

# 2025 Year-End Tax Planning Guide for Private Companies

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# Table of Contents

• Income Taxes	4
• Partnerships	11
• Credits and Incentives	20
• Capital Markets and M&A	30
• International Tax	37
• Compensation and Benefits	44
• State and Local Taxes	50
• Financial Statements	54



# From Survive to Thrive



**Private companies find themselves navigating a tax landscape marked by rapid change and increasing complexity. The wave of legislative, economic, and technological developments over the past year has created novel challenges. It's not enough to merely survive.**

All businesses are facing external challenges, and the most agile companies are often the most successful. Private companies should focus on converting new developments into opportunities to thrive. And there is no shortage of new developments this year.

Tariff policy often seemed to change by the hour, and the situation continues to evolve. Fortunately, mitigation tools and planning responses can help companies thrive despite the challenges.

On the tax side, sweeping new legislation will have major implications for private businesses. For example, companies will enjoy new opportunities to accelerate deductions for research and equipment. Changes to the limit on the interest deduction could be even more important for highly leveraged companies, particularly those owned by private equity. The most significant provisions include options for implementation, and planning decisions on one provision can affect others. Modeling will help identify beneficial strategies. A bevy of less heralded changes can also affect tax planning.

Private companies organized as pass-through entities must address a second layer of tax considerations: taxation at the owner level. While this year's tax legislation doesn't change the math on entity choice in profound ways, it does create new opportunities to structure business and investment activities tax efficiently. State taxes will be another important factor in these planning decisions, and numerous state tax law changes over the past year present their own issues.

With the multitude of challenges present today, the tax function must operate efficiently to identify tax risk and planning opportunities. Automation and other tools can help companies deploy the necessary resources to integrate tax considerations into critical business decisions.

This guide is a resource for understanding the most pressing tax issues facing private companies as 2025 closes and a new year begins. It covers important tax developments over the past year and offers practical insights and actionable planning strategies. But remember, no guide can cover every possible consideration, and there may be additional developments after the publication date. There is no substitute for a discussion with a tax professional.

Unless otherwise noted, the information contained in this guide is based on enacted tax laws and policies as of the publication date and is subject to change based on future legislative or tax policy changes.



# Income Taxes

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Regardless of whether your private company is taxed as a C corporation at the 21% rate or organized as a pass-through, the rules for calculating and recognizing income have changed significantly. The One Big Beautiful Bill Act (OBBBA) makes major changes to research expensing, bonus depreciation, and the limit on the interest deduction. Accounting methods planning can help leverage the implementation options. Strategically adopting or changing tax accounting methods to defer (or, in certain cases, accelerate) taxable income recognition can also enhance overall cash tax savings for 2025. The legislative and economic changes over the past year should prompt companies to reevaluate income tax planning at year-end.

## 100% BONUS DEPRECIATION

The OBBBA permanently restores 100% bonus depreciation for most investments in business property acquired and placed in service after January 19, 2025. Property is considered acquired no later than the date the taxpayer enters into a binding written contract for its acquisition. Eligible property includes tangible property with a class life of 20 years or less under the modified accelerated cost recovery system (MACRS), computer software, qualified improvement property, and other property listed in Section 168(k).

Property acquired on or before January 19, 2025, and placed in service after that date remains subject to the bonus depreciation phasedown rules under the Tax Cuts and Jobs Act (TCJA) — 40% for property placed in service in calendar year 2025 (60% for longer production period property and certain aircraft). Used property remains eligible for 100% bonus depreciation if it meets certain additional requirements.

The OBBBA continues to allow taxpayers to elect out of bonus depreciation by property class. However, the OBBBA also gives taxpayers the ability to elect 40% bonus depreciation instead of 100% bonus depreciation for the first tax year ending after January 19, 2025 (60% for longer production period property and certain aircraft).

The OBBBA also increases the annual Section 179 expensing limit from \$1 million to \$2.5 million, with a phaseout threshold of \$4 million (increased from \$2.5 million). The changes to Section 179 are effective for property placed in service after December 31, 2024, with both the deduction and the phaseout threshold indexed for inflation in future years. For taxpayers eligible to use Section 179 expensing, the yearly expensing election can be used in addition to bonus depreciation to claim deductions for property not eligible for bonus depreciation or to deduct only a portion of the property's cost.

**Determining the property's acquisition date.** The acquisition date will be critical for determining whether property is eligible for 100% bonus depreciation. It is not clear yet whether the IRS will provide new guidance for determining the acquisition date or rely on existing regulations issued in 2019 and 2020 after the bonus depreciation changes made by the TCJA. Under the existing guidance, if the acquisition is subject to a written binding contract, the taxpayer must look to the terms of the contract to determine the property's acquisition date for bonus depreciation eligibility.

**The property is deemed acquired on the later of the following dates:**

- The date the contract is entered into;
- The date the contract becomes enforceable under state law;
- If the contract has one or more cancellation periods, the date on which all cancellation periods end; or
- If the contract has one or more contingency clauses, the date on which all conditions subject to such clauses are satisfied.



Self-constructed property is deemed acquired when manufacturing, construction, or production of a significant nature begins, using a facts-and-circumstances test. Under a safe harbor, a taxpayer may choose to determine that physical work of a significant nature begins at the time the taxpayer pays or incurs more than 10% of the total costs of the property. When property is acquired, or manufactured, constructed, or produced for the taxpayer by another person, under a contract that does not meet the definition of a written binding contract, the property's acquisition date is the date on which the taxpayer has paid or incurred more than 10% of the total cost of the property, excluding the cost of land and preliminary activities.

Under the framework provided in the existing regulations, bonus depreciation can apply to qualifying components of a larger property acquired and placed in service after January 19, 2025, even if the larger property doesn't meet the requirements.

#### PLANNING CONSIDERATIONS

Accounting methods can be a powerful planning tool with depreciation. The recovery period over which depreciation is claimed impacts the calculation of taxable income over a number of years. In many cases, taxpayers have the flexibility to determine how much depreciation to claim in the year assets are placed in service. By claiming the default 100% bonus depreciation, electing out for certain categories of assets (or all assets), or making other available elections to slow down depreciation, taxpayers can manage taxable income in ways that benefit many other calculations.

## NEW 100% EXPENSING OF QUALIFIED PRODUCTION PROPERTY

The OBBBA adds Section 168(n) to the Internal Revenue Code, which introduces special 100% expensing for a new separate class of building property known as “qualified production property” (QPP). Under Section 168(n), taxpayers can elect to fully deduct amounts invested in QPP in the year the property is placed in service. Unlike bonus depreciation, which applies unless the taxpayer elects out, taxpayers must elect QPP expensing for each tax year it is claimed.

QPP includes any portion of nonresidential real property that meets the following requirements:

- Construction of the property begins after January 19, 2025, and before January 1, 2029;
- The property is placed in service within the U.S. or a possession of the U.S. before January 1, 2031;
- The property is used by the taxpayer as an integral part of a qualified production activity;
- The property's original use commences with the taxpayer; and
- The property is not required to use the alternative depreciation system.

An exception to the original use requirement applies to certain acquired QPP that is acquired after January 19, 2025, and before January 1, 2029, and was not used in a qualified production activity between January 1, 2021, and May 12, 2025.

QPP does not include any portion of building property used for offices, administrative services, lodging, parking, sales activities, research activities, software engineering activities, or other functions unrelated to a qualified production activity. In addition, QPP does not include property leased by the taxpayer to another party. Special recapture rules apply to dispositions of property that ceases to be used as part of a qualified production activity.

**What is a Qualified Production Activity?** A qualified production activity includes the manufacturing, production (limited to agricultural and chemical production), and refining of a qualified product. A qualified product includes tangible property, but excludes food and beverages prepared in the same building as a retail establishment in which they are sold.

A qualified production activity must result in a substantial transformation of the property. The OBBBA directs the IRS to issue guidance regarding what constitutes substantial transformation and indicates the guidance should be consistent with substantial transformation guidance under Section 954(d).

#### PLANNING CONSIDERATIONS

The ability for certain taxpayers to deduct new investments in production facilities also offers a substantial benefit for producers. It will be critical to determine whether the activities meet the definition of production. Companies with qualifying facilities will also need to carve out costs for any nonproduction functions.



# Income Taxes

## DEDUCTIBILITY OF R&E EXPENDITURES

The OBBBA creates new Section 174A, which reinstates the full deductibility of domestic research costs in the year paid or incurred, effective for tax years beginning after December 31, 2024. Software development remains statutorily included in the definition of research costs for purposes of Section 174A. Taxpayers have the option of electing to capitalize and amortize Section 174A amounts beginning with the month in which the taxpayer first realizes benefits from the expenses, with a 60-month minimum amortization period. The legislation also modifies Section 280C(c), requiring taxpayers to reduce their Section 174A deduction by the amount of their research credit or alternatively elect to reduce the amount of their credit.

Prior to the OBBBA, the TCJA required taxpayers to capitalize specified research and experimental (R&E) costs incurred in tax years after December 31, 2021, and amortize the costs of domestic research over five years and 15 years for research conducted outside the U.S. The OBBBA retains the Section 174 15-year amortization requirement for foreign research costs. Given the revisions to the treatment of domestic research, most taxpayers with domestic R&E costs will need to file at least one method change with their first tax year beginning after December 31, 2024, to comply with Section 174A.

The OBBBA includes a transition rule that allows taxpayers to elect to claim any unamortized domestic R&E costs incurred in calendar years beginning after December 31, 2021, and before January 1, 2025, in either their first tax year beginning after 2024 or ratably over their first two tax years beginning after 2024. Note that this election to accelerate the unamortized costs is considered a separate change in method of accounting from the general change to comply with Section 174A described above.

Eligible small business taxpayers can elect to file amended returns to claim full deductions for domestic R&E costs for tax years before 2025 (the small business taxpayer retroactivity election), or to file an accounting method change with tax returns beginning before January 1, 2025, to deduct the costs. This election is not available to small business taxpayers that are tax shelters, such as pass-through entities that allocate more than 35% of their losses to limited partners or limited entrepreneurs.

**Rev. Proc. 2025-28** provides procedural guidance for complying with or utilizing various elections available under new Section 174A, including the small business taxpayer retroactivity election and any accounting method change that may be needed for foreign R&E costs.



## PLANNING CONSIDERATIONS

For domestic R&E costs, taxpayers should carefully consider whether they wish to change to the new deduction method or the new capitalization and amortization method beginning with the 2025 year. Expenses claimed under the new deduction method are not amortization for purposes of the Section 163(j) interest limitation addback, and expensing Section 174A costs will limit some taxpayers' ability to deduct current year business interest. Taxpayers will likely not be able to change their method within a five-year period without having to file a non-automatic accounting method change.

The election to accelerate unamortized domestic R&E costs incurred from 2022 through 2024 should also be carefully analyzed to determine whether acceleration is beneficial, considering the impact on other Code sections with calculations based on taxable income. Although there is currently no explicit guidance on this issue, the acceleration of this amortization should still be considered amortization for purposes of the Section 163(j) addback.

## LIMIT ON THE INTEREST DEDUCTION

The OBBBA permanently restores the exclusion of amortization, depreciation, and depletion from the calculation of adjusted taxable income (ATI) for purposes of Section 163(j), which generally limits interest deductions to 30% of ATI. The change is effective for tax years beginning after 2024.

The change will be particularly important for portfolio companies owned by private equity funds and other highly leveraged entities. The more favorable treatment may allow many capital-intensive businesses to escape the limit on their interest deductions altogether. Some portfolio companies, however, will still need to plan around the limit.

The OBBBA generally shuts down interest capitalization planning for tax years beginning after 2025. Interest capitalized to other assets, other than interest capitalized to straddles under Section 263(g) or to specified production property under Section 263A(f), will remain part of the Section 163(j) calculation. Further, ATI will exclude income from Subpart F and global intangible low-taxed income (now net CFC tested income) inclusions and Section 78 gross-up for tax years beginning after 2025.

### PLANNING CONSIDERATIONS

Private companies with interest deductions that will remain limited under the new rules in 2025 should consider capitalizing interest in 2025 while the planning is still available. The OBBBA will not claw back any interest capitalized to other assets in tax years beginning before 2026, even if the capitalized interest has not been fully recovered with the asset. Taxpayers managing the limit should also consider the impact of other decisions on the tax return. As discussed above, capitalizing research costs, for example, could allow more interest to be deducted. Modeling will be key in identifying beneficial strategies.

## YEAR-END OPPORTUNITIES TO DEFER (OR ACCELERATE) TAXABLE INCOME

Companies still have time to take advantage of opportunities to change their tax accounting methods for 2025 and future years. Companies that want to reduce their 2025 taxable income (or create or increase a net operating loss) should consider “traditional” accounting method planning — method changes that accelerate deductions into 2025 or defer income recognition to a later year. However, some businesses may instead want to use “reverse” accounting method planning to accelerate taxable income into 2025 or defer deductions to later years. Reverse method planning may be prudent, for example, for taxpayers that wish to accelerate the use of net operating losses or to mitigate unfavorable limitations, such as the limitation on the deduction for business interest expense.

In addition to the planning considerations discussed above related to depreciation and R&E costs, common items for which accrual basis taxpayers may have flexibility to change their method of accounting include the following:

- **Advance payments.** A taxpayer may recognize income from certain advance payments (e.g., upfront payments for goods, services, gift cards, use of intellectual property, sale or license of software) in the year of receipt or defer recognizing a portion until the following year. (see: [Final 451 Regulations Clarified | New Tax Treatment](#))
- **Recurring liabilities.** Certain liabilities such as taxes, warranty costs, rebates, allowances, and product returns are required to be deducted in the year paid but may be accelerated using the “recurring item exception.”
- **Accrued bonuses.** Under carefully drafted bonus plans, taxpayers may deduct employee bonuses in the year they are earned (the service year) or, if the bonuses are not paid within two and a half months after year-end, in the year the bonuses are paid. While many taxpayers wish to have a provision that a bonus is not paid to an employee who departs before the date of the bonus payment, taxpayers may be able to implement strategies that allow for an accelerated deduction for tax purposes while retaining the employment requirement on the bonus payment date.
- **Prepaid expenses.** Under the “12-month rule,” a taxpayer may deduct prepaid expenses for certain incurred liabilities — such as insurance, government licensing fees, software maintenance contracts, and warranty-type service contracts — in the year the expense is paid, rather than having to capitalize and amortize the amounts over a future period.



- **Uniform capitalization costs.** A taxpayer may change its method for calculating the amount of uniform capitalization costs capitalized to ending inventory, including changing to simplified methods available under Section 263A.
- **Casualty or abandonment losses.** A taxpayer may be able to claim a deduction for certain types of losses it sustains during a tax year — including losses due to casualties or abandonment of property, among others — that are not compensated by insurance or otherwise.
- **Worthless inventory.** A taxpayer may be able to accelerate losses related to inventory that is obsolete, unsalable, damaged, defective, or no longer needed by disposing of or scrapping the inventory by the end of the taxable year. Taxpayers also may be able to write down the cost of qualifying “subnormal goods” held at the end of the year.
- **Electing shorter depreciable lives.** A taxpayer may be able to deduct “catchup” depreciation (including bonus depreciation, if applicable) for assets placed in service in prior years and mistakenly classified as longer recovery period property, by reviewing their fixed asset schedules or by performing a cost segregation study to identify assets eligible for an accounting method change to shorter recovery periods.

**Accounting Method Changes Require IRS Approval.** The rules for changing tax accounting methods are often complex and usually require taxpayers to submit a request to change their method of accounting to the IRS. The procedure for changing a particular method depends on the mechanism for receiving IRS consent, i.e., whether the change is “automatic” or “non-automatic.” [Rev. Proc. 2025-23](#), as modified by [Rev. Proc. 2025-28](#), contains the current list of automatic method changes.

The automatic change procedure generally requires a taxpayer to attach a Form 3115 to the timely filed (including extensions) federal tax return for the year of change and to file a separate copy of the Form 3115 with the IRS no later than the filing date of that return. However, non-automatic method changes, for which more information must be provided and which are more complex, require an application to be filed with the IRS prior to the end of the tax year for which the change is requested — i.e., prior to December 31, 2025, for 2025 calendar-year accounting method changes. Additional **issues or procedures** may need to be considered if a taxpayer is under IRS exam. Requests for accounting method changes that otherwise qualify as automatic must be submitted using the non-automatic change procedures if the taxpayer has made a change with respect to the same item within the last five years.

