the deduction percentage is slated to be reduced to 21.875%. In simple terms, the FDII deduction is computed by considering income from foreign sales (broadly defined) in excess of an assumed 10% return on tangible assets and allowing a deduction for the specified percentage thereof.

House bill (sec. 111004)

The bill would replace the reduction of the FDII deduction to 21.875% that is currently scheduled to occur for tax years beginning after December 31, 2025, with a permanent deduction of 36.5%.

Senate bill enacted as OBBBA (secs. 70321-70323)

The enacted Senate bill reduced the FDII deduction to 33.34%. Additionally, the bill will change the computation of FDII in several ways, effective for amounts received or accrued after June 16, 2025. Due to these changes, the bill renamed FDII to foreign-derived deduction eligible income (FDDEI). For further discussion of these changes, read the International report located on KPMG's dedicated webpage.

KPMG observation

In terms of state conformity to FDII, about 30 states allow the FDII deduction in some form. States allowing an FDII deduction include both rolling and static conformity states. The impact of the new law at the state level will be similar to the changes in GILTI proposed in the House and Senate bills. In both rolling and static conformity states that require a separate company computation of the FDII deduction, differences may also exist from the deduction computed for federal purposes under the consolidated return regulations. Because the Senate bill was adopted, the differences in static conformity states between the computation of FDII and the updated federal FDDEI amount would increase the complexity facing taxpayers.

Revising the base erosion and anti-abuse tax (BEAT)

Current law

The TCJA established a new minimum tax regime designed to ensure that U.S. multinational companies were not excessively using deductions against foreign activity to unduly reduce U.S. taxable income. BEAT is, for the large part, applicable to larger multinational operations.

House bill (sec. 111005)

The bill would make changes to the BEAT regime by eliminating a rate increase scheduled for tax years beginning after 2025 and altering somewhat the application of credits to the determination of a taxpayer's BEAT liability.

Senate bill enacted as OBBBA (sec. 70331)

The enacted Senate bill is similar to the House bill, except that the BEAT rate is increased from 10% to 10.5% for tax years beginning after December 31, 2025.

KPMG observation

The BEAT is structured as a separate minimum tax that currently has almost no direct effect on the states because it does not generally affect the calculation of federal taxable income, the starting point for state taxable income in most state corporate income taxes. Only Alaska currently taxes BEAT; it requires taxpayers to pay tax on BEAT apportioned to Alaska using the taxpayer's corporate income tax apportionment percentage. As a separate minimum tax, changes in BEAT are likely to have a minimal impact on the states.

Enforcement of remedies against unfair foreign taxes

Current law

Over time, Congress has enacted a number of measures to deal with international commerce and ensure that taxpayers, both foreign and domestic, are appropriately tax on their activities and income in the U.S. The One Big, Beautiful Bill takes this a step further by seeking to impose a penalty on countries the U.S. government deems to be imposing discriminatory taxes on U.S. companies doing business there.

House bill (sec. 1120228)

The bill proposes the addition of a new Code section 899 that would increase the rate of various taxes on taxpayers from countries that employ measures that are discriminatory foreign taxes, as defined. For most taxpayers, these changes would take effect in their 2026 tax year.

Senate bill enacted as OBBBA

The Senate bill does not contain a similar provision. The provision was deleted from the Senate bill at the request of the Administration. Per the Administration, it will now address the issue of unfair foreign taxes through negotiations.

Creation of 1% floor for charitable contribution deductions

Current law

Under present law, charitable contributions by a corporate taxpayer that exceed 10% of the entity's taxable income may not be deducted as an expense. Disallowed deductions may be carried forward for five years.

House bill (sec. 112027)

The bill would add a new provision requiring that charitable contributions by a business must exceed 1% of the taxpayer's taxable income to be deductible. The legislation retains the 10% taxable income cap on those deductions.

Senate bill enacted as OBBBA (sec. 70426)

The enacted Senate version made similar changes to the charitable contribution deduction as the House bill.

KPMG observation

Like other proposed changes, state conformity to the 1% floor will depend on each state's method of conforming to the Code (i.e., rolling or static conformity). For states that do not conform, taxpayers may have charitable contribution deductions and carryforwards that differ in some states from their federal amounts.

Modification of P.L. 86-272

Current law

In 1959, Congress passed a measure, known commonly as P.L. 86-272, that restricted the ability of states to tax certain interstate commerce. The law prohibits a state or locality from imposing a net income tax on a company whose only activity in the states is the solicitation of sales of tangible personal property, if the orders are sent outside the state for approval and the goods will be shipped to the purchaser from outside the state.

