M&A Tax Talk

The One Big Beautiful Bill Act: Tax planning considerations for M&A transactions

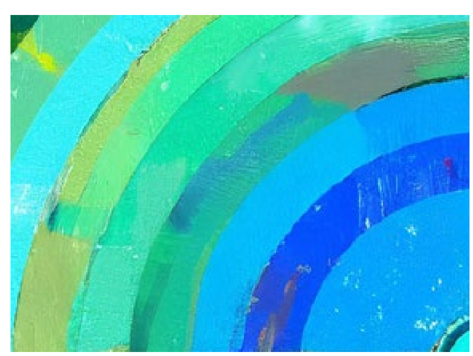
Introduction

On July 4, 2025, the budget reconciliation package commonly referred to as the "One Big Beautiful Bill Act" (the "OBBBA") was signed into law.[1] For a more detailed summary of the OBBBA provisions, see "A closer look: Inside the new tax law."

The OBBBA—a sweeping legislative package designed, in large part, to extend the expiring (or already expired) provisions of the 2017 Tax Cuts and Jobs Act (the "TCJA") and deliver additional tax relief for individuals and businesses—contains several significant changes to U.S. federal income tax law that should be considered by buyers and sellers in M&A transactions. These include changes related to: (1) bonus depreciation under section 168(k); (2) research and experimental ("R&E") expenditures under section 174; (3) business interest expense under section 163(j); (4) limitations on the deductibility of state and local taxes ("SALT"); (5) sales of qualified small business stock ("QSBS") under section 1202; (6) foreign tax credits; and (7) certain other provisions summarized at the end of this article.

Although many of these changes are generally beneficial, they may also result in more taxpayers being subject to the corporate alternative minimum tax (commonly referred to as the "book minimum tax") and the "base erosion and anti-abuse tax" ("BEAT") regimes.

From a state and local tax perspective, it remains unclear whether states will conform to the OBBBA's changes. Therefore, potential differences in state tax laws related to each of these topics should be considered.[2]



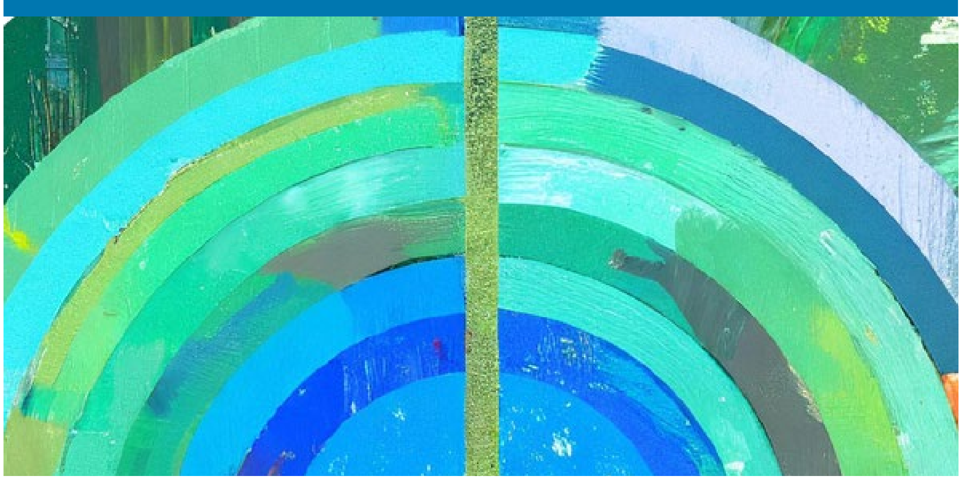
Bonus depreciation

The TCJA provided for immediate, 100 percent depreciation for qualified property (generally property with a modified accelerated cost recovery system ("MACRS") recovery period of 20 years or less) acquired and placed into service after September 27, 2017, and before January 1, 2023. The 100 percent depreciation was phased down for qualified property placed in service beginning on or after January 1, 2023 (*i.e.*, the bonus depreciation percentage was generally 80 percent, 60 percent, 40 percent and 20 percent, for qualified property acquired or placed in service in 2023, 2024, 2025 and 2026, respectively). For the portion of basis not deducted through bonus depreciation, and for all property placed in service after December 31, 2026, normal, pre-TCJA MACRS depreciation rules would have continued to apply.