## PLANNING CONSIDERATIONS

Taxpayers have numerous options when choosing methods of accounting and elections for various items of taxable income or deductible expense. These decisions may shift the amount of taxable income reported in a taxable year and can have consequences for purposes of other Code provisions. These other provisions may include the Section 55 corporate alternative minimum tax, disallowed business interest expense under Section 163(j), net CFC tested income (formerly global intangible low-taxed income) and/or **foreign-derived deduction-eligible income** (formerly foreign-derived intangible income) under Section 250, and the amount of base erosion and anti-abuse tax (BEAT). Taxpayers should also consider the impact of their accounting methods and planning on state returns, especially when states do not follow federal Code provisions.

Taxpayers should holistically model the implications of making accounting method changes and elections in all planning scenarios before deciding which method changes or elections to pursue.



## IRS ISSUES GUIDANCE ON TRACKING BASIS FOR DIGITAL ASSETS

Private companies with digital asset investments may no longer use the universal method for determining the tax basis of digital assets held in virtual wallets and accounts as of January 1, 2025. A taxpayer that applied the universal method treated all its digital assets as if held in one wallet or account, even if they were actually owned in multiple wallets or accounts.

Pursuant to [final regulations](#) issued in 2024, which implement the reporting requirements enacted by the Infrastructure Investment and Jobs Act, taxpayers must now use the “wallet-by-wallet” approach to digital asset identification for each transaction. Under this approach, on a wallet-by-wallet basis, taxpayers must adequately identify, among other information, the particular units sold, the price of such units, and the basis of such units for each transaction no later than the date and time of the transaction (specific identification). Taxpayers that are unable to adequately identify the specific digital asset prior to or at the time of the sale are required to use the first-in, first-out (FIFO) rule for determining basis.

Taxpayers with digital assets in the custody of a broker may use a standing order or instruction to the broker to adequately identify the digital assets sold, disposed of, or transferred.

**Under [Notice 2025-7](#), if the broker does not have the technology needed to accept specific instructions or standing orders communicated by taxpayers, the taxpayer may, until December 31, 2025:**

- Make an adequate identification no later than the date and time of the sale, disposition, or transfer and keep a record of such identification for each individual sale throughout the year; or
- Record a standing instruction on its books and records that applies to a custodial account for every sale during the year.

These changes align with new IRS requirements for brokers, who now have substantial reporting obligations.



## PLANNING CONSIDERATIONS

Specific identification requires more detailed recordkeeping but can result in more tax savings than applying the FIFO rule for each transaction. To simplify the administrative burden, private companies should consider using fewer wallets and use certain cryptocurrency tax software to maintain records. If a taxpayer has digital assets in the custody of a broker or exchange, the taxpayer should consult with their tax advisors to prepare an appropriate standing instruction as soon as possible before the December 31, 2025, deadline.



# Partnerships

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# Partnerships

Over the last several years, the IRS has been ramping up its scrutiny of partnership tax positions. Part of this effort included comprehensive basis shifting guidance issued in the summer of 2024. In 2025, the trend toward increased partnership enforcement eased under the new administration, which has withdrawn the bulk of the basis shifting guidance. And while the enactment of OBBBA was the major tax event of the year, the legislation's direct impact on partnership tax was limited.

Nonetheless, there were some important developments for private companies organized as partnerships in 2025.

**Key areas partnerships should be looking into as they plan for year-end and the coming year include:**

- Eased partnership Form 8308 reporting requirements
- Limited partner claims of exemption from self-employment tax
- Final rules on partners' shares of partnership recourse liabilities
- New reporting requirements for distributions of partnership property
- Simplified corporate alternative minimum tax (CAMT) guidance relating to partnership interests

## EASED PARTNERSHIP FORM 8308 REPORTING REQUIREMENTS

The IRS in August 2025 issued proposed regulations that would modify reporting requirements for partnerships with unrealized receivables or inventory items that are required to furnish Form 8308. The form is generally required to be furnished by January 31 to the transferor and transferee in connection with certain partnership interest transfers that occurred in the previous calendar year.

The IRS expanded Form 8038 reporting in late 2023, but offered temporary relief in Notice 2024-19 and Notice 2025-02. This guidance responded to partnerships' expressed concerns that they do not have the information necessary to complete the new Part IV of Form 8308 by the January 31 deadline.

The proposed regulations would modify the existing rules to remove the requirement to include Part IV in the statements generally required to be furnished by the January 31 deadline. Other Form 8308 requirements would remain.

### Expanded Form 8308 Reporting

Partnerships file Form 8308, Report of a Sale or Exchange of Certain Partnership Interests, to report the sale or exchange by a partner of all or part of a partnership interest when any money or other property received in exchange for the interest is attributable to unrealized receivables or inventory items (that is, when there has been a Section 751(a) exchange).

Final regulations published in November 2020 require a partnership to furnish to a transferor partner the information necessary for the transferor to make the transferor partner's required statement related to a Section 751(a) exchange. Under applicable regulations, a transferor partner in a Section 751(a) exchange must submit a statement with the transferor partner's income tax return for the tax year of the transaction separately stating the date of the sale or exchange, the amount of any gain or loss attributable to Section 751 property, and the amount of any gain or loss attributable to capital gain or loss on the sale of the partnership interest.

The IRS significantly expanded the Form 8308 reporting requirements in the revised form released in October 2023. For transfers occurring on or after January 1, 2023, the revised Form 8308 includes expanded Parts I and II and new Parts III and IV. Part IV is used to report specific types of partner gain or loss when there is a Section 751(a) exchange, including the partnership's and the transferor partner's share of Section 751 gain or loss, collectibles gain under Section 1(h)(5), and unrecaptured Section 1250 gain under Section 1(h)(6).

# Partnerships

## Furnishing Information to Transferors and Transferees

Partnerships with unrealized receivables or inventory items described in Section 751(a) (Section 751 property or “hot assets”) are required to provide information to each transferor and transferee that is a party to a Section 751(a) exchange.

Under the existing regulations, each partnership that is required to file a Form 8308 must furnish a statement to the transferor and transferee by the later of (1) January 31 of the year following the calendar year in which the Section 751(a) exchange occurred, or (2) 30 days after the partnership has received notice of the Section 751(a) exchange. A penalty applies under Section 6722 for failure to furnish statements to transferors and transferees on or before the required date, or for failing to include all the required information or including incorrect information.

## Proposed Regulations

The proposed regulations would eliminate the current regulatory requirement that partnerships furnish the information required in Part IV of Form 8308 by January 31 of the year following the calendar year in which the Section 751(a) exchange occurred. The IRS plans to update the instructions to Form 8308 in accordance with the proposed regulations.

Under the proposed regulations and modified Form 8308 instructions, partnerships would only be required to furnish the information in Parts I, II, and III of Form 8308 (or a statement with the same information) to the transferor and transferee in a Section 751(a) exchange by the later of (1) January 31 of the year following the calendar year in which the Section 751(a) exchange occurred, or (2) 30 days after the partnership has received notice of the exchange.

Partnerships would still be required to file the completed Form 8308, including Part IV, as an attachment to their Forms 1065, for the tax year of the partnership that includes the last day of the calendar year in which the Section 751(a) exchange took place.

The IRS states that partnerships may rely on the proposed regulations, and the described changes to the Form 8308 instructions, with respect to Section 751(a) exchanges occurring on or after January 1, 2025, and before the date final regulations are published.

## PLANNING CONSIDERATIONS

While the requirement of furnishing Form 8308 statements was not new, the inclusion of numerical “hot asset” (i.e., unrealized receivables or inventory items) information in Form 8308 for transactions in 2023 and later created difficulties, because, in many cases, partnerships do not have all the information required by Part IV of the Form 8308 by January 31 of the year following the calendar year in which the Section 751(a) exchange occurred.

The penalty relief related to the new requirements for the previous two years was welcome – but it was temporary, and it was unclear whether such relief would continue to be offered in future years. The new rules ease the most problematic Form 8308 information reporting requirements and give partnerships more certainty regarding compliance going forward.

## LIMITED PARTNER CLAIMS OF EXEMPTION FROM SELF-EMPLOYMENT TAX

Partnerships, particularly management fund entities, may need to revisit their tax positions on self-employment tax after a series of IRS court victories on the issue.

In the latest decision in December 2024, the Tax Court held in *Denham Capital Management LP v. Commissioner* that “active” limited partners in an investment management company formed as a limited partnership were subject to self-employment (SECA) tax and not entitled to the statutory exemption for limited partners.

The Tax Court relied on its earlier decision in *Soroban Capital Partners LP v. Commissioner*, which held that the determination of limited partner status is a “facts and circumstances inquiry” that requires a “functional analysis.” However, the *Denham* case is the first in which the Tax Court applied the functional analysis of whether a state law limited partner was, in fact, active in the business of the partnership and a “limited partner” in name only. The key issue in the *Denham* case, as in *Soroban*, was whether limited partners in state law limited partnerships may claim exemption from SECA taxes – despite being more than passive investors.

### Application of Functional Analysis in *Denham*

*Denham Capital Management* was organized as a limited partnership under Delaware law and offered investment advisory and management services to private equity funds. As the court addressed the functional analysis, it reaffirmed that determinations of eligibility for the exemption under Section 1402(a)(13) require a factual inquiry into how the partnership generated the income in question and the partners’ roles and responsibilities in doing so.

The court noted that, in the years at issue, *Denham*’s income consisted solely of fees received in exchange for services provided to investors, including advising and operating private investment funds. The court found the partners’ time, skills, and judgment to be essential to the provision of these services. It found unconvincing claims that *Denham*’s income – largely distributed to the partners as profits – was a return on investments, when only one of the partners had made a capital contribution to obtain their interest.

Moreover, the court stated that all the partners, except for one that had made a capital contribution, were required to “devote substantially all of [their] business time and attention to the affairs of the [p]artnership and its affiliates.” The court determined that the partners treated their roles in *Denham* as their full-time employment, with each participating in management and playing crucial roles in the business.

#### Other relevant facts cited by the court included:

- Fund marketing materials made clear that the partners had a significant role in *Denham*’s operation.
- The partners’ expertise and judgment were a significant draw for fund investors, who could withdraw their investments if certain partners no longer participated.
- Investment decisions for the funds were made by investment and valuation committees, which included the partners.
- The partners each exercised significant control over personnel decisions.
- A sizable number of *Denham* employees received total compensation exceeding the partners’ guaranteed payments, suggesting such payments were not designed to adequately compensate the partners for their services.

Concluding that “[i]ndividuals that serve roles as integral to their partnerships as those the [p]artners served for *Denham* cannot be said to be merely passive investors,” the court held that the partners were not “limited partners, as such” under Section 1402(a)(13) and the partners’ distributive shares were ineligible for the SECA tax exemption for limited partners.



# Partnerships

## PLANNING CONSIDERATIONS

Denham Capital was another big win for the government. Similar to the Tax Court's ruling in Soroban Capital, the Tax Court in Denham required a functional analysis centered around the roles and activities of the individual partners. In Denham, the Tax Court detailed the various activities of the partners to show that they were active participants in the business of Denham and not merely passive investors receiving a return on their capital.

The Tax Court again rejected the argument that the partners were eligible for the SECA tax exemption under Section 1402(a)(13) merely because they were limited partners in a state law limited partnership, making it clear that federal law and not state law prescribes the classification of individuals and organizations for federal tax purposes.

Given these decisions, partnerships should reevaluate whether a partner, including a limited partner in a state law limited partnership, is subject to SECA tax by assessing the activities of the partner using a functional analysis similar to the Tax Court's analysis in Denham. Partnerships should also consider the guidance provided for in 1997 Proposed Reg. §1.1402(a)-2(h), which is instructive despite never being finalized.

**Pursuant to this guidance, an individual is considered a limited partner unless the individual:**

- Has personal liability for the debts of or claims against the partnership by reason of being a partner;
- Has authority (under the law of the jurisdiction in which the partnership is formed) to contract on behalf of the partnership; or
- Participates in the partnership's trade or business for more than 500 hours during the partnership's tax year.

## FINAL RULES ON PARTNER SHARE OF PARTNERSHIP RECOURSE LIABILITIES

The IRS in December 2024 published final regulations ([TD 10014](#)) adopting rules – initially proposed more than 10 years earlier – to amend the rules under Section 752 regarding a partner's share of partnership recourse liabilities and associated special rules for related persons. The rules are critical for determining a partner's basis in the partnership interest.

### Partners' Liability Shares Under Section 752

Under Section 752, an increase in a partner's share of partnership liabilities is generally considered a contribution of money by the partner to the partnership, and a decrease in a partner's share of liabilities is considered a distribution of money to the partner by the partnership. In determining a partner's share of liabilities, the regulations distinguish between recourse and nonrecourse liabilities.

A partnership liability is generally considered recourse to the extent that a partner or related person bears the economic risk of loss under Reg. §1.752-2. A partner's share of a recourse liability is equal to the portion of that liability, if any, for which the partner or a related person bears the economic risk of loss. A partner bears the economic risk of loss for a partnership liability if the partner or related person has a payment obligation under Reg. §1.752-2(b), is a lender as provided in Reg. §1.752-2(c), guarantees payment of interest on a partnership nonrecourse liability as described in Reg. §1.752-2(e), or pledges property as a security as provided in Reg. §1.752-2(h).

### Final Regulations

The new regulations finalize rules proposed in 2013 covering when and to what extent a partner would be treated as bearing the economic risk of loss for a partnership liability when multiple partners bear economic risk of loss for the same liability, as well as rules addressing tiered partnerships and related parties. They also add an ordering rule. The final regulations apply to any liability incurred or assumed by a partnership on or after December 2, 2024.

# Partnerships

## Overlapping Economic Risk of Loss

With respect to overlapping economic risk of loss, the final regulations include a proportionality rule that applies when multiple parties bear the economic risk of loss for the same liability. Under this rule, the economic risk of loss borne by a partner equals the amount of the partnership liability (or portion thereof) multiplied by a fraction equal to the amount of economic risk of loss borne by the partner divided by the sum of the economic risk of loss borne by all partners with respect to that liability. The proportionality rule is intended to address uncertainty regarding how partners should share a partnership liability when multiple partners bear economic risk of loss with respect to the same liability.

## Tiered Partnerships

For tiered partnerships, the final regulations address how a lower-tier partnership must allocate a liability in cases in which a partner of an upper-tier partnership is also a partner of the lower-tier partnership and that partner bears economic risk of loss with respect to the lower-tier partnership's liability. The regulations in effect before the final regulations did not address this situation. Under the final regulations, the lower-tier partnership must allocate the liability directly to the partner.

The final rule is broadly consistent with the proposed rule. The final rules add a clarification regarding how the tiered partnership rule applies in a case in which there is overlapping economic risk of loss among unrelated partners and add an example to illustrate the application of the proportionality rule when there are tiered partnerships.

## Related-Party Rules

The final regulations also include changes to the related-party rules, including constructive ownership rules, the related-party exception to the related-party rules, and a multiple partner rule.

## Ordering Rule

The final regulations add an ordering rule to clarify how the proportionality rule interacts with the multiple partner rule and how the multiple partner rule interacts with the related partner exception. The ordering rule includes three steps to be followed in order, and the final regulations include an illustrative example.

### PLANNING CONSIDERATIONS

The final regulations adopt the regulations that were proposed more than 10 years earlier with only a few minor changes and additions. Among other changes, the final regulations largely resolve uncertainty in several areas, such as when there is an overlapping of economic risk of loss and how to allocate liabilities in a tiered partnership where a partner in an upper-tier partnership is also a partner in a lower-tier partnership. They also adopt the result reached by the Tax Court in *IPO II v. Commissioner*, 122 T.C. 295 (2004), and change the multiple related partners rule.