House bill (sec. 70301)

The House bill includes a provision would modify P.L. 86-272 to specify that activities ancillary to the solicitation of sales of tangible personal property will be considered as "protected" even if those activities serve some other “independently valuable business function apart from solicitation” of sales. Questions may be raised regarding the budgetary impact requirement for federal budget reconciliation legislation. This language is not in the federal tax provisions of the bill. It was added by the House Judiciary Committee which has jurisdiction over interstate commerce in the House.

Senate bill enacted as OBBBA

The Senate bill does not contain a similar provision. The provision is not part of the new law.

Moratorium on the regulation of artificial intelligence systems

Current law

There is currently no comparable provision in federal law.

House bill (sec. 43201)

The House bill contains a provision that would limit state and local jurisdictions from imposing certain laws and regulations, including taxes, on artificial intelligence models, artificial intelligence systems, and automated decision systems (as defined in the provision) for a period of 10 years after enactment. Under the provision, states could impose a tax on these items only if the tax is generally applied to models and systems other than artificial intelligence models and systems that provide comparable functions.

Senate bill enacted as OBBBA

The Senate bill does not contain a provision addressing state and local regulation of artificial intelligence models and systems. The provision is not part of the new law.

Federal excise tax provisions

Reduction of excise tax on certain devices under the National Firearms Act

Current law

Importers, manufacturers, and dealers in firearms are required to pay an excise tax on the transfer and making of firearms, pursuant to the National Firearms Act (NFA), as codified in chapter 53 of the Code. An excise tax of $200 is generally imposed on each firearm that is transferred (“transfer tax”) or made (“making tax”), except that the transfer tax is reduced to $5 for certain weapons classified as ”any other weapon”. Certain transfers are exempted from the transfer tax, such as transfers to the United States and its agencies. Manufacturers that are qualified under the NFA are not required to pay the making tax. The term “firearm” includes (1) certain shotguns; (2) certain modified shotguns; (3) certain rifles; (4) certain modified rifles; (5) any other weapon; (6) a machine gun; (7) a silencer; and (8) a destructive device. The term “any other weapon” is broadly defined to include a weapon or device capable of being concealed on the person from which a shot can be discharged through the energy of an explosive and a pistol or revolver having a barrel with a smooth bore designed or redesigned to fire a fixed shotgun shell but excludes pistols or revolvers having a rifled bore. Current law also requires all firearms to be registered with the federal government. Manufacturers, producers, and importers of certain devices are also liable for an excise tax (“percentage tax”) on the sale of such devices at a rate of 10 percent (for pistols and revolvers) and 11 percent (for firearms other than pistols and revolvers), shells, and cartridges). However, the percentage tax does not apply to the sale of any firearm on which the transfer tax has been paid.

House bill (sec. 112029)

The proposal would (1) remove the term "destructive device" from the definition of firearm; (2) reduce the transfer tax on "any other weapon" from $200 to $5; and (3) reduce the transfer tax on silencers from $200 to $0 for each silencer transferred and from $200 to $0 for each silencer made. The proposal is effective for calendar quarters beginning more than 90 days after the date of the enactment of this Act.

Senate bill enacted as OBBBA (sec. 70436)

The enacted Senate bill will amend both the making and the transfer taxes in the following manner: (1) the rate of tax for any machinegun or any destructive device is $200, and (2) the rate of tax for any firearm not described in paragraph (1) (i.e., any firearm that is not a machine gun or destructive device) is $0. The Senate bill also provides that any firearm subject to the transfer tax is exempt from the percentage tax, and any firearm described in the transfer tax provision with a rate of $0 is deemed to be a firearm on which the transfer fax has been paid and is also exempt from the percentage tax. The bill is effective for calendar quarters beginning more than 90 days after the date of the enactment, July 4, 2025.

KPMG observation

The Senate version of the bill is considerably broader in terms of the types of firearms affected by the reduction in rates.

Allow for payments to certain individuals who dye fuel

Current law

In general, section 4081 imposes an excise tax on the removal of diesel fuel and kerosene from any terminal, except that no tax is imposed on diesel fuel and kerosene that is destined for a nontaxable use and is indelibly dyed ("dyed fuel"). Tax may be imposed on the same gallon of diesel fuel or kerosene should multiple taxable events occur. If any person pays an excise tax on the removal of diesel fuel or kerosene and can establish that a prior tax was paid (and not credited or refunded), the tax paid by such person is treated as an overpayment. However, if a person removes dyed fuel from a terminal on which tax was previously paid (and not credited or refunded), the tax previously paid is not treated as an overpayment, and there is no mechanism by which the person can claim a refund of such tax paid.

House bill

This provision is not included in the House bill.