The OBBBA reinstated and made permanent 100 percent depreciation of qualified property acquired and placed in service after January 19, 2025, as well as extended bonus depreciation to qualified sound productions. Taxpayers may elect to claim 40 percent (60 percent for certain property) bonus depreciation on qualified property placed in service during the taxpayer's first taxable year ending after January 19, 2025.[3]

M&A observations:

- **Structuring** – structuring transactions as taxable asset acquisitions (and other transactions treated as taxable asset acquisitions for tax purposes, such as purchases of S corporations and members of consolidated groups with a section 338(h)(10) election, purchases of limited liability companies that are disregarded for U.S. federal income tax purposes, and certain purchases of interests in partnerships) become potentially even more beneficial for buyers because of the ability to immediately deduct the portion of the consideration allocated to qualified property. Purchase price allocations in these transactions should also be analyzed carefully, as buyers may have a desire to allocate more purchase price to qualified property, which may not align with the desires of sellers in certain transactions. In addition, claiming bonus depreciation may result in lower tax basis being available to offset gain (and more gain being treated as ordinary, rather than capital) in a subsequent exit transaction, depending on the structure of such subsequent transaction.
- **Cash tax projections** – taxpayers should consider go-forward cash tax projections prior to deciding whether or not to claim bonus depreciation (*e.g.*, whether taxes are actually offset or whether net operating losses are created, etc.).
- **Due diligence** – consideration should be given as to whether a target company has accurately computed its depreciation deductions in historical periods.



R&E expenditures

Prior to the TCJA, R&E expenditures were generally deductible as paid or incurred. For R&E expenditures paid or incurred in taxable years beginning after December 31, 2021, taxpayers were required to capitalize and amortize R&E expenditures over five or 15 years, for domestic or foreign R&E expenditures, respectively. In some cases, that resulted in significant differences between the deduction of certain R&E expenditures for financial reporting purposes and tax purposes. This, coupled with the limitation on the utilization of post-2017 net operating losses to 80 percent of a company's taxable income, resulted in a number of companies that generated financial statement losses paying significant federal income taxes in 2022 through 2024. For background on the treatment of R&E Expenditures under the TCJA, see Section 174 in M&A Transactions.

The OBBBA provides that domestic R&E expenditures are deductible when paid or incurred for taxable years beginning after December 31, 2024. Alternatively, taxpayers may elect to capitalize and amortize such expenditures ratably over a period of no less than 60 months, beginning with the month in which the taxpayer first realizes benefits from the expenditures. In addition, a taxpayer that deducts R&E expenditures as paid or incurred may instead elect to capitalize some or all of such expenditures and amortize the capitalized costs ratably over ten years beginning in the taxable year such expenditures are paid or incurred. R&E expenditures attributable to research that is performed outside the U.S. continue to be capitalized and amortized over 15 years.[4]

The OBBBA also contains transition rules that generally permit taxpayers that incurred domestic R&E expenditures after December 31, 2021 and before January 1, 2025 to elect to accelerate the remaining deductions for such expenditures over a one-year period or equally (*i.e.*, 50/50) over a two-year period beginning with the first taxable year (notwithstanding the existence of a short taxable year as a result of an M&A transaction) beginning after December 31, 2024. If no election is made, the taxpayer continues to amortize its previously capitalized domestic R&E expenditures over the remaining portion of the five-year period.

In addition, taxpayers with average annual gross receipts of $31 million or less for the three tax years prior to its first tax year beginning after December 31, 2024 may elect to apply the OBBBA changes retroactively to taxable years beginning after December 31, 2021.