As taxpayers may choose to apply the final regulations to liabilities incurred or assumed before the effective date with respect to all returns, including amended returns, filed after the date the regulations were published, taxpayers should evaluate whether the final regulations provide a more favorable result for the partners in the partnership. Note that if a partnership chooses to apply the final regulations to liabilities incurred or assumed prior to the effective date (December 2, 2024), the partnership must apply the final rules consistently to all its partnership liabilities.



## New Reporting for Distributions of Partnership Property

The IRS in December 2024 released the final version of new Form 7217, Partner's Report of Property Distributed by a Partnership, as well as the accompanying instructions, reflecting a new reporting requirement for partners in tax years beginning in 2024 or later.

This new reporting requirement applies to any partner in any partnership that receives from the partnership distributions of property other than cash and marketable securities treated as cash.

Investment partnerships that meet certain requirements can distribute marketable securities to partners on a tax-free basis, and the recipient partner can defer income recognition until the securities are later sold. Other partnerships are generally required to treat marketable securities as cash, resulting in more immediate tax consequences.

Each partner receiving a tax-free distribution of property, including marketable securities from an investment partnership, is required to file the new Form 7217. A separate Form 7217 is required to be filed for each date during the tax year in which a distribution was received and will be attached to the recipient's tax return. The information reported must include the basis of the distributed property and any required basis adjustments to such property.

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## PLANNING CONSIDERATIONS

This new filing requirement reflects a continuation of the IRS's recent efforts to expand required disclosures from partnerships. Private companies organized as partnerships should be prepared to receive additional requests from limited partners as they comply with the Form 7217 reporting requirement.



## SIMPLIFIED CAMT GUIDANCE RELATING TO PARTNERSHIP INTERESTS

The IRS announced in [Notice 2025-28](#) that it intends to partially withdraw proposed regulations on the application of the corporate alternative minimum tax (CAMT) to partnerships and CAMT entity partners and to issue revised proposed regulations. Pending publication of the revised proposed regulations, the notice provides interim guidance.

The modified guidance is intended “to reduce burdens and costs” in applying the CAMT to applicable corporations with financial statement income (FSI) attributable to investments in partnerships. The notice includes interim guidance on simplified methods to determine an applicable corporation’s adjusted financial statement income (AFSI) with respect to an investment in a partnership, reporting by partnerships of information needed to compute AFSI, and rules for partnership contributions and distributions.

### Key changes in the revised guidance include:

- Adding two alternative methods for calculating a CAMT entity partner’s distributive share of modified FSI (e.g., the top-down election and the limited taxable-income election);
- Loosening requirements for requesting information; and
- Introducing modifications to the AFSI adjustments that apply certain partnership principles in current proposed regulations (i.e., Prop. Reg. §1.56A-20).

### CAMT Background and Previous IRS Guidance on Partnership Interests

For tax years beginning after December 31, 2022, the CAMT imposes a 15% minimum tax on the AFSI of applicable corporations (generally, those with average annual AFSI exceeding \$1 billion). AFSI is generally defined as the net income or loss of the taxpayer set forth on the taxpayer’s applicable financial statement for that tax year, adjusted as further provided in Section 56A.

In September 2024, the IRS issued proposed regulations on the CAMT that included significant new provisions for partnerships. The proposed regulations set out rules for determining and identifying AFSI, including applicable rules for partnerships with CAMT entity partners.

The 2024 proposed regulations set out rules regarding a partner’s distributive share of partnership AFSI. The IRS explained in the preamble to the proposed rules that it was proposing adopting a “bottom-up” method, which it believed was consistent with the statute and more conducive to taking into account Section 56A adjustments. Under the proposed bottom-up method, a partnership would calculate its AFSI and provide this information to its partners. Each partner would then need to determine its “distributive share” of the partnership’s AFSI. Under the proposed rules, the CAMT entity partner would undertake a four-step calculation to arrive at its distributive share amount.

The 2024 proposed regulations also included rules to provide for adjustments to carry out the principles of Subchapter K regarding partnership contributions, distributions, and interest transfers. For both contributions and distributions of property, the IRS proposed a deferred sale method.

### New Interim Guidance and Planned Proposed Regulations

Notice 2025-28 describes interim guidance intended to simplify the rules set out in the 2024 proposed regulations, and the IRS said it anticipates releasing proposed regulations consistent with the guidance to be effective for tax years beginning after the publication of final regulations. For tax years beginning before the forthcoming proposed regulations are issued, taxpayers may choose to apply the guidance described in the notice.

### Top-Down Election

The interim guidance allows a CAMT entity partner to make a “top-down election” to determine its amount of AFSI from a partnership investment for each tax year (starting with the first tax year for which the election is in effect) by reference to the amount the CAMT entity partner reflects in its FSI for the tax year with respect to the partnership investment. Under this election, the four-step calculation of a CAMT entity partner’s AFSI under the 2024 proposed regulations would be replaced by a simplified calculation. This alternative calculation equals the sum of (i) 80% of the “top-down amount,” which is defined as “any amounts reflected in the CAMT entity partner’s FSI for the tax year that are attributable to the partnership investment for which the top-down election is in effect,” (ii) amounts included in AFSI from sales or exchanges, and (iii) certain adjustments described in section 3.02 of the notice. The numerous adjustments not enumerated in section 3.02 of the notice are excluded from an electing partner’s AFSI calculation.

# Partnerships

## ***Different CAMT Entity Partners in the Same Partnership Can Take Different Approaches***

If a CAMT entity partner makes a top-down election, the partnership is no longer required to report its modified FSI to that partner. But if a CAMT entity partner has not made the election, the partnership is still required to compute and report its FSI to a non-electing partner that gives the partnership notice that it requires the partnership to compute and report its modified FSI. A partnership may have both electing and non-electing partners.

## ***Who Can Elect the Top-Down Approach?***

Any CAMT entity partner can make the top-down election, provided it is not a partnership. If a CAMT entity is a partner in multiple partnerships, it can choose where it would like to make the election.

## ***Alternative Approaches for Calculating Partnership AFSI***

The IRS is also considering a “limited taxable-income election,” pursuant to which some CAMT entity partners may use taxable-income amounts to determine their AFSI from a partnership investment. The notice provides a formula for this, which, broadly speaking, is the sum of taxable income, AFSI attributable to sales/exchanges, and AFSI inclusions attributable to foreign stock.

## ***Calculating a CAMT Entity Partner’s Distributive Share Under the Bottom-Up Approach***

New rules will provide greater flexibility in determining a CAMT entity partner’s distributive share. The 2024 proposed regulations set out a rather formulaic approach that was outside of typical Subchapter K concepts. The new rules would provide for certain “reasonable methods” for determining distributive share by using existing Subchapter K concepts, such as net Section 704(b) income or loss.

## ***Requesting Information from Partnerships***

The notice gives a CAMT entity more time to request necessary information from the partnership if the “top-down election” is not made. If a partnership fails to provide the requested information, the partner may use its books and records rather than applying required estimate rules.

## ***Contributions and Distributions***

The IRS provides additional rules on how to account for partnership contributions and distributions. Under the notice, CAMT entities may choose from two additional methods to determine AFSI adjustments for partnership contributions and distributions (other than partnership contributions and distributions involving stock of a foreign corporation): the “modified -20 method” and the “full Subchapter K method.”

Under the modified -20 method, a CAMT entity partner may apply Prop. Reg. §1.56A20 with certain modifications provided by the notice. These modifications include (1) applying Sections 752 and 707 in determining whether Sections 721(a) or 731(b) apply to partnership contributions and distributions of property subject to liabilities, and (2) changes to recovery period rules for property to which Section 168 applies as well as property for which there is no applicable recovery period.

Under the full Subchapter K method, a partnership may apply the principles of Sections 721 and 731 to determine its partners’ distributive shares of partnership AFSI resulting from contributions or distributions. If a partnership adopts this method, it must also apply the principles of other relevant Subchapter K provisions (e.g., Sections 704(c), 732, 734, and 737).

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## **PLANNING CONSIDERATIONS**

Notice 2025-28 provides CAMT entity partners with new approaches for determining their AFSI from partnership investments. These approaches are intended to streamline the calculation process and reduce administrative complexity, particularly for taxpayers seeking alternatives to the current, more burdensome distributive share rules. Taxpayers should consider the calculations underlying each approach to determine which would best serve their interests.

While taxpayers may apply the notice’s interim guidance for tax years before new proposed regulations are issued, the IRS anticipates further modifications to be reflected in the anticipated proposed regulations, particularly regarding partnership distributive share and contribution/distribution rules. Accordingly, partnerships with CAMT partners should watch for new guidance and be prepared to adjust their approaches as the rules evolve.



# Credits and Incentives

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# Credits and Incentives



With all the challenges facing private companies this year, it's critical that they leverage every available tax benefit. Fortunately, lawmakers have packed the Code with credits and incentives designed to reward taxpayers for certain types of activities and investments. The OBBBA made significant revisions to energy credits, imposing new restrictions and phasing out many of the credits early. Despite the changes, there is still considerable runway for many projects, and the tax equity financing and credit transfer markets should both be robust over the next several years. In addition, the OBBBA enhanced existing incentives in ways that offer new opportunities for tax-efficient structuring.

## ENERGY PROVISIONS FOLLOWING ENACTMENT OF THE OBBBA

The OBBBA has reshaped the energy credit landscape. Several credits were extended or enhanced, while many others are subject to new sourcing and investment requirements or are phasing out early. The legislation does not affect the ability to transfer or claim refundable payments for specified credits

### Consumer Credits

#### Section 25E – Previously Owned Clean Vehicle Credit

- Repealed for vehicles acquired after September 30, 2025.

#### Section 30D – Clean Vehicle Credit

- Repealed for vehicles acquired after September 30, 2025.

#### Section 45W – Commercial Clean Vehicle Credit

- Repealed for vehicles acquired after September 30, 2025.

#### Section 30C – Alternative Fuel Refueling Property Credit

- Repealed for property placed in service after June 30, 2026.

### Depreciation

The bill eliminates the five-year depreciable life for qualified energy property, and the Section 179D deduction is repealed for construction beginning after June 30, 2026.

#### Section 25C – Energy-Efficient Home Improvement Credit

- Repealed for property placed in service after December 31, 2025.

#### Section 25D – Residential Clean Energy Credit

- Repealed for expenditures made after December 31, 2025.

#### Section 45L – New Energy-Efficient Home Credit

- Repealed for property acquired after June 30, 2026.

# Credits and Incentives

## Sections 48E and 45Y – Investment and Production Tax Credits

The OBBBA accelerates the phaseout of the investment tax credit under Section 48E and the production tax credit under Section 45Y. Projects that begin construction after 2033 will generally no longer qualify for these credits, with solar and wind facilities facing even earlier deadlines. To remain eligible, solar and wind projects that begin construction after July 4, 2026, must be placed in service by the end of 2027.

The legislation also introduces new restrictions related to prohibited foreign entities. Facilities beginning construction after December 31, 2025, may not receive material assistance from such entities. Material assistance is determined based on a cost ratio tied to the sourcing of eligible components. In addition, Section 48E now includes stricter domestic sourcing requirements to obtain the 10% bonus credit, reflecting a broader policy shift toward supply chain security and energy independence.

Importantly, the IRS has **tightened the rules** for establishing that construction has begun for purposes of the July 4, 2026, deadline for solar and wind facilities. Under Notice 2025-43, the 5% safe harbor method is available only if taxpayers can use it to establish that construction began by September 1, 2025. Starting September 2, the physical work test is the sole method for establishing beginning of construction (BOC) for wind and solar projects for purposes of the July 4, 2026, deadline.

This change applies to the credit phaseouts under the OBBBA, but not to the foreign entity of concern (FEOC) rules. For FEOC exemption purposes, facilities may still use the 5% safe harbor to establish that construction began by December 31, 2025. Additionally, low-output solar facilities ( $\leq 1.5$  MW AC) may continue to use the 5% safe harbor beyond that date. The four-year continuity safe harbor remains in place for projects that meet BOC requirements.

Historically, taxpayers could rely on either the physical work test or the 5% safe harbor. Notice 2025-42 now limits this to the physical work test, which requires significant physical work related to the energy property, either on-site or off-site, under a binding contract. Preliminary activities like design or site clearing do not qualify.

To maintain credit eligibility, taxpayers must also meet the continuity requirement, which can be satisfied if the facility is placed in service within four years of the BOC year.

### PLANNING CONSIDERATIONS

Facilities must establish BOC by December 31, 2025, to avoid FEOC restrictions beginning in 2026, and facilities can continue to rely on the 5% safe harbor specifically for the purpose of meeting this deadline through the end of 2025. Solar and wind projects beginning construction more than 12 months after the OBBBA enactment must be placed in service by the end of 2027 to qualify for Section 48E or 45Y credits. Facilities that establish BOC by the deadline can rely on the four-year continuity safe harbor to place in service and preserve credit eligibility.

## Section 45X – Advanced Manufacturing Credit

The advanced manufacturing credit under Section 45X has been modified significantly. While the credit is repealed for wind energy components sold after 2027, it remains available for other eligible components before a phasedown begins in 2031. Components sold in 2031 will qualify for a 75% credit, decreasing to 50% in 2032 and 25% in 2033. The credit is fully repealed for sales occurring in 2034 or later. Notably, the scope of the credit has been expanded to include metallurgical coal. As with other energy provisions, the material assistance restrictions for prohibited foreign entities apply to all qualifying components.

## Section 45Z – Clean Fuel Production Credit

Under the OBBBA, the clean fuel production credit under Section 45Z has been extended through 2031. The bill also reinstates the small agri-biodiesel credit under Section 40A, which can now be stacked with the 45Z credit. A new geographic restriction has been added, disallowing the credit unless the feedstock is produced or grown in Canada, Mexico, or the U.S. Additionally, the methodology for calculating greenhouse gas emissions has been revised to exclude indirect land use changes. Prohibited foreign entity rules have also been extended to apply to clean fuel production facilities.

# Credits and Incentives

## Other Energy Provisions

The clean hydrogen production credit under Section 45V is repealed for construction beginning after 2027 — two years later than previously proposed. Section 45Q credit rates for carbon capture used as a tertiary injectant or for productive use are increased to match those for permanent geologic storage, with new foreign entity restrictions.

Publicly traded partnership (PTP) rules now include income from carbon capture; nuclear, hydropower, and geothermal energy projects, as well as the transport or storage of sustainable aviation fuel or hydrogen. The nuclear production credit under Section 45U is also subject to foreign entity restrictions.

### PLANNING CONSIDERATIONS

Taxpayers should assess project timelines and sourcing strategies in light of phaseouts and new restrictions. For Sections 45Y and 48E, construction must begin within eligibility windows — especially for solar and wind projects facing a 2027 placed-in-service deadline.

Supply chain planning is critical to avoid disqualification under foreign entity rules. Manufacturers of wind property eligible for Section 45X should consider accelerating production before the phaseout in 2027. Clean fuel producers must ensure feedstock sourcing complies with geographic limits and updated emissions rules.

Entities pursuing carbon capture, hydrogen, or nuclear projects should factor in expanded PTP eligibility and foreign entity restrictions when structuring financing and partnerships. Early action can help preserve credit eligibility and provide long-term benefits.

## STATE TAX CREDIT TRANSFERS

Following the enactment of the OBBBA, many states have expanded or introduced transferable tax credit programs, particularly in clean energy, affordable housing, and infrastructure. These programs allow taxpayers to sell unused credits to third parties, creating liquidity and broader access to state-level incentives. Transfer mechanisms vary by state, with some requiring pre-approval, certification, or registration, while others impose annual caps or limits on transfer volume. The trend mirrors federal credit transferability under Section 6418 and reflects growing interest in flexible credit monetization strategies.

States are also beginning to adopt market infrastructure—such as broker platforms and insurance products — to support credit transfers and mitigate buyer risk. As more jurisdictions adopt these frameworks, taxpayers with multistate operations should monitor developments closely to identify new opportunities.

### PLANNING CONSIDERATIONS

Taxpayers should assess eligibility and timing for generating transferable credits, especially in states with strict certification or sourcing requirements. Early coordination with legal and tax advisors is essential to confirm compliance with documentation and reporting rules. Buyers should conduct due diligence on project qualification, transfer terms, and potential recapture risks.

