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MULTISTATE INCOME/FRANCHISE TAX

State income tax implications of the One Big Beautiful Bill Act

Tax Alert

Overview

Congress has approved and President Donald Trump has signed into law the legislation formally titled “An Act to provide for reconciliation pursuant to title II of H. Con. Res. 14”—and commonly referred to as the One Big Beautiful Bill Act (the “Act”). This Tax Alert summarizes the state income tax implications of some of the relevant provisions in the Act.

State income tax conformity

Many state corporate income tax regimes are affected by federal tax law changes because states conform to the Internal Revenue Code (“IRC”) for purposes of administrative ease by either incorporating the IRC in whole or in part, or by using federal taxable income as the starting point. Generally, states that incorporate the IRC either: (1) conform to the IRC as of a specific date (“Fixed Date Conformity”); or (2) automatically follow the version of the IRC in effect for the current tax year (“Rolling Conformity”). However, some states, like California, only selectively conform to specific IRC provisions ("Selective Conformity”).

While Rolling Conformity states may choose to later decouple from any IRC provisions enacted by Congress through state legislative action, the Fixed Date Conformity states would continue to use a version of the IRC prior to the amendments in the Act unless and until they updated their conformity date. These differences can lead to different tax outcomes at the state level when compared to federal.

Any specific states referred to in this alert may change as they react to the passage of the Act and may vary depending on a particular company’s fact pattern and/or elections.

Specific provisions with potential state nonconformity

Provisions which may create a federal/state disconnect in Fixed Date Conformity states for state corporate income tax purposes include (but are not limited to) the following:

Global Intangible Low-Tax Income ("GILTI") and Foreign-Derived Intangible Income ("FDII")

The Act changes the calculation of tested income for CFCs to "net CFC tested income" ("NCTI") which does not include a deduction for qualified business asset investment ("QBAI") as well as certain other changes to the computation of NCTI as well as foreign-derived deduction eligible income ("FDDEI" replacing FDII). Currently, the deductions for GILTI and FDII are 50% and 37.5%, respectively, and were scheduled to be reduced to 37.5% and 21.875%, respectively, beginning in tax year 2026. Under the Act, the deductions related to NCTI and FDDEI are reduced to 40% and 33.34%, respectively. Certain states may continue to follow the lower deduction percentages prescribed in section 250 for years 2026 and later instead of the 40% and 33.34% deduction amounts for NCTI and FDDEI, respectively. Potential states where nonconformity issues may arise related to the section 250 deduction for NCTI, where the states do not otherwise provide a full subtraction, include Idaho, New Hampshire, and Vermont. However, arguably in those jurisdictions, as well as Maine and Minnesota, a deduction for QBAI and expense apportionment as calculated under the old law may be available. Potential states where nonconformity issues may arise related to the section 250 deduction for FDDEI include Arizona, Florida, Georgia, Indiana, Idaho, Vermont, Virginia, and West Virginia.

Section 163(j)

Currently, the computation of adjusted taxable income ("ATI") includes depreciation, amortization, and depletion. Under the Act, the calculation of ATI aligns with earnings before interest, taxes, depletion, depreciation, and amortization for tax years beginning after December 31, 2024. Certain states may continue to require the computation of ATI without additions for depreciation, amortization, and depletion. Potential states where nonconformity issues may arise include Arizona, Florida, Hawaii, Idaho, Kentucky, Maine, Minnesota, North Carolina, Vermont, Virginia, and West Virginia.

Section 174

Under current law, domestic research and experimental expenditures are amortized over a 5-year period and foreign research and experimental expenditures are amortized over a 15-year period. The Act includes a new section 174A, which allows an immediate deduction of domestic research and experimental expenditures paid or incurred in tax years beginning after December 31, 2024. Certain fixed date conformity states may continue to require amortization for domestic research expenditures during the period that they are not required to do so for federal tax purposes. Potential states where nonconformity issues may arise include Arizona, Florida, Hawaii, Idaho, Kentucky, Maine, Minnesota, New Hampshire, North Carolina, South Carolina, Vermont, Virginia, and West Virginia.

States that currently adopt a version of section 174 prior to the TCJA would continue to allow full expensing for domestic and foreign expenses, unless a taxpayer has elected to amortize.

Section 168(k)

Current law requires expensing 40% for qualified property placed in service after January 1, 2025. The Act makes permanent 100% expensing for qualified property acquired and placed in service after January 19, 2025. Certain states may not allow full expensing of qualified property. Potential states where nonconformity issues may arise include West Virginia.

Section 168(n)

The Act added a new subsection 168(n), which allows taxpayers to elect to apply 100% expensing of qualified production property placed in service before

January 1, 2031. Certain states may not allow the full expensing of "qualified production property" under new 168(n). Fixed Date Conformity states would generally not follow section 168(n) until further legislative action occurs.

State Pass-Through Entity Taxes ("PTETs")

The SALT Cap is increasing to $40,000 for tax year 2025, with a phaseout for taxpayers with modified adjusted gross income ("AGI") in excess of $500,000 (to no less than a $10,000 cap). The SALT Cap and AGI threshold will increase by 1% each year through 2029, after which the cap reverts back to $10,000 beginning in tax year 2030.

The Act does not include a limitation on the deductibility of "substitute payments" or pass-through entity taxes, nor does it impose a tax on partners that benefit from a "state and local tax allocation mismatch." While the Act does not impose any new restrictions on the deductibility of PTETs, it also does not codify the guidance contained in IRS Notice 2020-75, which allowed owners of pass-through entities a deduction for PTETs, effectively circumventing the SALT Cap. In contrast, each of the House-passed bill and the Senate Finance Committee version of the bill would have imposed substantial new restrictions on the deductibility of PTETs. However, the House-passed bill and the Senate Finance Committee version of the bill would have expressly provided, at least for certain situations, a deduction for PTETs. Under the House-passed bill, the PTET regime construct would have been respected for a qualified trade or business pass-through entity. Under the Senate Finance Committee version of the bill, the PTET regime construct would have been respected in all cases, but subject to a cap of the greater of $40,000, or 50% of PTET. The Act is silent on PTET; therefore, the viability of PTET remains absent future Treasury guidance.

Get in touch

Corporate conformity

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