M&A observations:

- **Transaction value/purchase agreements** – capitalized pre-OBBBA R&E expenditures may now be seen as a valuable asset in M&A transactions for which sellers may expect to be compensated, particularly given the ability to accelerate these deductions and/or obtain an immediate refund for small business taxpayers. Purchase agreements should be carefully drafted (and, for transactions that have already signed, closely examined) to determine who is entitled to the tax benefits associated with such attributes.
- **Cash tax projections** – given the significant optionality for deducting R&E expenditures, projections should be prepared to consider a range of outcomes. Importantly, consideration should also be given to the interaction with section 163(j), discussed more broadly below, (*i.e.*, whether the write-off of capitalized R&E expenditures is equivalent to "amortization" for purposes of computing adjusted taxable income for the section 163(j) limitation on the deductibility of business interest expense) and section 382 limitations on loss utilization following an ownership change.
- **Due diligence** – the treatment of R&E expenditures under the TCJA was often an area of significant attention in tax diligence as the quality of documentation supporting taxpayers' cost allocations often varied significantly. This will continue to be true with respect to historical periods and with respect to R&E expenditures incurred outside of the U.S. going forward.

Interest expense

Very generally, section 163(j) limits a company's ability to deduct business interest expense each year to the sum of (i) the company's business interest income and (ii) 30 percent of the company's "adjusted taxable income" ("ATI"). Business interest expense in excess of this limitation is generally carried forward indefinitely and can be deducted in subsequent years to the extent the section 163(j) limitation in any such subsequent year exceeds the net business interest expense paid or accrued in such subsequent year.

Prior to the OBBBA:

- In taxable years beginning before January 1, 2022, ATI was computed *before* taking into account tax deductions for depreciation, amortization, and depletion (and thus roughly approximated U.S. EBITDA);[5] and
- In taxable years beginning on or *after* January 1, 2022, ATI was computed after taking into account tax deductions for depreciation, amortization and depletion (and thus roughly approximated U.S. EBIT).

One unexpected result of the EBIT-based limitation in effect prior to the OBBBA was that asset acquisitions (and other transactions treated as taxable asset acquisitions for tax purposes) generated significant depreciation and amortization deductions that had the effect of reducing the company's ability to deduct interest expense post-transaction.

The OBBBA made three principal changes to the section 163(j) limitation. First, for taxable years beginning after December 31, 2024, the OBBBA permanently reverted to the U.S. EBITDA-based definition of ATI that applied to tax years beginning before January 1, 2022.[6] This change will increase the ability of many companies to deduct interest expense.

The second principal change made by the OBBBA, however, would complicate the calculation of the section 163(j) limitation for many U.S.-based multinational companies that conduct business in foreign jurisdictions through controlled foreign corporations ("CFCs"). Very generally, under the so-called "subpart F" and "GILTI" regimes, U.S. shareholders who own 10 percent or more of the stock of a CFC are required to include certain income of such CFC in taxable income each year, regardless of whether that income is repatriated to the U.S. shareholder. Prior to the OBBBA, those U.S. shareholders were able to include a portion these items in the computation of ATI by relying on proposed section 163(j) regulations. Under the OBBBA, however, these types of items are excluded from the computation of ATI in tax years beginning after December 31, 2025. Whether this change results in incremental tax liability will depend on the facts and circumstances. As a result, more detailed tax modeling for these multinational companies may be required to ensure that these legislative changes are taken into account in investment models, go-forward cash tax projections, and decisions regarding the amount (and location) of debt financing.[7]

M&A observations:

- Investment models and broader debt financing analyses may need to be adjusted to take into account the greater interest expense deductions resulting from the U.S. EBITDA-based computation of ATI.
  - This change also may increase the value of section 163(j) carryforwards that may have otherwise been viewed as unusable, and may reduce the drag on the deductibility of interest expense caused by the depreciation/amortization of a basis step-up in asset acquisitions and similar transactions.
  - State tax debt-pushdown techniques in connection with debt-financed acquisitions should also continue to be considered.