Engaging with credit brokers or marketplaces may help improve pricing and identify reliable counterparties. Additionally, taxpayers should consider how state credit transfers interact with federal incentives, particularly in structuring financing and partnership arrangements. Strategic planning now can help enhance credit value and avoid missed opportunities as state programs continue to evolve.

# Credits and Incentives



## OBBBA MAKES NEW MARKETS TAX CREDIT PROGRAM PERMANENT

The New Markets Tax Credit (NMTC) program supports capital investments in low-income communities by offering tax credit-subsidized loans to eligible businesses for use toward eligible costs (e.g., real estate and furniture, fixtures, and equipment (FFE)). These loans often feature interest-only terms, below-market rates, and principal forgiveness after seven years, providing a permanent cash benefit to businesses.

Previously set to expire at the end of 2025, the NMTC program was made permanent by the OBBBA, with a continued annual allocation authority of \$5 billion. Eligible businesses — both for-profit and nonprofit — can apply for NMTC financing for capital expenditure projects in qualifying census tracts. The program supports a wide range of sectors, including manufacturing, healthcare, education, renewable energy, and retail, though it excludes farming and residential rental activities.

Each year, certified Community Development Entities (CDEs) apply to the CDFI Fund for NMTC allocations. If awarded an allocation, CDEs raise equity from tax credit investors and deploy capital to eligible businesses (otherwise known as Qualified Active LowIncome Community Businesses) based on community impact and strategic priorities, which may vary by geography or industry.

### PLANNING CONSIDERATIONS

The NMTC program remains highly competitive. Early engagement with CDEs and timely application are critical to securing financing. Businesses should prepare detailed project plans that demonstrate strong community impact and align with CDE priorities. Acting early improves the likelihood of receiving funding and may unlock additional benefits.

## WORK OPPORTUNITY TAX CREDIT SET TO EXPIRE

The OBBBA did not extend the work opportunity tax credit (WOTC), which is now set to expire for any individuals who begin work after December 31, 2025. The WOTC provides a valuable incentive for employers who often hire workers from certain targeted populations, including veterans, people with disabilities, people on food assistance, certain youth employees, and ex-felons. Employers who frequently screen for qualified individuals as part of their hiring process should monitor the legislative process for a potential extension of the credit.

## PASS-THROUGH DEDUCTION

The OBBBA makes permanent the 20% deduction for qualified business income under Section 199A and favorably adjusts the phaseout of the deduction for taxpayers who do not meet the wage expense and capital investment requirements or who participate in a “specified service trade or business.”

### PLANNING CONSIDERATIONS

The permanence of this provision provides welcome certainty for private companies engaged in qualifying activities. The deduction is not available for a range of specified service businesses. There may be opportunities to segregate activities and to increase or allow deductions. The safe harbor for rental activity to qualify as a Section 199A trade or business under [Rev. Proc. 2019-38](#) remains in effect.



# Credits and Incentives



## R&D Credit Opportunities

The research credit remains one of the most powerful incentives in the tax code, and the IRS continues to receive a high volume of claims, straining examination resources. To improve administration and reduce improper claims, the IRS recently made several changes to Form 6765, clarifying documentation requirements for claiming the credit.

The revised Form 6765 was partially finalized for tax year 2025, with the IRS making optional the mandatory reporting of qualified research expenses (QREs) by business component in Section G of the form. When Section G becomes mandatory for the 2026 tax year, taxpayers will be required to disclose the top 80% of QREs, with controlled group members required to attach detailed breakdowns by entity. Section E is currently mandatory and includes new questions related to officer wages, acquisitions, and use of the ASC 730 directive. These updates reflect the IRS's ongoing efforts to enhance transparency and strengthen audit readiness.

In response to ongoing compliance concerns, the IRS has increased scrutiny of research credit filings, including more frequent audits. However, due to temporary resource constraints, some IRS Exam functions are operating at reduced capacity, which may delay enforcement actions. Taxpayers should confirm that they are properly documenting claims and explore state credit opportunities.



# Credits and Incentives



## STATE CREDIT CHANGES

Over the past year, several states have enacted or revised legislation related to research and development (R&D) tax credits. These changes reflect a growing trend to incentivize innovation and attract high-tech investment.

### These states include:

**Arizona:** Arizona now permits use of the alternative simplified credit (ASC) method for computing its credit for increased research activities. This provides greater flexibility and may result in increased benefits. Refundable credits are available for small businesses with fewer than 150 employees, subject to pre-approval from the Arizona Commerce Authority.

**Arkansas:** Arkansas expanded its credit options, offering up to 33% for strategic research areas and university partnerships. Credits are nonrefundable but can offset 100% of state tax liability and be carried forward for up to nine years.

**Connecticut:** Connecticut expanded its R&D and R&E credits under H.B. 7287. Single-member LLCs may now qualify if they meet specific criteria. Refundability increased to 90% for small biotech firms and 65% for other small businesses, capped at \$1.5 million per company annually.

**Iowa:** Iowa enacted Senate File 657, replacing its research activities credit with a targeted R&D tax credit program effective January 1, 2026. Eligibility is limited to sectors such as advanced manufacturing, bioscience, finance, insurance, and technology. Credits are capped at \$40 million annually and require CPA-verified QREs and a competitive application process through the Iowa Economic Development Authority.

**Massachusetts:** Massachusetts increased the maximum allowable credit for certain industries and introduced new documentation requirements for software development and AI-related R&D.

**Michigan:** Effective January 1, 2025, Michigan reintroduced its R&D tax credit. Large businesses may claim 3% of qualifying expenses up to a base amount and 10% above it, capped at \$2 million. Small businesses may claim 15% above the base amount, capped at \$250,000. An additional 5% credit is available for university collaborations, capped at \$200,000. The credit is refundable and subject to a \$100 million annual cap.

**Minnesota:** Minnesota introduced partial refundability for its R&D credit: 19.2% for 2025, increasing to 25% for 2026–2027.

**Oklahoma:** Oklahoma revised its R&D credit to align more closely with federal QRE definitions and introduced a new pre-approval application process.

**Texas:** Texas enhanced its franchise tax R&D credit via SB 2206 and repealed the R&D equipment sales tax exemption effective January 1, 2026.

## PLANNING CONSIDERATIONS

Navigating the R&D credit has become more complex amid heightened review, evolving case law, and new compliance measures. Taxpayers should make sure claims are well-supported and consistent with updated guidance to reduce audit risk and avoid delays.

Taxpayers should carefully assess eligibility for both federal and state research credits, maintain contemporaneous documentation, and prepare to defend claims under examination. Strategic planning is essential to leveraging available incentives, especially given the complexity and variability of state-level programs. Using a trusted tax advisor can help taxpayers maintain compliance with IRS and state regulations and effectively substantiate research credit claims.

# Credits and Incentives



## OBBBA CHANGES RULES FOR QUALIFIED SMALL BUSINESS STOCK

The OBBBA significantly enhances a tax-efficient structuring option for private companies. Qualified small business stock (QSBS) under Section 1202 offers tax-free appreciation, and has been increasingly used by private equity in recent years.

Enacted in 1993, Section 1202 generally allows a non corporate taxpayer to exclude a percentage of the gain from the sale or exchange of QSBS held for more than five years. The eligible gain exclusion percentage is based on the date the stock is issued.

For stock issued before July 5, 2025, the maximum amount of gain on QSBS that can be excluded for any tax year by each taxpayer with respect to each issuing C corporation is generally limited to the greater of: (i) \$10 million, minus the amount of gain excluded by that taxpayer in prior years with respect to the same issuing corporation; or (ii) 10 times the taxpayer's aggregate adjusted basis in the QSBS sold during the tax year.

For stock issued after July 4, 2025, the OBBBA increases the \$10 million limit to \$15 million and adjusts this limit for inflation beginning in 2027. In addition, the OBBBA creates new 50% and 75% gain exclusion categories for QSBS held for at least three and four years, respectively.

The various QSBS exclusion percentages, exclusion limits, and required holding periods by stock issuance date are set out in the table below.

QSBS Issued:		Percentage of Eligible Gain Excluded	Limited to Greater of 10x Basis or	Required Holding Period (Years)
After	and Before			
8/10/1993	2/18/2009	50%	\$10M	More than 5
2/17/2009	9/28/2010	75%	\$10M	More than 5
9/27/2010	7/5/2025	100%	\$10M	More than 5
7/4/2025		50%	\$15M	3
7/4/2025		75%	\$15M	4
7/4/2025		100%	\$15M	5 or more

The OBBBA also increases the limit on aggregate gross assets to satisfy the qualified small business test for purposes of Section 1202.

These thresholds are now as follows:

- At all times through the date of issuance, the corporations aggregate gross assets must not have exceeded \$50 million for issuances before July 5, 2025, or \$75 million for issuances after July 4, 2025; and
- Immediately after the date of issuance (and after considering amounts the corporation received in the issuance) the aggregate gross assets of the corporation must not exceed \$50 million or \$75 million for issuances before July 5, 2025, or after July 4, 2025, respectively.

Aggregate gross assets are defined as cash plus the aggregate adjusted tax basis of the corporation's other assets.

## PLANNING CONSIDERATIONS

After an issuance is deemed to be QSBS under Section 1202, the corporation's gross assets can exceed the applicable threshold (either \$50 million or \$75 million) at a later date without prohibiting the previously issued stock from receiving Section 1202 treatment. By increasing the threshold, the OBBBA renews an existing corporation's ability to issue QSBS if their aggregate gross assets have exceeded \$50 million in the past but have never exceeded \$75 million. This higher threshold also expands the potential QSBS benefits for private equity firms when acquiring target businesses with enterprise values of up to \$75 million.



## Credits and Incentives

### OPPORTUNITY ZONE EXTENSION CREATES TAX PLANNING OPTIONS

The OBBBA made the qualified opportunity zone (QOZ) program permanent, preserving one of the most generous tax incentives ever offered by Congress. The provision can offer benefits to investors looking for tax-efficient returns, individual private companies investing in specific geographies, or asset managers setting up funds.

The OBBBA not only makes the program permanent, but it changes the rules in important ways. Funds and investors should consider the implications for their planning strategies. The changes could affect the timing of gain transactions and capital contributions, the location of investments, and the compliance burdens for funds.

The current QOZ designations will expire at the end of 2026. New zones will be designated in rolling 10-year designation periods under new criteria that are expected to shrink the number of qualifying zones.

As under the current program, taxpayers can defer capital gains by investing in a qualified opportunity fund (QOF). For investments made after 2026, taxpayers will be required to recognize the deferred gain five years after making the investment but will receive a 10% increase in basis for holding the investment five years. For QOFs operating in a new category of rural opportunity zones, this basis increase is 30%. Taxpayers who make investments before the end of 2026 must still recognize the deferred gain at the end of 2026.

The more powerful tax benefit may be the tax-free appreciation on the underlying investment itself. Taxpayers will still receive a full basis step-up to fair market value (FMV) for property held 10 years, but the OBBBA added a rule freezing the basis step-up to the FMV at 30 years after the date of the investment.

The operational rules for QOFs and qualified opportunity zone businesses (QOZBs) are generally unchanged, except for property held in a rural opportunity zone. The threshold for establishing the substantial improvement of qualifying property in a rural opportunity zone will be 50% of basis rather than 100%, effective for any determinations after July 4, 2025. QOFs and QOZBs will both be subject to increased reporting requirements.

Companies looking for new tax-efficient investing opportunities and gain deferral strategies should reassess their investment options, paying particular attention to which geographies are likely to qualify in 2027.



### PLANNING CONSIDERATIONS

The timing of capital gains transactions will be important. Delaying a capital gain transaction could allow taxpayers to make a deferral election in 2027 and defer recognizing the gain until well after the current 2026 recognition date. Conversely, taxpayers planning investments in geographic areas that are unlikely to be redesignated may need to make the investments before the end of 2026. Existing QOFs and QOZBs should consider their long-term capital needs because it is not clear whether any “grandfathering” relief will allow additional qualified investments in funds operating in QOZs that are not redesignated. The new reporting rules will apply to both new and existing QOZs and QOZBs for tax years beginning after the date of enactment, and those entities will need to collect and report substantial new information that has never before been required.



# Credits and Incentives



## REIT STRUCTURING AND REAL ESTATE BENEFITS

The real estate investment tax (REIT) structure remains an effective way to structure certain real estate activities with only one layer of tax. The OBBBA raises from 20% to 25% the portion of the gross asset value of a REIT that may be attributable to equity and debt securities of taxable REIT subsidiaries, effective for tax years beginning after 2025. The change should provide added flexibility.

In addition, the OBBBA allows the completed contract method of accounting for many residential condominium, construction, and sale projects, effective for contracts entered into after July 4, 2025. For residential developers that meet the average annual gross receipts test under Section 448 (\$31 million in 2025), the maximum estimated contract length is increased from two years to three years to qualify for the exception from the UNICAP rules under Section 263A.

### PLANNING CONSIDERATIONS

This provision provides much-needed tax relief to condo developers who often had to report income under the percentage of completion method, which often required the reporting of income before receiving payment. Allowing the use of the completed contract method of accounting allows better matching of reporting taxable income with the receipt of cash by the developer.

Unfortunately, the relief is provided only prospectively for contracts entered into after the July 4, 2025, enactment date. Therefore, taxpayers with contracts entered into prior to the enactment date will continue to be subject to the old rules. Moreover, reporting income for projects begun in prior years may be bound to the prior method of accounting.



# Capital Markets and M&A

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The current capital markets environment remains marked by volatility, persistent inflationary pressure, and structurally higher interest rates. Companies are facing less predictable financing windows, with higher cost debt and volatile equity valuations. As a result, many issuers are increasingly turning to hybrid instruments such as convertibles, opportunistic equity raises, or converting maturing debt to equity when credit provides unfavorable refinancing options. With the current economic headwinds, companies are proactively recapitalizing to preserve flexibility ahead of potential market tightening.

The same economic factors are affecting the M&A market, which is beginning to rebound. Overall deal values increased over the summer despite fewer transactions, driven partially by digital transformation as companies seek to enhance capabilities.

Whether managing capital needs or engaging in strategic M&A activity, tax considerations should be part of the decision-making process. Several key issues and developments can impact strategy. Debt refinancing and hedging transactions can have important tax implications. Section 382 can restrict the value of tax attributes and may be particularly important with increasing deductions thanks to the OBBBA. The Tax Court has also issued an important ruling on termination fees, and the IRS has rescinded new reporting on certain types of transactions.

## PLANNING FOR SECTION 382 LIMITATIONS

Section 382 limitations can significantly reduce the net present value of a corporation's net operating losses, Section 163(j) interest expense carryforwards, tax credit carryforwards, and Section 174 balances following an "ownership change." Section 382 limitations also may impact anticipated tax benefits when companies exit non-core businesses.

For purposes of Section 382, an ownership change occurs if there is a 50% shift in the corporation's 5% shareholder ownership within a rolling three-year period. An ownership change may occur as a result of cumulative transactions between a corporation and its shareholders, or it may come about because of an acquisition or merger. When an ownership change occurs, the analysis required to compute the applicable limitations is complex.

Regular, real-time monitoring of a company's Section 382 profile can identify opportunities to defer or avoid Section 382 ownership changes and associated tax attribute limitations

### Opportunities may include, for example:

- Sizing a stock issuance to keep the ownership shift below 50%.
- Delaying an issuance or similar transaction to allow previous equity events to fall outside the rolling three-year window.
- In certain circumstances, involving potential ownership shifts associated with large cash raises, redeeming non-participating 5% shareholders below 5% in conjunction with the capital raise.
- Implementing strategies such as poison pills and share restrictions to avoid unanticipated ownership changes.

In some situations, triggering an ownership change during high equity valuations may be beneficial to limiting adverse consequences of Section 382 and may increase the company's flexibility to execute additional issuances or recapitalizations without triggering further ownership changes.

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## PLANNING CONSIDERATIONS

Timely, robust Section 382 analyses can provide strategic advantages in M&A transactions by:

- Accurately pricing net operating losses, credits, and Section 174 balances into deal negotiations.
- Identifying opportunities to unlock built-in gains in transactions that increase annual limitation capacity.
- Avoiding post-transaction surprises by structuring ownership changes with Section 382 impacts in mind.