Senate bill enacted as OBBBA (sec. 70525)

The enacted Senate bill added new section 6435 to the Code. It will treat any excise tax paid on diesel fuel or kerosene that is later indelibly dyed and removed from a terminal as an overpayment and eligible for a claim of refund or credit. If an excessive claim for credit or refund is made under this section, a 200% penalty may be assessed. The bill applies to eligible indelibly dyed diesel fuel or kerosene removed on or after the date that is 180 days after the date of enactment of this section on July 4, 2025.

KPMG observation

The Senate bill introduced a new provision that allows for excise tax refunds on diesel fuel or kerosene that is subjected to tax and then later indelibly dyed for nontaxable use. In so doing, it addresses a gap in current law where no refund mechanism exists for previously taxed dyed fuel. The bill includes a stringent 200% penalty for excessive claims, ensuring compliance and discouraging abuse.

Permanent increase in limitation on cover over of tax on distilled spirits

Current law

Under current law, certain distilled spirits that are produced in Puerto Rico or the U.S. Virgin Islands (USVI) and then brought into the U.S. are subject to federal excise taxes. In addition, certain amounts of the excise taxes collected on such products are "covered over" (i.e., paid by U.S. Treasury to the Puerto Rico or USVI Treasury). There are some limits on the cover over, and the limitation has varied over time.

House bill

This provision is not included in the House bill.

Senate bill enacted as OBBBA (sec. 70427)

The enacted Senate bill increases the cover over limitation from $10.50 per proof gallon to $13.25 per proof gallon, with no expiration date on the increased cover over limitation. The bill applies to distilled spirits brought into the United States after December 31, 2025.

KPMG final observations

Congress approved substantial federal tax changes in 2025 with the enactment of the OBBBA. From a structural standpoint, the changes envisioned in the individual income tax would potentially have the most significant impact on the states. The extension of TCJA individual tax provisions; additional deductions for tips, overtime pay, and car loan interest; and an additional deduction for seniors could have a significant impact on the yield and distribution of the personal income tax, depending on how a state responds. As it relates to the proposed business tax provisions, the impact would seem to be more modest given that many changes are focused on extending the TCJA provisions, with some modifications, which many states have already addressed. There is likely to be ongoing complexity as states and taxpayers continue to navigate the challenges posed by different filing methods and current state law provisions in such areas as interest limitations, expensing, foreign source income, and the like. In addition, further compliance challenges could arise if there is a time lag between federal enactment and any corresponding state legislative action to conform or decline from doing so.

In evaluating how states might respond to the proposed changes, state taxpayers would be well-advised to keep a few fundamentals in mind. First, the reaction to federal tax changes by individual states may largely be driven by the fiscal impact of conformity to the revised Code. State balanced budget requirements could have a significant influence on whether and to what extent states conform to the federal changes. Simply put, many states do not have the ability to run a deficit under their typical one or two-year state budget cycles. While the additional complexity and compliance challenges associated with nonconformity will be evaluated, the fiscal concerns could well be paramount in many states. Ongoing uncertainty regarding the level of federal funding to be provided to the states in the future could exacerbate these challenges. General economic uncertainty may also be a constraint for states. All these concerns could impact the ability or willingness of states to conform to federal changes that reduce state revenue.

Second, timing is everything. Because the bill, which has several provisions effective for the 2025 tax year, was signed into law after many state legislatures adjourned, those states will have limited ability to assess the fiscal and tax effect of the federal change and may not be able to address conformity until the legislature reconvenes in early 2026. The priority of the states is likely to be fashioning a response to the personal income tax changes. The delay caused by a mismatch between federal bill passage and state legislative session dates could lead to a significant disconnect between federal and state tax laws in the short-term. This potential timing gap would seem to place a priority on closely monitoring state legislation updating conformity statutes in late 2025 and early 2026.

Third, as with TCJA, there may be limited guidance available on the interactions between federal changes and existing state laws, along with a great variety in how different states choose to conform to these federal changes. In 2017 and 2018, states often tweaked their conformity to exclude or reduce the impact from TCJA provisions which had a large budgetary impact. Further, in states which did choose to conform, differences between state and federal filing positions still raised questions on how to compute certain items. If similar trends hold true in response to any 2025 tax legislation, taxpayers may lack clarity on how states tax certain items for a period.

Finally, there is no "one size fits all" state or state taxpayer response to federal tax reform. The federal changes will affect each state differently and will need to be carefully analyzed by state tax administrators and state legislators so that the state can effectively address these changes. The effect on each taxpayer will also vary widely and will depend on the taxpayer's particular situation, current state filing position, and industry.

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