M&A observations continued:

- For multinational organizations, the OBBBA's exclusion from ATI of certain income of foreign entities may also need to be taken into account in connection with other changes to the U.S. international tax regime described below. As noted above, the ultimate impact of these changes will depend on the facts and circumstances and will require detailed tax modeling analyses.

Deductibility of state and local taxes

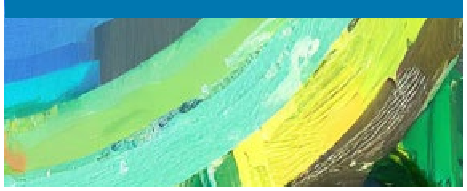
Prior to the enactment of the OBBBA, the TCJA limited an individual taxpayer's ability to deduct state and local taxes for U.S. federal income tax purposes to $10,000 per year (the "SALT Cap") for tax years 2018 through 2025. For individuals owning equity in businesses held by a pass-through entity (*e.g.*, partnerships or subchapter S corporations), this limitation also generally applied to such individuals' distributive share of state and local taxes arising from the conduct of the business conducted by the pass-through entity. To ameliorate the impact of the SALT Cap in these situations, many states adopted so-called "pass-through entity tax" ("PTET") regimes whereby an election could be made for state and local taxes to be paid at the pass-through entity level. Based on IRS guidance, the SALT Cap generally did not apply to individual taxpayers' distributive share of state and local PTET expense deducted by the pass-through entity.

Despite earlier proposals to the contrary, the OBBBA is silent on PTETs, and therefore generally preserves the viability of state PTET regimes. In addition, the OBBBA temporarily increases the SALT Cap to $40,000 for the 2025 tax year (increased to 101 percent of the prior year's SALT Cap per annum for 2026-2029), subject to a phase-down to $10,000 for high-income individuals.[8] After 2029, the SALT Cap reverts to the pre-OBBBA limitation of $10,000.

While the increase in the SALT Cap will provide relief to many individual taxpayers, the low cap and phase-down provisions will continue to make PTET elections attractive to many companies in pass-through form. As a result, the validity of PTET elections will continue to be a focus in the due diligence process in situations where the target business is held in pass-through form prior to an acquisition. Moreover, PTETs may offer an opportunity for significant tax savings for individual sellers in M&A transactions. For example, in many states, gain recognized by an aggregator entity or an S corporation that has made a PTET election may be taxed under PTET regimes (in which case, the resulting state tax would be deductible by the ultimate owners for federal income tax purposes), whereas the state tax on the same gain might not be deductible if recognized by the ultimate holders. It should be noted that each state with a PTET has its own rules and procedures, and compliance with each state's requirements is essential to effective planning. For additional background on PTETs, see State Pass-Through Entity Tax Elections: Strategic Tax Considerations in M&A Transactions.

M&A observations:

- **Diligence** – analysis regarding the validity of PTET elections (and any regulatory developments related to them) will continue to be important in future tax years in which the increased SALT Cap is in effect.
- **Structuring** – structuring certain dispositions to confirm that gains recognized by sellers of pass-through entities will be taxed under relevant PTET regimes so that the resulting state and local tax is not subject to the SALT Cap will similarly continue to be an important consideration.



Exclusion for gain on sales of Qualified Small Business Stock (QSBS)

Under pre-OBBBA law, section 1202 provided an exclusion for a portion (or, in some cases, all) of the gain recognized on a sale of QSBS held by an individual or other non-corporate taxpayer for more than five years. Among other requirements to qualify as QSBS, the "aggregate gross assets" of the issuing corporation must not have exceeded $50,000,000 at any time prior to, on, or immediately after the stock issuance (the "Gross Asset Threshold"). The percentage of gain that could be excluded depends on the date on which the taxpayer acquired such stock. Specifically, the exclusion percentages for QSBS held for more than five years were: (i) 50 percent for QSBS acquired before February 17, 2009; (ii) 75 percent for QSBS acquired between February 17, 2009 and September 27, 2010; and (iii) 100 percent for QSBS acquired after September 27, 2010 and before July 5, 2025. Lastly, taxpayers were also subject to a per-issuer limitation on the amount of gain that could be excluded with respect to QSBS equal to the greater of (i) $10,000,000[9] (reduced by gain taken into account with respect to stock in prior years) and (ii) ten times the taxpayer's adjusted tax basis in the QSBS that is disposed of in the current year.