Companies with large unamortized Section 174 balances may face higher stakes. The OBBBA has increased the ambiguity of whether these costs constitute built-in losses for Section 382 purposes, making proactive planning essential to mitigating the risk of unexpected limitations.

With rising costs and volatile valuations, Section 382 planning is vital, and tax departments cannot afford to treat potential Section 382 limitations as an afterthought. By integrating real-time ownership and tax attribute monitoring into strategic tax planning decisions, tax departments can help companies preserve and enhance the value of companies' tax attributes.

## TAX COURT SUPPORTS DEDUCTION FOR TERMINATION FEE

The Tax Court held earlier this year in *AbbVie, Inc. Subsidiaries v. Commissioner* that an approximately \$1.6 billion termination fee was properly deductible as an ordinary business expense, and should not be treated as a capital loss. The case has important implications for the treatment of termination and cancellation fees.

The case centered on a proposed merger between AbbVie and Shire to combine the two companies into a new holding company in Jersey. The transaction was subject to various conditions, including regulatory and shareholder approval.

The two parties entered into a “Cooperation Agreement” obligating both sides to be bound by the transaction and to perform certain actions to implement it. Significantly, the agreement required AbbVie to pay a break fee to Shire if AbbVie’s board of directors failed to recommend the merger or shareholder approval was not obtained. After unfavorable tax guidance was released, AbbVie’s board of directors withdrew its recommendation for the proposed merger and paid Shire the break fee.

AbbVie and the IRS disagreed on the treatment of the break fee. AbbVie argued the fee was deductible either as an ordinary and necessary expense paid or incurred during the tax year in carrying on any trade or business, or as a loss deductible under Section 165, which allows a deduction for any loss sustained during the tax year that is not compensated by insurance or otherwise. The IRS argued that the break fee was a capital loss under Section 1234A, a provision intended to prevent taxpayers from converting capital transactions into ordinary losses via contract terminations. Section 1234A provides that gain or loss attributable to the cancellation of “a right or obligation... with respect to property which is...a capital asset in the hands of the taxpayer” is itself treated as a capital gain or loss.

The Tax Court rejected the Service’s position, finding that the agreement between AbbVie and Shire was not a right or obligation “with respect to property.” The court’s decision was based on a few key determinations. First, the agreement primarily focused on mutual commitments related to obtaining regulatory approval and the provision of corporate facilitative services rather than any direct transaction involving property rights. Second, the Tax Court interpreted the phrase “with respect to property” in Section 1234A to mean a right or obligation in exchange for property interests. The court found that the cooperation agreement included rights or obligations to perform services related to the property, but did not contain rights or obligations to transfer property. Accordingly, the court concluded that Section 1234A limits the scope of the provision to cases in which the taxpayer has a “right or obligation to exchange (i.e., to buy, sell, or otherwise transfer or receive) an interest in property.”

### PLANNING CONSIDERATIONS

The decision provides welcome and favorable guidance with respect to the tax treatment of termination fees, potentially limiting the scope of Section 1234A. Taxpayers should continue to monitor this area, however, as the IRS has appealed the decision to the Seventh Circuit. It should also be noted that the decision was very fact-specific and relied heavily on the determination that the obligations were largely service-oriented. The result underscores the importance of evaluating whether a contract obligates the parties to complete a transaction, or merely facilitates one. Companies should also note that notwithstanding the holding in AbbVie, a termination fee may not necessarily be currently deductible. Consideration must also be given to Reg. §1.263(a)-5, which generally requires termination fees to be capitalized if the payer is terminating the transaction to enter into another transaction.



## IRS RESCINDS NEW REPORTING REQUIREMENTS FOR M&A TRANSACTIONS

The IRS has withdrawn and superseded guidance released just before former President Biden left office that covers the nonrecognition of gain or loss in corporate separations, incorporations, and reorganizations and updated reporting requirements for Section 355 transactions. The Biden-era guidance process started in May 2024 when the IRS updated its private letter ruling policy in [Rev. Proc. 2024-24](#) and outlined its views in [Notice 2024-38](#). The IRS followed with two sets of proposed regulations in January 2025 ([REG-112261-24](#) and [REG-116085-23](#)), which translated their views into formal guidance and imposed new multiyear reporting requirements.

The IRS has now withdrawn both sets of proposed regulations and issued a new revenue procedure ([Rev. Proc. 2025-30](#)) superseding the private letter ruling guidance in Rev. Proc. 2024-24. The maneuver essentially reverts to the rules in place under [Rev. Proc. 2017-53](#) and [Rev. Proc. 2018-53](#).

The move is welcome news for taxpayers, particularly those seeking private letter rulings. Although the regulations were still in proposed form, the IRS had been applying them to private letter ruling requests. The new rules (largely reverting to rules in place before Rev. Proc. 2024-24) will apply for any ruling requests postmarked or received after Sep. 29, 2025.

## TREASURY TAX REVIEW

Treasury groups are facing unprecedented challenges from volatile market conditions. Uncertain interest rates, volatile credit markets, currency fluctuations, and strained commodity markets have all been affecting financing, investing, and cash management and have caused treasurers to reevaluate how and when to hedge various risks. These activities will generally have significant tax consequences and the need for tax departments to be involved in these decisions has never been greater. Companies should evaluate all treasury activities from a tax perspective on a regular basis.

## DEBT REFINANCING TRANSACTIONS

Over the past year, many private companies have refinanced their existing debt to secure current interest rates, with the potential for rates to decrease in the future. Refinancing transactions that result in a “significant modification” of the debt under applicable regulations can have disparate tax consequences depending on the specific circumstances. Although the regulations provide relatively clear rules for determining when a modification is “significant,” the application of these rules is highly fact-dependent and frequently requires relatively complex calculations.

Companies should review their debt modification transactions during the year to confirm their tax impact. Companies that are considering changes to existing credit facilities in the coming year should likewise assess whether the proposed change would amount to a significant modification and, if so, determine the tax implications of the modification.

### Tax Treatment of Debt Modifications

The income tax treatment of debt refinancing transactions is highly fact-specific and requires careful analysis. Certain refinancing transactions may be treated as a taxable retirement of the existing (refinanced) debt, which may give rise to the ability to write off any unamortized debt issuance costs and original issue discount, the latter as “repurchase premium.” However, in certain situations a refinancing transaction may also give rise to taxable ordinary income in the form of “cancellation of indebtedness income.”

The tax consequences of a debt refinancing transaction hinge in part on whether the transaction results in a significant modification of the debt under rules set out in Reg. §1.1001-3, which results in a deemed retirement of the existing debt in exchange for a newly issued debt instrument.

## When Is a Modification Significant?

As a threshold matter, a modification includes not only a change to the terms of an existing debt instrument but would also include an exchange of an old debt instrument for a new one or the retirement of an existing debt instrument using the proceeds of a new debt instrument. Stated differently — it is the substance, not the form, that governs whether debt has been modified for federal income tax purposes.

Whether a modification of a debt instrument constitutes a significant modification depends on the materiality of the changes. The regulations provide a general “economic significance” rule and several specific rules for testing whether a modification is significant. In practice, most debt modifications are covered by two specific rules governing changes in the yield to maturity of a debt instrument (the change in yield test) and deferrals of scheduled payments (the deferral test).

- **Yield test:** Under the change in yield test, a modification is significant if the new yield of the modified debt instrument differs from the old yield of the unmodified debt instrument by more than 25 basis points (i.e., 1/4 of 1%) or 5% of the unmodified yield. Various changes, such as adjusting the interest rate, altering payment schedules, or paying modification fees, can impact the yield. It is not uncommon for a modification with only a minor (or no) change to the stated interest rate to result in a significant modification due to changes in the yield to maturity that result from the payment of modification fees or changes to the due dates for certain payments. This issue is often overlooked.
- **Deferral test:** Under the deferral test, a modification is significant if it causes a material deferral of payments. While the test does not define “material deferral,” it offers a safe harbor: a deferral is not significant if all payments are unconditionally made within the safe harbor period. This safe harbor period starts on the first deferred payment date and lasts for the lesser of five years or 50% of the original term (e.g., the deferral safe harbor for a five-year debt instrument would be two-and-a-half years).

In applying both the change in yield test and the deferral test, taxpayers are required to consider the cumulative effect of the current modification with any prior modifications (or, in the case of a change in yield, modifications occurring in the past five years). This cumulative rule is particularly noteworthy for taxpayers who routinely modify their debt (and often incur modification fees in connection with the modification), as the results of certain modifications may not be significant when viewed in isolation but may be significant when combined with prior modifications.

## Tax Implications of Significant Debt Modifications

A significant modification results in the deemed retirement of the existing debt instrument in exchange for a newly issued debt instrument. The existing debt instrument will be deemed retired for an amount equal to the “issue price” of the newly issued debt instrument, together with any additional consideration paid to the lenders as consideration for the modification.

The issue price of a debt instrument depends on whether the debt instrument was issued for cash or property. If a significant amount (generally 10%) of the debt was issued for money, the issue price will be the cash purchase price. Otherwise, assuming the debt instrument is in excess of \$100 million, the issue price will be its fair market value (or the fair market value of the property for which it was issued) if it is “publicly traded.” In all other cases, the issue price of the debt instrument will generally be its stated principal amount.

If the issue price of the modified debt instrument (i.e., the repurchase price) is less than the tax-adjusted issue price of the old debt instrument, a borrower will incur cancellation of indebtedness income, which is generally taxed as ordinary income in the current tax year. If instead the repurchase price exceeds the adjusted issue price (this may occur when the old debt instrument had unamortized original issue discount or when the debt is publicly traded and has a fair market value in excess of its face amount), the borrower will incur repurchase premium. Repurchase premium is deductible as interest expense. Special rules apply to determine whether such repurchase premium is currently deductible or is instead amortized over the term of the newly issued debt instrument.

The retirement of an existing debt instrument may also give rise to the ability to deduct any unamortized debt issuance costs. As a general matter, the determination of whether any unamortized debt issuance costs should be written off or carried over and amortized over the term of the new debt instrument generally follows the same analysis as repurchase premium. Notably, debt issuance costs are deducted as ordinary business expenses under Section 162, and therefore are not subject to the limit on business interest expense deduction under Section 163(j).

Finally, a significant modification may give rise to additional tax implications that companies should consider, including the potential for foreign currency gain or loss and the need to “mark-to-market” existing tax hedging transactions.

## TAX HEDGING IDENTIFICATION AND DOCUMENTATION

Most companies enter into hedging transactions to manage risk that arises in their business, such as interest rate, currency, and commodity price risk. These transactions are subject to tax hedging rules, and failure to follow the requirements under those rules could result in negative tax consequences. The tax hedging rules impose a same-day identification requirement with timing and character whipsaw rules that may apply if such transactions are not timely identified.

As part of year-end reviews and planning for next year, companies should review these rules and the sufficiency of their hedging identification and documentation processes so they can properly meet the requirements.

### Tax Hedge Qualification & Character

To qualify as a tax hedge, the transaction must occur within the normal course of business and be used to manage interest rate, currency, or commodity price risk with respect to ordinary property or ordinary obligations (incurred or to be incurred) by the taxpayer. For this purpose, property is ordinary if a sale or exchange of the property could not produce capital gain or loss under any circumstances. Taxpayers may manage risk on a transaction-by-transaction basis or, alternatively, may manage aggregate risk (i.e., they may enter into one or more foreign currency contracts to manage aggregate foreign currency risk).

Gain or loss on a tax hedging transaction will be ordinary income or loss if the transaction is properly identified and documented in a timely manner.

### Same-Day Identification Requirement

The tax hedging rules require that each tax hedging transaction be identified as such no later than the close of the day on which the hedge was entered into. The hedged item must be identified substantially contemporaneously with the tax hedging transaction, but in no case more than 35 days after the hedging transaction was entered into.

An identification must identify the item, items, or aggregate risk being hedged. Identification of an item being hedged involves identifying a transaction that creates risk and the type of risk that the transaction creates. This identification is made in (and retained as part of) the company's tax files and is not sent to the IRS. A GAAP (or IFRS) hedge identification will not satisfy the tax hedge identification requirement unless the taxpayer's books and records make clear that such identification is also being made for tax purposes. Additional regulatory guidance is provided for certain categories of hedging transactions, including hedges of debt issued (or to be issued) by the taxpayer, inventory hedges, and hedges of aggregate risk.

Taxpayers are given significant flexibility regarding the form of such identification. For companies that enter into tax hedging transactions infrequently, a same-day identification may be prepared and saved in the company's tax files. However, this approach is often challenging for taxpayers that enter into hedging transactions routinely (often on a daily basis). For taxpayers who enter into hedging transactions frequently, the same-day identification requirement can be satisfied through a tax hedging policy. A tax hedging policy will identify the types of transactions entered into to manage risk and the risk managed (and how such risk is managed) and will identify all transactions described in the policy as tax hedging transactions. If properly prepared, the tax hedging policy will serve as identification (for tax hedging purposes) of any transactions described in the policy.

### Hedge Timing Rules

IRS regulations provide special tax accounting rules for tax hedging transactions known as the "hedge timing rules." The hedge timing rules provide a general requirement that the method of accounting used to account for hedging transactions must clearly reflect income by matching the recognition of income, deduction, gain, or loss on the hedging transaction to the recognition of income, deduction, gain, or loss on the hedged item. Special rules are provided for specific types of hedging transactions.

## Failure to Identify — Timing & Character Whipsaws

Failure to properly identify a hedging transaction generally establishes that the transaction is not a tax hedging transaction. As a result, gain or loss on the hedging transaction is determined under general principles. However, the regulations provide a broad anti-abuse rule that will frequently treat any gains as ordinary, which may result in a character whipsaw in which losses are capital and any gains are ordinary income. The regulations provide an inadvertent-error exception, which, if applicable, may allow taxpayers to treat losses in some circumstances as ordinary.

A proper and timely hedge identification also prevents the application of certain loss deferral rules. One example is the tax "straddle" rules, which may defer losses (but not gains) on certain unidentified hedging transactions.

### PLANNING CONSIDERATIONS

Given the volatility of commodity prices, interest rates, and foreign currency exchange rates, businesses are increasingly incentivized to rely on hedging activities to manage risk and reduce exposure to dramatic market movements. To prevent the character and timing mismatches previously discussed and properly report gains and losses from these hedging transactions, companies should carefully review their tax hedge identification policies or establish them if none exist. These are important planning considerations, and while the identification and documentation requirements are complex, failure to comply with these rules may result in significant adverse tax consequences.





# International Tax

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International tax planning is becoming both more complex and more important. Major changes to foreign currency and digital content rules will have a significant impact across a broad range of companies and international structures. As important as new guidance is, it may have been eclipsed by legislative developments. The international tax reform in the OBBBA raises novel planning considerations, and ongoing negotiations over Pillar Two could result in meaningful changes for private companies in scope of the rules as we approach year-end.

## INTERNATIONAL TAX PLANNING AFTER THE OBBBA

The OBBBA enacted several changes to the global intangible low-taxed income (GILTI), foreign-derived intangible income (FDII), and the base erosion and anti-abuse tax (BEAT) regimes. Combined with changes in certain domestic provisions, such as Section 174 and Section 168, the changes could have a significant impact on multinational taxpayers.

### GILTI Changes

GILTI is now known as “net CFC tested income” (NCTI). The effective tax rate on NCTI changes from 10.5% to 12.6% as a result of the change in the Section 250 deduction (from 50% to 40%). The NCTI foreign tax credit (FTC) haircut was reduced from 20% to 10% and now applies to previously taxed earnings and profits (PTEP) distributions. The reduction for qualified business asset investment (QBAI) was repealed, and the FTC expense allocation toward NCTI is limited to those expenses that are “directly allocable,” with carveouts for interest and research and experimentation (R&E). In addition, foreign taxes associated with PTEP are no longer treated as deemed paid under the Section 78 gross-up mechanism. Overall, the changes to NCTI could result in taxpayers generating higher NCTI inclusions in the U.S.

### FDII Changes

FDII is now known as “foreign-derived deduction-eligible income” (FDDEI). The effective tax rate on FDDEI changes from 13.125% to 14% as a result of the change in the Section 250 deduction (from 37.5% to 33.34%). As with NCTI, QBAI was repealed, and the FTC expense allocation toward FDDEI is limited to those expenses that are “properly allocable,” with carveouts for interest and R&E. Additionally, FDDEI excludes income or gain from dispositions of intangible property (IP) (as defined in Section 367(d)) and any other property subject to depreciation, amortization, or depletion by the seller occurring after June 16, 2025. Overall, the changes to FDDEI are taxpayer favorable, making FDDEI more valuable and accessible, particularly for heavy industry. But the deduction is available only to private companies organized as C corporations.

### BEAT Changes

The tax rate increased from 10% to 10.5%.

### Domestic Changes

The OBBBA made several important domestic tax changes that could affect international planning.

These changes were discussed earlier in the **corporate income tax chapter** and include:

- Permanently restoring full expensing of domestic R&E costs for tax years beginning after December 31, 2024.
- Making bonus depreciation permanent at 100% for property acquired after January 19, 2024.
- Creating a new category of 100% expensing for real property (buildings) involved in qualified production activities if construction begins after January 19, 2025, and before 2030, and the property is placed in service by the end of 2030.
- Permanently removing amortization, depreciation, and depletion from adjusted taxable income for the limit on interest deductions under Section 163(j) for tax years beginning after December 31, 2025.

## Effective Dates

Generally, the NCTI, FDDEI, and BEAT changes are effective for tax years beginning after December 31, 2025. As mentioned, 100% bonus depreciation is effective for property acquired and placed in service after January 19, 2025, while businesses can immediately begin deducting domestic R&E expenditures paid or incurred after December 31, 2024.

### PLANNING CONSIDERATIONS

Given the significant changes to NCTI and FDDEI, as well as the changes in the tax rate for BEAT, modeling will be important for multinational taxpayers to effectively plan.

These strategies should be considered, when appropriate:

#### NCTI

- Increase tested income taxes, as more taxpayers are likely to be in an excess limitation position for FTC purposes.
- Accelerate income into 2025 and/or defer deductions until 2026 and beyond.
- Consider high-tax exclusion election.

#### FDDEI

- Expense apportionment and lack of QBAI opens up potential planning opportunities, particularly for capital-intensive and research-heavy taxpayers.
- Consider potentially onshoring IP.
- For outbound services, consider increasing inbound income streams if locally deductible.

#### BEAT

- Consider capitalizing interest, Section 174, and other items.
- Evaluate the services cost method (SCM) exception.
- If subject to Section 1059A, consider increasing cost of goods sold (COGS).

## CLASSIFYING AND SOURCING DIGITAL CONTENT AND CLOUD TRANSACTIONS

The IRS on January 10, 2025, released final regulations on the classification of digital content and cloud transactions. The regulations are generally effective for tax years beginning on or after January 14, 2025, with the option to elect to apply to tax years beginning on or after August 14, 2019, and all subsequent tax years.

The IRS also released proposed regulations to determine how income from cloud transactions is to be sourced for U.S. federal tax purposes, and a notice requesting comment on the potential implications of applying the characterization rules for digital content and cloud transactions to all provisions of the Internal Revenue Code.

### A Closer Look

The final regulations modify Reg. §1.861-18 to expand its scope to include the transfer of all manner of digital content so that it is no longer limited to computer programs. Digital content is defined as a computer program or any other content, such as books, movies, and music, in digital format that is protected by copyright law or not protected by copyright law solely due to the passage of time or because the creator dedicated the content to the public domain.

#### Reg. §1.861-18 classifies transfers of digital content into one of four categories:

- A transfer of a copyright right in the digital content;
- A transfer of a copy of the digital content (a copyrighted article);
- The provision of services for the development or modification of the digital content; or
- The provision of know-how relating to development of digital content.

The final regulations replace the de minimis transaction rule with a predominant character rule for the characterization of digital content and cloud transactions. Under the new predominant character rule, a transaction that has multiple elements is classified in its entirety as digital content or a cloud transaction if the predominant character is digital content or a cloud transaction.

If a copyright is transferred, the transaction will generally be classified as a sale or license of intangible property. If a copyrighted article is transferred, the transaction will generally be classified as a sale or lease of tangible property.



## YEAR-END TAX PLANNING GUIDE FOR PRIVATE COMPANIES

# International Tax

New sourcing rules provide that when a copyrighted article is sold and transferred through an electronic medium, the sale is deemed to have occurred at the location of the purchasers' billing address for purposes of Reg. §1.861-7(c). Reg. §1.861-19 provides rules that generally classify all cloud transactions as services income, eliminating a delineation made in the 2019 proposed regulations between lease and services income. A cloud transaction is defined as a transaction through which a person obtains on-demand network access to computer hardware, digital content (as defined in Reg. §1.861-18(a)(2)), or other similar resources. A cloud transaction does not include network access to download digital content for storage and use on a person's computer or other electronic device.

The addition of numerous examples in Reg. §1.861-18 help illuminate the rules, particularly surrounding the classification of digital content transactions in various industries, including online gaming and streaming of other types of content. The examples emphasize that providers will need to pay careful attention to contracting with customers, including the method and terms of delivery for digital content to achieve a preferred tax outcome. One specific example of this concept is the clarification of rules related to the distribution of "software as a service" or "SaaS."

### Sourcing of Cloud Transactions

The proposed regulations (mostly designated as Reg. §1.861-19(d)) classify cloud transactions (such as SaaS, on-demand platform access) as services and follow Sections 861(a)(3) and 862(a)(3) and some court cases in generally sourcing income to where services are performed. However, the preamble to the proposed regulations recognizes that such general sourcing rules were designed with more traditional operating models in mind. Thus, the proposed regulations attempt to consider the distinctive attributes of cloud transactions. The proposed regulations provide a mechanical formula that is based on the location of intangible assets, employee functions, and tangible property pertaining to the provision of the cloud transaction, and results in a fraction that is applied to the gross income from the cloud transaction to determine source.

One of the most important aspects of the proposed regulations is that the above factors are applied exclusively on a taxpayer-by-taxpayer basis. Therefore, if the cloud transactions involve multiple related parties, the factors and activities of the related parties are not considered for purposes of the sourcing rules. However, attention should be paid to any related parties acting as agents for the taxpayer, as such factors/attributes presumably may be imputed to the taxpayer.



### PLANNING CONSIDERATIONS

Today, most business interactions with customers occur in some form of digital or cloud environment. Until now, there have been no final regulations specifically addressing the treatment of digital content and cloud transactions for federal income tax purposes. Both the characterization and sourcing of income from these transactions are important because they impact the application of various international tax provisions of the Code, including the determination of U.S. withholding tax and other income tax reporting obligations. These regulations will apply to any taxpayer that engages in digital content and cloud transactions across various industries and in a cross-border context.

# International Tax



## OBBBA REPLACES DOWNWARD ATTRIBUTION PROHIBITION WITH NEW RULES

The restoration of Section 958(b)(4) under the OBBBA represents a significant change in the determination of controlled foreign corporation (CFC) and U.S. shareholder status.

Prior to the enactment of the TCJA, Section 958(b)(4) prohibited the downward attribution of stock ownership from a foreign person to a U.S. person, which limited the number of foreign corporations classified as CFCs and reduced filing obligations for constructive U.S. shareholders. The TCJA's repeal of this provision resulted in many foreign corporations being treated as CFCs, triggering new reporting requirements for U.S. shareholders.

Effective for tax years beginning after December 31, 2025, the OBBBA reinstates this downward attribution prohibition, potentially simplifying reporting obligations for certain taxpayers.

In conjunction with the restoration of Section 958(b)(4), the OBBBA introduces Section 951B, which extends the CFC inclusion rules to foreign controlled U.S. shareholders (FCUSS) of foreign controlled foreign corporations (FCFC). Under these new rules, an FCUSS would generally be required to include Subpart F income or net CFC tested income (NCTI) of an FCFC only if it owns a direct or indirect interest, under Section 958(a), in the FCFC. This approach narrows the scope of income inclusions for FCUSSs, focusing on direct and indirect ownership rather than constructive ownership through downward attribution.

### PLANNING CONSIDERATIONS

Guidance is expected to clarify the reporting requirements for FCUSSs and FCFCs, as well as the impact on the passive foreign investment company (PFIC) rules. Taxpayers affected by the prior repeal of Section 958(b)(4) should carefully review these new provisions and forthcoming regulations, particularly regarding reporting for FCUSSs and FCFCs, pro rata share rules, and potential overlap with the PFIC rules.

The restoration of Section 958(b)(4) and introduction of Section 951B may simplify compliance for some taxpayers, but also introduce new complexities and areas requiring regulatory guidance.

## SECTION 987 REGULATIONS ON FOREIGN CURRENCY GAIN OR LOSSES

The IRS has issued final and proposed regulations under Section 987, which are effective for tax years beginning after December 31, 2024. This marks the end of years of uncertainty, during which the IRS continually deferred proposed rules and were willing to accept “reasonable methods” based on a slew of proposed regulations — a period that earned the regime the nickname “the Wild West.”

Section 987 governs the recognition of foreign currency gain or loss for qualified business units (QBUs) with a different functional currency than its taxpayer. Partnerships and S corporations generally remain outside the scope of the final regulations. Nevertheless, certain applicable provisions may apply (e.g., character and sourcing rules, suspended or deferred losses, and treatment of QBU terminations).

The proposed regulations include an election intended to reduce the compliance burden of accounting for certain disregarded transactions between a QBU and its owner.

### Transition Rules

The owner of a QBU must adopt the Section 987 regulations as of the transition date — January 1, 2025 — for calendar year taxpayers (or the day of a termination event after November 9, 2023). Pretransition gain or loss must be computed as if each QBU were terminated the day before the transition date. The method for computing the pretransition gain or loss depends on whether the taxpayer has applied an eligible method for computing Section 987 gains and losses in prior years.

### Pretransition Gain or Loss - Eligible Method

The pretransition gain or loss amount, in general, is the amount of Section 987 gain or loss that would have been recognized by the owner under the eligible method if the Section 987 QBU terminated on the transition date and transferred all of its assets and liabilities to the owner.

# International Tax

## Pretransition Gain or Loss – No Eligible Method

The pretransition gain or loss amount, in general, is the amount of the “annual unrecognized Section 987 gain or loss” computed each year that the owner held the QBU after September 7, 2006, and before the transition date (the “transition period”). This total amount is adjusted for the amount of Section 987 gain or loss recognized by the owner of such QBU for all those years.

The annual unrecognized Section 987 gain or loss is the amount of Section 987 gain or loss computed as though a current rate election was in effect for each year of the transition period. A current rate election is an election to treat all balance sheet items as a marked item which is translated at the end of year spot rate rather than a historic rate.

The Section 987 regulations provide an alternative method for computing QBU net value for purposes of Reg. §1.987-4(d), but only when a current rate election is made. Thus, this alternative approach may be applied for purposes of computing pretransition gain or loss when an eligible method has not been previously applied, as a current rate election is deemed made for the transition period.

## Definition of “Eligible Pretransition Method”

The Section 987 regulations provide that an eligible method includes an earnings and capital method, which is defined as a method that requires Section 987 gain or loss to be determined and recognized with respect to both the earnings of the Section 987 QBU and capital contributed to the Section 987 QBU.

The Section 987 regulations further provide that another reasonable method could also qualify as an eligible method if it produces the same total amount of income over the life of the owner of a Section 987 QBU as the earnings and capital method described above.

## Recognition of Pretransition Gain or Loss

Pretransition gain is treated as net accumulated unrecognized Section 987 gain, which will be recognized in future years as remittances are made from the Section 987 QBU. Alternatively, taxpayers may elect to recognize pretransition gain ratably over 10 years.

Pretransition loss is generally treated as suspended Section 987 loss, which means that such loss will be recognized in future years to the extent the QBU generates Section 987 gain. If a current-rate election is in effect on the transition date, then the pretransition loss becomes unrecognized Section 987 loss that will be recognized upon remittances in future years. Alternatively, taxpayers may elect to recognize pretransition loss ratably over 10 years.

### PLANNING CONSIDERATIONS

Taxpayers have waited a long time for final Section 987 guidance and although clarity in the area is welcome, many issues will need attention. As year-end approaches, taxpayers should inventory their QBUs, quantify pretransition amounts, model election strategies, and coordinate choices across the enterprise. The more immediate concerns are the transition to the new regulations and the computation of pretransition gain or loss. Taxpayers will then need to focus on gathering the required data to compute Section 987 gains and losses as well as evaluating the many elections that are available under the final regulations beginning with the 2025 tax year, modeling the overall impact of the regulations with and without the new elections.



## U.S. WITHDRAWS FROM GLOBAL TAX AGREEMENT, LEAVING PILLAR TWO IN LIMBO

President Donald Trump on January 20, 2025 — his first day in office — issued a [memorandum](#) to clarify that the “Global Tax Deal” has no force or effect in the U.S., and directing the Secretary of the Treasury and the U.S. permanent representative to the OECD to notify the global organization that any commitments made by the Biden administration regarding the global tax deal have no force or effect in the U.S. absent an act by Congress adopting the relevant provisions of the deal.

The global tax deal referenced in the memorandum alludes to Pillar Two of the OECD’s two-pillar framework for addressing the tax challenges arising from the digitalization of the economy and may be directed at aspects of Pillar One as well. The global anti-base erosion (GloBE) model rules issued under Pillar Two — which introduced the undertaxed profits rule (UTPR) and the income inclusion rule (IIR) — are designed to ensure that large multinational companies pay a minimum tax of 15% on taxable profit in each jurisdiction in which they operate. While more than 56 jurisdictions have enacted domestic legislation implementing Pillar Two, including all EU member states, the U.S. has not.

On June 28, Treasury released a statement by the G-7 nations asserting that “there is a shared understanding that a side-by-side system could preserve important gains made by jurisdictions in the Inclusive Framework in tackling base erosion and profit shifting and provide greater stability and certainty in the international tax system moving forward.”

### The side-by-side system would be based on four principles:

- It would fully exclude U.S.-parented groups from the UTPR and the IIR in respect of both their domestic and foreign profits.
- It would include a commitment to ensure that any risks of base erosion and profit shifting are addressed to preserve the common policy objectives of the side-by-side system.
- Work to deliver a side-by-side system would be undertaken alongside material simplifications being delivered to the overall Pillar Two administration and compliance framework.
- Work to deliver a side-by-side system would be undertaken alongside considering changes to the Pillar Two treatment of substance-based non-refundable tax credits.

A statement from House Ways and Means Committee Chairman Jason Smith (R-MO) and Senate Finance Committee Chairman Mike Crapo (R-ID) indicated that the side-by-side agreement had been predicated on the removal of proposed Section 899 from the OBBBA. Section 899 would have imposed a retaliatory tax on some non-U.S. corporations and individuals if their home jurisdiction had adopted taxes on U.S. taxpayers deemed to be discriminatory or extraterritorial.

The U.S. is now actively negotiating with the OECD to try to reach agreement on a “side-by-side” framework by the end of the year. It has recently been reported that the OECD circulated a 30-page draft proposing targeted changes to the global minimum tax to address how the regime applies to U.S. multinationals.

Reportedly, the draft provides that companies based in a jurisdiction that qualifies as “side-by-side” would not be subject to the IIR and the UTPR.

### PLANNING CONSIDERATIONS

Several OECD countries have fully implemented the UTPR in their domestic tax laws and many more have indicated their intention to do so. Therefore, a looming conflict between U.S. tax law and the OECD Pillar Two regime would need to be addressed during 2025 to avoid a conflict of laws applicable to U.S.-parented multinationals.

Private companies in multinational groups that are within the scope of Pillar Two should carefully consider these international tax developments with their advisors and monitor developments for any impact on tax planning and tax compliance.



# Compensation and Benefits

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# Compensation and Benefits



Human capital challenges remain at the forefront as private companies look to retain and attract talent and leverage tax rules to efficiently offer competitive equity and benefit programs. This year companies will need to navigate several important new tax considerations. The OBBBA makes significant changes to compensation and benefit rules and imposes new reporting. The challenge will be even greater for companies with a global footprint, as they may need to adjust tax equalization payments to account for the individual tax changes in the new legislation.