The OBBBA modifies the QSBS exclusion in several respects. Specifically, for QSBS acquired after July 4, 2025:

- The exclusion percentages are changed to (i) 50 percent for QSBS held for more than three years; (ii) 75 percent for QSBS held for more than four years; and (iii) 100 percent for QSBS held for more than five years;
- The Gross Asset Threshold is increased from $50,000,000 to $75,000,000, adjusted for inflation, for stock issued after July 4, 2025; and
- The $10,000,000 (or $5,000,000 for married taxpayers filing separately) threshold for the per-issuer limitation is increased to $15,000,000 (or $7,500,000 for married taxpayers filing separately), adjusted for inflation.

Although the requirements of the QSBS regime are restrictive, they may be extremely beneficial for individual and other non-corporate sellers of certain businesses, depending on the situation. The OBBBA amendments expand the ability of non-corporate taxpayers to qualify for the QSBS exclusion.

M&A observations:

- Individuals and other non-corporate sellers in M&A transactions should consider whether they might now qualify for an exclusion under section 1202.
- Buyers in M&A transactions should consider whether they are acquiring QSBS and take any reduced tax liability imposed on sellers into account in deal negotiations and tax modeling.

Foreign tax credit considerations

Under historic tax rules, taxpayers were generally able to credit foreign taxes paid (or deemed paid) against their U.S. tax burden on net foreign income. However, due to the way interest expense and certain other deductions were allocated and apportioned, the foreign tax credit limitation for highly leveraged companies or those with significant R&E expenditures was often significantly reduced or eliminated entirely, resulting (post-TCJA) in possible double-taxation of the earnings of foreign subsidiaries of U.S. corporations.

The OBBBA makes a number of technical changes to the treatment of interest expense and R&E expenditures for multinational companies, including:

- As noted above, for purposes of section 163(j), subpart F income, "net CFC tested income" (formerly known as GILTI tested income) and certain related items are not taken into account in determining ATI; and
- For purposes of the foreign tax credit rules, interest expense and R&E expenditures are not allocated or apportioned to net CFC tested income.[10]

M&A observations:

- These provisions will generally have the effect of reducing the ability of a US-parented multinational company to deduct interest expense, while increasing the likelihood that such companies would be able to credit foreign taxes against their U.S. tax liability. Overall, the interplay of these two changes may provide a net benefit or a net detriment to a multinational company, depending on its overall tax profile.
- As a result, more detailed tax modeling for these multinational companies may be required to confirm that these legislative changes are taken into account in investment models, go-forward cash tax projections, and decisions regarding the amount (and location) of debt financing.

Certain other changes

In addition to the provisions described above, the OBBBA made a number of other changes that could reduce the tax burden on certain investors:

- The OBBBA permanently extended the section 199A deduction (generally 20 percent of qualified business income) for sole proprietors and non-corporate owners of certain businesses held in pass-through form (*e.g.*, partnerships and S corporations) and indexed the applicable thresholds for inflation.

M&A observations:

- The section 199A deduction will likely continue to be a topic of consideration in the tax distribution provisions of limited liability company agreements (and similar agreements for pass-through entities organized under other state law forms) and modeling of go-forward distributions in M&A transactions in a similar fashion as under pre-OBBBA law.