## NEW EMPLOYER REPORTING REQUIREMENTS ON TIPS AND OVERTIME

Employers will be required to report qualified tips and qualified overtime compensation to both employees and the IRS beginning in 2025 to facilitate new individual deductions under the OBBBA. The deductions are effective from 2025 through 2028.

**Businesses will have to make a number of important determinations to properly report tips, including:**

- Identifying employees in occupations that customarily and regularly received tips before December 31, 2024
- Determining whether the tips are earned in a disqualified specified service trade or business
- Verifying that the tips are voluntary

For overtime reporting, employers will report only the additional compensation premium due to the higher overtime rate (the “half” in “time-and-a-half”). This includes only federal Fair Labor Standards Act (FLSA) required overtime premiums (not state/local or contractual overtime). Employees cannot use the same compensation as the basis for a deduction on their Form 1040 for both qualified tips and qualified overtime.

## PLANNING CONSIDERATIONS

The IRS announced that it will not revise the 2025 Form W-2 or update 2025 withholding tables for qualified tips or qualified overtime, and it has not yet made clear the form and manner of reporting. Despite the current lack of clarity, employers will still be required to report qualified tips and qualified overtime to employees in 2025. Companies should update payroll and recordkeeping for the new reporting, which requires tracking data points that previously have never been separately identified. There will be transition relief in 2025 whereby the employer can approximate a separate accounting of amounts designated as qualified tips and qualified overtime using any reasonable method specified by the IRS. Qualified tips and qualified overtime remain subject to federal withholding and benefit plan compensation rules.

For 2026, the IRS released a [draft Form W-2](#) that adds a new Box 14b for the tipped occupation code, which will be used to report the deduction for qualified tips on Form 1040, Schedule 1-A. Box 14 (Other) has been renumbered as Box 14a on the draft 2026 Form W-2. However, there are no new boxes for qualified overtime or qualified tips. Instead, there are new codes for Box 12 for those items, as well as a new code for contributions to a “Trump account.”

# Compensation and Benefits



## OBBBA ENACTS SIGNIFICANT PAYROLL & BENEFITS CHANGES

The OBBBA introduced numerous changes that may affect organizations' management of payroll and employee benefits and compliance obligations.

- **Higher 1099-NEC & 1099-MISC Reporting Threshold for 2026 Onward.** For payments made after December 31, 2025, the threshold for providing a Form 1099-NEC (non-employee compensation, which is used for independent contractors) and Form 1099-MISC (used for amounts not reported on 1099-NEC or W-2) increases from \$600 to \$2,000. Starting in 2027, the \$2,000 threshold will be indexed for inflation. This threshold has not changed since 1954.
- **Employer Tax Credit for Paid Family & Medical Leave (PFML).** For tax years beginning after December 31, 2025, the Section 45S employer tax credit for PFML becomes permanent and will include amounts paid for state-mandated paid leave and insurance premiums. The credit broadens the eligibility of part-time employees, clarifies the aggregation rules, and provides flexibility for multistate employers who operate in states where PMFL is not required even if the employer operates in other states that require PFML. These expansions are expected to make the credit more widely available to employers.
- **Employer Tax Credit for Employer-Provided On-Site Child Care.** For tax years beginning after December 31, 2025, the Section 45F employer tax credit for on-site employer-provided child care increases from \$150,000 to \$500,000 (\$600,000 for small businesses), indexed for inflation, up to 40–50% of expenses (increased from 25%). The definition of qualified expenditures will expand to include costs of third-party arrangements and jointly owned or operated child care facilities.
- **Employer Student Loan Debt Payments.** The OBBBA made permanent the \$5,250 annual amount that employers can pay or reimburse tax-free to employees for student loan debt payments if the employer has a written education assistance plan that complies with Section 127. Starting in 2026, the \$5,250 will be indexed for inflation.

### PLANNING CONSIDERATIONS

All employers should update their tracking and reporting for Form 1099-NEC and 1099-MISC, based on the significantly higher threshold for issuing those forms for 2026 and beyond.

Employers may want to revisit their eligibility for the expanded PFML and on-site child care tax credits.

Now that Section 127 permanently allows employers to make tax-free payments of student loan debt for employees, employers may want to look into adopting a written education assistance plan. The IRS recently published a model plan document, making it easier for employers to satisfy the written plan requirement.

## IRS ISSUES GUIDANCE FOR STATE PAID FAMILY AND MEDICAL LEAVE PROGRAMS

The IRS recently issued its first-ever guidance on the federal income and employment tax treatment of contributions made to, and benefits paid from, a state-run paid family and medical leave (PFML) program, as well as the related reporting requirements. This had become an area of concern for many employers since more than a dozen states have enacted PFML laws without any federal guidance on how to tax the premiums paid to and benefits paid from such programs.

[Rev. Rul. 2025-4](#) provides rules for employers operating in the states (and the District of Columbia) that have mandatory PFML programs and for employees working in those states. These state programs pay employees who can't work because of non-occupational injuries to themselves or family members, as well as sickness and disabilities. While the details of the programs vary substantially from state to state, PFML programs generally operate as social insurance programs, with premium contributions from both employers and employees and benefits paid at a fixed rate, based on the employee's wages.

### 2025 Transitional Relief

The ruling is effective for PFML benefits paid by a state on or after January 1, 2025. However, it provides transition relief for states and employers for calendar year 2025 from withholding, payment, and information reporting requirements for state PFML benefits. For 2025 only, employers who voluntarily "pick up" the required employee contribution into a state PFML fund are not required to treat those amounts as wages for federal employment tax purposes.

### Key Points

The guidance draws important distinctions on how contributions and benefits are treated for federal income and employment tax purposes. Employers will need to pay careful attention to these new rules.

#### The guidance clarifies the following key points:

- Employers can deduct their contributions to state mandatory PFML programs as a payment of an excise tax.
- Employees can deduct their contributions to such programs as a payment of state income tax, if the employee itemizes deductions, to the extent the employee's deduction for state income taxes does not exceed the state income tax deduction limit. However, required employee contributions to the state PFML program are not excludible from income under Section 106 (i.e., the contributions are after-tax, not pre-tax).
- Employees who receive state-paid family leave payments must include those amounts in the employee's gross income. Generally, the IRS considers benefits that replace wages during an employee's leave as wages for income and employment tax purposes, unless the benefits qualify for an exclusion. Paid family leave is generally not eligible for any exclusion. Employees also do not have a "tax basis" in employee or employer pick-up contributions previously treated as taxable wages.
- Employees who receive state paid medical leave payments must include the amount attributable to the employer's portion of the contributions in the employee's gross income and such amount is subject to both the employer and employee share of Social Security and Medicare taxes. The amount attributable to the employee's portion of the contributions is excluded from the employee's gross income and is not subject to Social Security or Medicare taxes.

Thus, except for leave for the employee's own injury or illness, PFML is not accident or health insurance, so most PFML benefits will be taxable to the employee.

### PLANNING CONSIDERATIONS

Employers should update their payroll systems to come into compliance with the new rules starting with the 2026 calendar year. Such changes often take significant time to implement.

Failure to accurately reflect amounts on an employee's Form W-2 can subject the employer to IRS penalties. The guidance places new administrative burdens on employers (and their payroll systems) to understand the income and employment tax consequences of such state PFML programs, and to coordinate with the states to obtain information that may be required to correctly report taxable benefits (in a manner similar to that which exists for employers that utilize a third-party insurer to administer short-term or long-term disability). Thus, employers will be expected to correctly determine the taxable and nontaxable contributions and benefits for payroll processing and W-2 reporting purposes. Employers should proactively review their payroll practices to achieve compliance.



## GLOBAL MOBILITY PROVISIONS WILL IMPACT TAX-EQUALIZED EMPLOYEES

The OBBBA will also have a significant impact on the global mobility programs of private companies with employees working outside their home country. Some of the individual changes are immediately effective for 2025, so employers should quickly assess the implications for any tax equalization programs. The key changes most likely to affect global mobility programs and employees are outlined below.

- **Moving expenses:** For tax years beginning after 2025, the OBBBA permanently suspends the moving expense deduction for employees (except for active-duty military members and those in the intelligence community) and the income tax exclusion for most taxpayers, which had been previously suspended under the TCJA from 2017 to 2025. Employers who pay employees' moving expenses must report those amounts as taxable wages on Form W-2, making the amounts subject to income, Social Security, and Medicare taxes. Employers can deduct these amounts as compensation expenses.
- **Individual SALT limitation:** The OBBBA temporarily increases the limit on the federal deduction for state and local taxes (the SALT cap) to \$40,000 in 2025 (from the current \$10,000) and adjusts it annually through 2029. In 2026, the cap will be \$40,400, and then will increase by 1% annually, through 2029. Starting in 2030, the SALT cap will revert to the current \$10,000.

The deduction amount available phases down for taxpayers with modified adjusted gross income (MAGI) over \$500,000 in 2025. The MAGI threshold will be increased by 1% each year from 2026 to 2029. The phasedown will reduce the taxpayer's SALT deduction by 30% of the amount the taxpayer's MAGI exceeds the threshold amount, but the limit on a taxpayer's SALT deduction could never go below \$10,000.

- **Limitations on itemized deductions:** The OBBBA permanently repeals the Pease limitation, which had been suspended under the TCJA, but introduces a new rule: starting after 2025, the value of itemized deductions will be reduced by 2/37 of the lesser of the allowable itemized deductions or the excess of taxable income over the 37% tax rate threshold, effectively capping the benefit of itemized deductions at 35% for taxpayers in the highest tax bracket. The legislation also makes permanent the repeal of miscellaneous itemized deductions.
- **Excise tax on certain remittance transfers:** The OBBBA imposes a 1% excise tax on electronic fund transfers of cash, money order, cashier's check, or similar instrument from U.S. senders to foreign recipients, effective for transfers after December 31, 2025. Exemptions apply for transfers from certain financial institutions or those funded by U.S.-issued debit or credit cards. No tax credit is available for this tax.

- **Deduction for qualified residence interest:** For tax years after 2025, the OBBBA makes permanent the limit on the mortgage interest deduction to acquisition debt of \$750,000 (\$375,000 if married filing separately), with the \$1 million cap still applying to debt incurred on or before December 31, 2017.

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## PLANNING CONSIDERATIONS

The OBBBA provisions affecting global mobility deserve careful review and modeling of the cost implications for both global businesses and their mobile employees.

The greatest impact of the increased SALT cap for tax-equalized employees is that it will affect the employees' actual and hypothetical tax liabilities, particularly for those who reside in high-tax states. However, high-income taxpayers may not fully benefit from the increased SALT cap because of the limitations on itemized deductions. In addition, because the SALT deduction is an add-back for alternative minimum tax (AMT) purposes, it may render some taxpayers subject to AMT.

With the OBBBA making permanent the repeal of miscellaneous itemized deductions, employees repaying income of \$3,000 or less will not be entitled to a deduction. Consequently, tax-equalized employees who repay tax settlement balances to their employers cannot receive a tax benefit for this repayment. However, repayments exceeding \$3,000 may still be claimed as a credit or deduction on the tax return, since they are eligible for claim of right treatment.

Because itemized deductions, such as the mortgage interest deduction, directly impact a tax-equalized employee's hypothetical and actual tax liability, global mobility programs should work with their tax advisors to determine how program costs may be impacted.

# Compensation and Benefits



## IRS INSTRUCTED TO PHASE OUT PAPER REFUND CHECKS

An executive order signed on March 25, 2025, instructs the IRS to discontinue issuing paper checks for tax refunds. After September 30, 2025, a taxpayer who is expecting a tax refund from the IRS will generally receive the refund via direct deposit to a U.S. bank account. This could present a problem for global mobility programs and their cross-border employees.

Because the IRS limits the number of refunds that can be deposited into a single financial account, many global mobility programs are unable to directly receive U.S. tax refunds for their equalized cross-border employees. Consequently, these employees must first receive their tax refunds in their U.S. bank account and subsequently remit the funds to the company.

The absence of paper refund checks creates a challenge for foreign nationals without a U.S. bank account because tax refunds can only be deposited into an account with a routing number linked to a U.S. bank. In addition, those foreign nationals who do have a U.S. bank account will need to maintain their account after departing the U.S. so that any forthcoming tax refunds to be received.

Non-U.S. individuals who do not have a U.S. bank account may now need to rely on other options, such as international wire transfers, credit cards, debit cards, or digital wallets.

### PLANNING CONSIDERATIONS

While additional guidance is expected from the IRS, global mobility programs should proactively prepare for these changes. Preparations may include making changes to the program's current procedures regarding the receipt of tax settlement payments and exploring alternative digital payment options for their cross-border employees.





# State and Local Taxes

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State and local tax (SALT) issues consistently rank among the top concerns of tax and finance professionals. The [2025 BDO Tax Strategist Survey](#) found that the most prevalent issues in audits and disputes were SALT-related (52%). It's no surprise why. State laws evolve rapidly and vary widely by entity, income, or industry.

This year will only bring more complexity. The OBBBA made significant changes to federal tax law that will have many implications for state tax planning based on conformity decisions. Fortunately, there are plenty of planning strategies, including nexus evaluations and apportionment reviews, to manage state tax issues.

## STATE CONFORMITY PLANNING CONSIDERATIONS

State considerations will be important for companies implementing the OBBBA changes. The dizzying variety in state conformity regimes can present planning challenges.

States are split roughly 50-50 between conforming to the U.S. Internal Revenue Code on a rolling basis versus a fixed-date basis. Complicating the picture, states in both categories often choose not to conform to specific provisions for policy or revenue reasons.

States with rolling conformity will generally incorporate OBBBA changes by default unless they specifically opt to decouple from particular provisions. States with fixed-date conformity will have to proactively update their conformity dates or rules to implement any OBBBA changes. Fixed-date states are even more likely to make state-specific deviations as part of the process.

Many of the most important provisions in the OBBBA offer multiple implementation options, and the state treatment will be a major factor in planning decisions. Companies should fully assess the state implications of various federal planning strategies.

### Key considerations for major provisions include:

- **Section 174 expensing:** The restoration of expensing of domestic research costs will potentially harmonize the federal and state treatment for the handful of states that have already decoupled from the pre-OBBBA rules requiring five-year capitalization. States that follow the capitalization rules might need to consider whether to revert to expensing and whether to incorporate the federal transition rules for accelerating unused deductions. Companies should pay particular attention to how quickly states with fixed conformity dates react because the provision is generally effective for tax years beginning after 2024.
- **Section 163(j):** Many states will be tempted to decouple from the OBBBA provision restoring the more favorable calculation of the limit on the interest deduction under Section 163(j), which could be costly. Because the rules are generally effective for tax years beginning after 2024, fixed-date conformity states will face an early deadline for action.
- **Bonus depreciation:** Many states already decouple from bonus depreciation for revenue reasons and will be unaffected by the restoration of the 100% rate. All states will have to decide whether to conform to the new expensing provision for building property used in some production activities. Current conformity statutes for bonus depreciation likely will not cover the new provision because it was created under new Section 168(n) and not incorporated as part of the existing bonus depreciation rules under Section 168(k).
- **Base erosion and anti-abuse tax:** The BEAT rate will increase from 10% to 10.5%, but taxpayers retain planning options such as interest capitalization and the election to waive deductions under Reg. §1.59A-3(c)(6). Companies should consider the state income tax implications of those choices.
- **Section 250 deduction:** For states that allow the deduction under Section 250 for foreign-derived intangible income (now foreign-derived deduction-eligible income or FDDEI) and global intangible low-taxed income (now net controlled foreign corporation (CFC) tested income or NCTI), the amounts will likely need to be recomputed. When there are differences in profile between a company's federal consolidated group and state filing (for example, a combined group with different members for state purposes or a state that requires separate filing), companies should remember that the NCTI inclusion must be recomputed.
- **Charitable contributions:** The new 1% floor for corporate charitable deductions is likely to create significant differences in state and federal charitable carryforwards.