- The OBBBA reverted the attribution rules for determining CFC status to their pre-TCJA language, and extended the international tax regime to a new category of "foreign controlled foreign corporations." The TCJA rules were intended to avoid certain perceived abuses by foreign-parented multinational companies with U.S. subsidiaries, but inadvertently subjected many U.S. investors who owned 10 percent or more of a foreign corporation to U.S. tax on the foreign corporation's earnings. The revised language attempts to achieve the government's original objectives without the unforeseen consequences. In addition, the taxation of U.S. shareholders on a CFC's income in the case of a sale is changed from a "hot potato" method (where the income of a CFC is imputed to the U.S. shareholder who owns the CFC on the last day of its taxpayer year) to a proration method.[11]

M&A observations:

- These changes result in meaningful differences to the mechanics of the pre-OBBBA regime governing the allocation/imposition of U.S. taxation of income of CFCs among buyers and sellers in M&A transactions involving multinational organizations and, as a result, should be considered closely in the drafting of transaction documents, tax structuring, and tax modeling analyses.

- The deduction for foreign derived intangible income or "FDII" (now called "foreign derived deduction eligible income") is modified and reduced to 33.34 percent, resulting in an effective tax rate of approximately 14 percent for a typical taxpayer. Under the TCJA, this deduction was scheduled to be reduced from 37.5 percent to 21.875 percent in these tax years, which would have resulted in an effective tax rate of 16.406 percent.

- The deduction for GILTI tested income (now called “net CFC tested income”) is modified and reduced to 40 percent for tax years beginning after December 31, 2025, resulting in an effective tax rate of 12.6 percent for a typical taxpayer. Under the TCJA, this deduction was scheduled to be reduced from 50 percent to 37.5 percent in these tax years, resulting in an effective tax rate of 13.125 percent.
- The alternative rate of tax imposed on certain corporations with significant “base erosion payments” under the BEAT regime is permanently fixed at 10.5 percent. The TCJA imposed a rate of 10 percent that was scheduled to increase to 12.5 percent for taxable year beginning after December 31, 2025.
- The OBBBA also made several changes to the tax credit and other regimes, primarily related to the energy industry. A detailed description of these changes is beyond the scope of this article.

Conclusion

Although the OBBBA is expected to provide considerable tax benefits for many taxpayers, the various changes increase the complexity for participants in M&A transactions. When evaluating potential opportunities, buyers and sellers should confirm that their cash tax, effective tax rate and gain/loss models properly reflect the evolving tax landscape and that acquisition structures are set up to achieve the intended tax consequences. As always, close collaboration with tax advisors will be critical to align the tax posture with the business objectives.

Endnotes

1 P.L. 119-21.

2 For example, for corporate income tax purposes, states with fixed date conformity to the Internal Revenue Code, including Florida and Georgia, would continue to use a version of the Code prior to the amendments made by the OBBBA unless and until they update their conformity date by a legislative act. Additionally, a few states, such as Massachusetts and New York, have specifically decoupled their tax laws from specific sections of the Internal Revenue Code, *e.g.*, section 168(k), as of certain effective dates.

3 The OBBBA also included a provision under which a taxpayer may elect 100 percent depreciation for the portion of certain nonresidential real property that is used for the manufacture, production (but only for agriculture and chemicals), or refining of a qualified product.

4 The OBBBA also clarifies that taxpayers may not recover capitalized foreign R&E expenditures, either as a deduction or a reduction to the amount realized, for any property disposed of, retired or abandoned after May 12, 2025.

5 The CARES Act provided various modifications that temporarily impacted the section 163(j) limitation for certain tax years within this period (generally, tax years beginning in 2019 or 2020). These modifications are no longer in effect and therefore are not discussed herein.

6 This change is expected to apply to taxable years beginning after December 31, 2024. Note, however, that the applicability of this change to “short” taxable years beginning after December 31, 2024 and ending prior to the enactment of the OBBBA on July 4, 2025 is uncertain and is expected to be clarified by Treasury regulations. Because M&A transactions frequently result in the termination of taxable years, taxpayers that have engaged in M&A transactions during this period should endeavor to stay apprised of future regulatory developments in this regard.

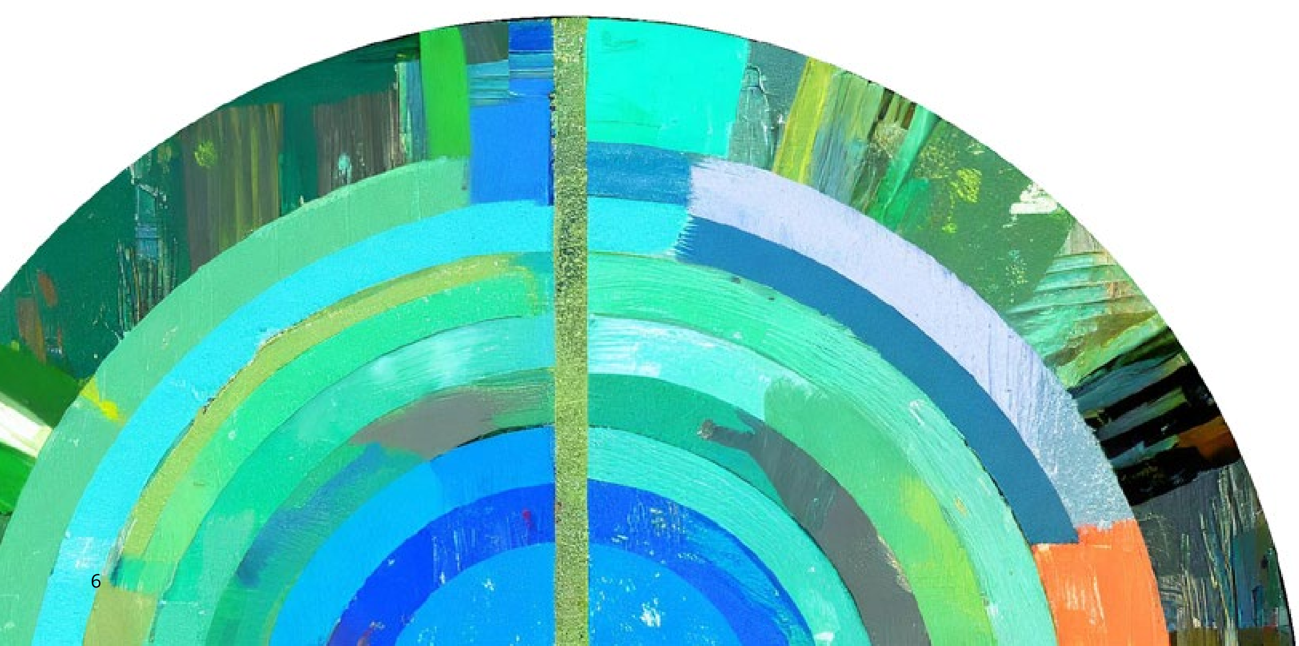
7 The third principal change made by the OBBBA requires the section 163(j) limitation on the deductibility of business interest expense to be calculated before applying certain other provisions under which interest expense is capitalized (*e.g.*, under section 266), subject to certain exceptions (*e.g.*, related to interest allocable to personal property that is part of a straddle and interest allocated to property produced by the taxpayer).

8 This phase-out threshold begins at $500,000 of modified adjusted gross income for 2025, and increases to 101 percent of the prior year’s threshold in 2026, 2027, 2028, and 2029. The phase-out mechanism reduces the SALT Cap by 30 percent of the excess of the taxpayer’s modified adjusted gross income over the applicable threshold amount, but does not reduce the SALT Cap below $10,000. For married individuals filing separately, these phase-out thresholds are reduced by 50 percent.

9 This amount is reduced to $5,000,000 for married taxpayers filing separately.

10 Interest expense and R&E expenditures are instead allocated and apportioned to U.S. source income. The impact of this change (*e.g.*, the consequences if this allocation and apportionment results in a U.S. source loss) is unclear.

11 These changes are generally effective for taxable years beginning after December 31, 2025.



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