# State and Local Taxes



## TURNING STATE TAX COMPLEXITIES INTO A PLAN FOR SUCCESS

SALT laws evolve rapidly and are becoming increasingly convoluted. However, what makes state tax so challenging isn't just the complexity – it's also the inconsistency. Rules vary not just across states but also within the same state based on the type of entity, income, or industry. Navigating the fragmented state tax landscape requires proactive strategies and knowledgeable guidance to manage compliance, reduce tax liabilities, and mitigate risks. That's why companies of all sizes should consider a range of planning strategies.

A holistic review of state tax issues can unlock tax savings opportunities by helping companies identify nexus and filing obligations, uncover potential past exposures, and leverage voluntary disclosure programs to limit penalties and interest. Companies should also analyze apportionment methods and filing practices to correctly perform tax calculations, and to potentially reveal missed deductions, credits, or alternative methods that can reduce state tax liabilities.

It's critical to have robust internal and external resources in the tax function to strategically plan for changes. Quality professional guidance supports business restructurings, expansions, and mergers and acquisitions by improving state tax outcomes and preventing future risks related to combined reporting and intercompany transactions.

Companies should also make sure they have an effective audit defense. This includes preparing documentation, engaging with tax authorities, and leveraging deep knowledge of state statutes and processes to resolve audits efficiently and avoid prolonged disputes and unfavorable outcomes.

### PLANNING CONSIDERATIONS

State taxation cannot be treated as an afterthought because it can affect where a company operates or how it is structured. Without an informed approach, companies risk missing state tax savings, facing unexpected state tax liabilities, and losing control over a growing portion of their tax profiles. Ensuring the tax function has adequate internal and external support can turn those risks into advantages by offering not just compliance but also strategy and foresight.

## HARNESSING THE POWER OF STATE APPORTIONMENT RULES

Apportioning income across the states where a private company does business is a highly complicated area of SALT, especially given that states continue to change their apportionment rules and the guidance on those rules. It takes a deep tax bench to keep up with the ever-evolving SALT landscape. Understanding apportionment, particularly sales factor sourcing, can help businesses identify tax liabilities and savings opportunities across different states.

While states have shifted from three-factor to single-sales factor formulas, using market-based sourcing for services and intangibles, their methodologies vary. That results in diverse interpretations of where sales are sourced, such as in the context of services which may focus on the location where the service is delivered, where the customer is located, or where the benefit of the service is received. Further, states apply different sourcing rules depending on service type and industry, or how the intangible was used, with cascading rules that require moving through multiple sourcing methods if the location cannot be determined, sometimes requiring reasonable approximations. And despite some state guidance, ambiguities remain, leading to multiple reasonable interpretations of sourcing methods, especially when applying reasonable approximation methods.

Many states also allow requests for alternative apportionment methods if standard methods do not fairly represent activities conducted in the state, but approval depends on following specific procedures and maintaining proper documentation.

### PLANNING CONSIDERATIONS

It is important to examine each company's facts. The nature of a private company's revenue streams and business activities influences which sourcing rules apply, with distinctions such as in-person versus electronic services affecting sourcing outcomes. Detailed apportionment studies help uncover tax exposures and savings by analyzing company facts against varied state rules, preventing overreporting or underreporting across states.



# State and Local Taxes



## ADDRESSING SALT EXPOSURE USING EFFECTIVE TRANSFER PRICING STRATEGIES

State transfer pricing is an often overlooked but critical element of tax planning. While companies frequently focus on federal and international transfer pricing issues, the state implications can be equally material. Ignoring state transfer pricing considerations can expose companies to substantial state tax risk, unexpected state tax liabilities, and missed opportunities for state tax savings.

Every transfer pricing arrangement that affects related-party transactions has potential state tax consequences, whether in cross-border contexts or purely domestic settings. States apply their own rules, often diverging significantly from federal standards, creating substantial complexity. If state impacts are not analyzed, companies can face duplicative adjustments, double taxation, or disallowed deductions.

**Integrating state transfer pricing into overall tax planning delivers two key advantages:**

- It reduces exposure to audit challenges and penalties, and it can unlock meaningful tax savings by aligning intercompany pricing with state-specific requirements.
- Companies that proactively incorporate state rules into their transfer pricing policies strengthen compliance, lower risk, and improve after-tax results.

Given the differences in state rules — from separate reporting jurisdictions to combined reporting states with unique adjustment powers — thoughtful planning and detailed documentation are essential. By embedding state transfer pricing analyses into benchmarking, implementation, and continual monitoring, taxpayers can better navigate the evolving SALT landscape while safeguarding enterprise value.





# Financial Statements

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The tax function is under increasing pressure. Legislative changes and new disclosure rules will make accounting for income taxes more complex and challenging. Plus, it's not enough to be reactive: The tax function also must proactively identify and manage tax risk while incorporating planning considerations into key business decisions. Automation, data management, and analytics can help. It's important to give tax leaders a seat at the decision-making table and to be aware of major changes in the legal, regulatory, & economic landscapes.

## OBBBA IMPLICATIONS FOR INCOME TAX ACCOUNTING

The OBBBA made important tax law changes that will affect U.S. income tax accounting under Accounting Standards Codification (ASC) 740, Income Taxes, including current and deferred taxes, valuation allowances, and financial disclosures. The changes have varied effective dates and will affect corporate tax provisions, international tax rules, energy credits, and state tax considerations.

### Key corporate provisions include:

- Restoring 100% bonus depreciation;
- Reinstating expensing for domestic R&E expenditures;
- Modifying the Section 163(j) interest limit;
- Amending the rules for energy credits;
- Expanding Section 162(m) aggregation requirements; and
- Updating the rules for GILTI (now NCTI) and FDII (now FDDEI)

President Trump signed the bill July 4, 2025, which is considered the enactment date under U.S. generally accepted accounting principles (GAAP).

### Tax Law Changes

Changes in taxes payable or receivable resulting from the new law are reflected in the annual effective tax rate (AETR) in the period including the enactment date, with discrete recognition of prior-year adjustments. Law changes affecting deferred taxes on temporary differences are also recognized discretely at enactment.

Some companies may be considering an alternative policy to use beginning-of-year temporary differences and related deferred tax balances when evaluating the impact of tax law changes during an interim period. Companies should discuss the approach with their auditors and tax advisors.

## PLANNING CONSIDERATIONS

If a tax law change is retroactive, the accounting treatment depends on whether the impact relates to prior periods or the current year. For prior-period deferred taxes and taxes payable or receivable, the effect is recognized discretely in the period of enactment. However, if the retroactive change affects current-year taxes payable or receivable – when the effective date is before the enactment date but still within the current year – the impact is recognized through an adjustment to the AETR. The updated AETR is then applied to year-to-date ordinary income, resulting in a catch-up adjustment for taxes payable or receivable in earlier interim periods.

Companies should consider that rule when assessing the financial reporting implications of some provisions enacted in July 2025 that are retroactive to the beginning of 2025. That includes provisions such as R&E expensing, Section 163(j) limitation on interest deductions, and 100% bonus depreciation (for property acquired and placed in service after January 19, 2025).

# Financial Statements



## Valuation Allowance

Adjustments to valuation allowances for deferred tax assets (DTAs) existing at enactment are discrete items, while allowances for temporary differences arising after enactment are incorporated into the estimated AETR.

The major corporate provisions discussed above could affect projections of future taxable income, potentially triggering a change in judgment about the realizability of DTAs

### PLANNING CONSIDERATIONS

Before, companies might have recorded a full valuation allowance on their Section 163(j) DTA as a result of the interest deduction limitation being based on 30% of adjusted taxable income, which included amortization, depreciation, and depletion (that is, the earnings before income and taxes limitation). The reinstatement of the earnings before income, taxes, depreciation, and amortization limitation under Section 163(j) for tax years beginning after December 31, 2024, might require a reassessment of the realizability of the current-year disallowed interest deduction and Section 163(j) carryforward DTAs from prior years that were previously subject to a full valuation allowance.

## International Taxation

The OBBBA modifies the rules for GILTI (now NCTI) and FDII (now FDDEI) by raising effective tax rates and altering deductions and expense allocations effective for tax years after 2025. It also raises the base erosion and anti-abuse tax (BEAT) rate from 10% to 10.5% for tax years beginning after 2025 and repeals a scheduled 2026 change that would have increased BEAT liability by the sum of all income tax credits.

Because most of the OBBBA international provisions do not take effect until tax years beginning after December 31, 2025, companies will likely see an immediate accounting impact at enactment only if the law change affects their valuation allowance assessments.

## Other Changes

The OBBBA curtails Inflation Reduction Act energy tax incentives, imposes new restrictions, and phases out credits.

Companies must assess uncertain tax positions under ASC 740 and analyze state and local tax effects based on conformity with federal tax changes, especially regarding bonus depreciation, R&E expensing, FDII, GILTI, and interest deductibility.

### PLANNING CONSIDERATIONS

Companies need to consider disclosing the expected effects of new tax laws in the notes to the financial statements, management's discussion and analysis, and risk factors.

Tax law changes enacted after interim balance sheet dates but before financial statements are issued are considered nonrecognized subsequent events, requiring disclosure of nature and estimated effects if material. Annual statements must detail tax effects of enacted changes and reconcile the effective tax rate accordingly.

Companies must assess the impact of the tax legislation on their income tax provision calculations, including current and deferred tax balances, the AETR, valuation allowances, and related financial statement disclosures. The provisions are highly interconnected, so the analysis will likely require extensive modeling and planning. Further, it is important to consider how the changes apply to specific facts and circumstances.

# Financial Statements

## NEW INCOME TAX DISCLOSURES

Private companies should be preparing for new rules meant to increase the transparency and usefulness of income tax disclosures by improving those related to the rate reconciliation and income taxes paid.

Accounting Standards Update (ASU) No. [2023-09](#), “Income Taxes (Topic 740): Improvements to Income Tax Disclosures,” will be effective for entities other than public business entities (PBEs) for fiscal years beginning after December 15, 2025. Early adoption is allowed.

The new rate reconciliation rules involve standardized categories and greater disaggregation of information based on a quantitative threshold. The income taxes paid disclosures must be disaggregated by jurisdiction. ASU 2023-09 further mandates disaggregation of pretax income or loss and income tax expense or benefit from continuing operations and eliminates some disclosures.

### Income Taxes Paid

Information on taxes paid (net of refunds) must be disaggregated for federal, state, and foreign taxes. Further disaggregation is required for specific jurisdictions if the income taxes paid (net of refunds) meet or exceed the quantitative 5% threshold.

The quantitative threshold is calculated by dividing the income taxes paid (net of refunds) in a jurisdiction by the total income taxes paid (net of refunds). In quantifying the 5% threshold for income taxes paid, the numerator of the fraction should be the absolute value of any net income taxes paid or income taxes received for each jurisdiction and the denominator should be the absolute value of total income taxes paid or refunds received for all jurisdictions in the aggregate.

The ASU made no changes to interim disclosure requirements.

## Rate Reconciliation

Entities other than PBEs must qualitatively disclose the nature and effect of specific categories of reconciling items and the individual jurisdictions that result in a significant difference between the statutory and effective tax rates. They do not have to present the information in tabular format or provide numerical reconciliations. All reconciling items should be presented on a gross basis.

**In the annual rate reconciliation disclosures, entities other than PBEs must include:**

1. State and local income taxes in the country of domicile net of related federal income tax effects;
2. Foreign tax effects, including state or local income taxes in foreign jurisdictions;
3. Effects of changes in tax laws or rates enacted in the current period;
4. Effect of cross-border tax laws;
5. Tax credits;
6. Changes in valuation allowances;
7. Nontaxable or nondeductible items; and
8. Changes in unrecognized tax benefits.



# Financial Statements



## Income Statement

The ASU made minor changes to the required income statement disclosures relating to income taxes to conform to existing SEC requirements, stipulating that income or loss from continuing operations before income tax expense or benefit be disclosed and disaggregated between domestic and foreign sources.

The update also requires the disclosure of income tax expense or benefit from continuing operations disaggregated by federal, state, and foreign jurisdictions. Income tax expense and taxes paid relating to foreign earnings that are imposed by the entity's country of domicile would be included in tax expense and taxes paid for the country of domicile.

## Eliminated Disclosures for PBEs and Non-PBEs

Entities no longer are required to disclose information concerning unrecognized tax benefits that have a reasonable possibility of significantly changing in the 12 months following the reporting date, nor must they make a statement that an estimate of the range cannot be made.

ASU 2023-09 also removed the requirement to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures. Entities still must disclose the types of temporary differences for which deferred tax liabilities have not been recognized under ASC 740-30-50-2(a), (c), and (d).

## USING YEAR-END LESSONS TO IMPROVE PROCESS

Effective management of the year-end close process is crucial for companies to adapt to changing financial numbers, regulatory environments, and business transformations. Improving the process enhances the tax function's strategic role and supports accurate, timely financial reporting. Starting it months in advance helps address resource constraints and regulatory complexities, enabling more efficient and accurate closings.

Companies benefit from understanding tax- and accounting-related risks, which prepares them for growth and regulatory changes. To build trust with leadership, tax departments should implement comprehensive reporting that explains key performance indicators (KPIs) and any differences between forecasted and actual results from both GAAP and non-GAAP perspectives.

A flight plan, or a detailed checklist covering calculation methodologies, documentation, and key milestones, can help tax teams manage adjustments (especially late changes) and supports audit readiness. If some adjustments cannot be automated, it is crucial to document estimation methodologies and involve the audit function to achieve accuracy and compliance.

Post-close discussions with C-suite executives about KPI variances and internal reviews of the close process foster transparency and identify areas for enhancement.

Integrating tax provision software and other technologies reduces reliance on spreadsheets, improves accuracy, accelerates calculations, and lowers risk. All that positions the tax function for future challenges.

# Financial Statements



## HOW MATURE ARE YOUR OPERATIONS?

Tax function maturity significantly affects risk management. Mature tax functions possess effective processes and technology and are involved in key business decisions, thereby helping reduce operational tax risks. Less mature functions are susceptible to unanticipated tax issues.

Strategic tax goals enhance any overall company impact, making it imperative for tax leaders to have a seat at the decision-making table. Including them in C-suite agendas helps proactively manage tax implications across an array of business lines and initiatives. That in turn drives sustainable value.

Companies must also consider adequate resourcing and strive to build tax teams with the right personnel, processes, and technology. Compliance and reporting benefit from a deep tax bench, and mature tax departments leverage advanced technology for automation, data management, and analytics to improve accuracy and mitigate potential tax risks. Further, tax leaders must develop strategies to improve transparency and align sustainability and tax goals.

The bottom line? Proactivity reduces risk. Tax strategists are proactive in anticipating and mitigating tax risks. Less mature tax tacticians tend to be reactive, which makes their companies more vulnerable to risks and underscores the need for ongoing maturity improvement.

## KEY CONSIDERATIONS IN ADDRESSING TAX RISK

Rapid changes in regulatory requirements, technology, and growth patterns have made tax risk management critical. Despite an increased business and regulatory focus on tax, many organizations have yet to adopt comprehensive tax risk mitigation strategies or fully leverage tax technology. Effective management involves upgrading technology, ensuring the internal tax team is focused on strategy (with possible outsourcing of more routine tasks), and conducting global tax risk reviews with cross-functional collaboration.

### Common contributors to heightened risk include:

- Noncompliance, or an inability to keep up, with new laws;
- Organizational changes such as market expansion or mergers;
- Under-resourced tax teams;
- A lack of automation; and
- Failure to seek external advisory services.

To mitigate potential financial, legal, and reputational consequences, tax leaders should consider conducting global tax risk reviews to better understand and manage risk by identifying strengths and weaknesses. Those reviews should involve members from cross-functional teams to anticipate scenarios that could lead to tax risk. Prioritizing those risks and planning mitigation strategies may include **implementing tax internal controls**, maintaining process documentation, developing contingency plans, and ensuring tax leaders have a seat at the table during business decision-making processes.

As the end of 2025 nears, businesses should consider a full range of tax planning strategies to help manage their long-term total tax liability and cash flow.

Sorren tax professionals approach every issue with a total tax mindset. Our advisors help businesses and organizations assess the tax implications of business decisions and identify planning opportunities across international, federal, state and local jurisdictions to create a total tax strategy.

