



STATE OF VERMONT

MEMORANDUM

To: House Committee on Ways and Means
From: Kirby Keeton, Office of Legislative Counsel
Date: December 19, 2025
Subject: Corporate and Business Tax Impacts of the Reconciliation Act of 2025

INTRODUCTION

This memo identifies and explains the sections of the federal budget reconciliation act of 2025 affecting Vermont corporate and business income taxes.

RECONCILIATION ACT SECTIONS AND THEIR IMPACTS

DOMESTIC RESEARCH AND EXPERIMENTAL PROCEDURES (SEC. 70302)

Summary: Federal law will now allow a deduction for domestic research and experimental expenses in the year in which expenses are incurred.

Background: The deduction is allowed for expenditures on research and experiments conducted in the United States, the Commonwealth of Puerto Rico, or any possession of the United States. Starting in 2022, domestic research and experimental expenses were required to be capitalized and amortized over five years. That meant that the tax benefit from the deduction was delayed as it incrementally took effect over those years.

Before the Tax Cuts and Jobs Act (TCJA), these expenditures could be deducted immediately. Some of the expenditures were eligible for the research and development credit with a basis adjustment (the amount that was deducted would be reduced by the credit amount). This section restores that pre-TCJA treatment.

Analysis: These changes flow through to Vermont because the deduction is factored into a corporate taxpayer's federal taxable income and Vermont has not decoupled from this deduction. This change is expected to cause a short-term reduction in revenue as taxpayers will usually deduct new domestic research and experimental expenses right away instead of expensing them across five years.¹ Ultimately, this changes the timing of

¹Vermont allows a credit equal to 27 percent of the federal research and development credit. 32 V.S.A. § 5930ii. It is unclear whether this change will cause taxpayers to claim less federal credit and thereby reduce the revenue cost of the Vermont credit. The Vermont credit may not be affected because most taxpayers may claim the full federal credit and use the basis adjustment for domestic research and experimental expenditures.

when the deductions are made but does not increase the overall revenue impact in the long term.

The section also allows taxpayers with up to \$31 million of gross receipts to retroactively deduct expenditures made since 2022. Other taxpayers may deduct remaining expenditures over the next two years. This means the impact on Vermont in fiscal years 2026 and 2027 will be even greater because some corporate returns in those years will include deductions for expenditures on domestic research and experiments that were done in the past few years.

AMENDED LIMITATION ON BUSINESS INTEREST DEDUCTION (SECS. 70303 AND 70341)

Summary: Federal law allows a corporate income tax deduction for the interest paid on loans used for a business purpose during the tax year. Taxpayers may deduct interest expenses paid or accrued but only up to a certain limit. The Reconciliation Act expands that limit, which will result in taxpayers claiming larger deductions. It further requires the limitation to be calculated before any unpaid interest is added to the principal of the debt.²

Background: As mentioned above, the deduction has an upper limit for the amount of loan interest that can be deducted. The limit is calculated based on certain details related to the business. A taxpayer's business interest deduction is limited to the sum of (1) its business interest income, (2) floor plan financing interest, and (3) 30 percent of adjusted taxable income (ATI). The Reconciliation Act changes the calculation for ATI so that depreciation and amortization no longer reduce ATI, allowing for a greater deduction.

Before the TCJA, the deduction was limited to 50 percent of ATI for certain taxpayers, which meant a larger deduction could be claimed. It also allowed ATI to be calculated before taxes, interest deductions, depreciation, amortization, or depletion. Those items reduce taxable income, so by not including them, the deduction limit was even larger.

In 2018, the TCJA limited deductible interest to 30 percent of ATI for businesses with gross receipts greater than \$31 million and changed the calculation so that the deduction amount was determined after being reduced by depreciation, amortization, and depletion. These changes resulted in a smaller amount of eligible interest deductions. Under the Reconciliation Act, the deduction is still limited to 30 percent of ATI but the calculation of ATI was reverted back so that the interest limit is determined before being reduced by depreciation, amortization, and depletion.

Analysis: This deduction is for the interest on indebtedness and the changes provide a tax benefit to corporations that take on more indebtedness. Overall, these changes result in reduced Vermont revenue.

These changes flow through to Vermont because the deductions reduce the taxable income of the taxpayer under the laws of the United States and the definition of "Vermont net income" for corporate taxpayers does not alter how the business interest deduction is calculated or have an add-back for any part of it.

² That is, before the interest is "capitalized."

EXCEPTIONS FROM LIMITATIONS ON THE BUSINESS MEALS DEDUCTION (SEC. 70305)

Summary: Makes permanent the exceptions from deduction limitations for food and beverages provided by an employer to employees in certain situations. It also adds some exceptions to the deduction limitation. This section slightly limits the deduction, which could have a positive impact on revenue.

Background: The TCJA eliminated the general deduction of business entertainment expenses under 26 U.S.C. § 274(a) but kept a similar deduction for food and beverage expenses.³ It also had a provision to deny a deduction for certain meals provided to employees for the convenience of the employer, which was to take effect in 2026. The Reconciliation Act kept the delayed restriction on meals provided to employees for the convenience of the employer but created exceptions for expenses relating to goods or services sold for adequate and full value (when the employee pays the same for the item as the general public), meals provided to crews on commercial vessels and oil platforms, and meals provided on certain fishing vessels and facilities.

Analysis: The exceptions from deduction limitations for food and beverages provided by an employer to employees will flow through to Vermont. It is expected to have a marginal impact on revenue.

INCREASED LIMITATION ON EXPENSING OF DEPRECIABLE BUSINESS ASSETS (SEC. 70306)

Summary: Increases the maximum amount that a taxpayer may expense for the costs of a qualifying depreciable business asset in lieu of recovering the costs through depreciation. The maximum amount that can be expensed is increased from \$1,000,000 to \$2,500,000 and is indexed for inflation.

Background: Previously, taxpayers could deduct the full amount of investment in qualified long-life property up to \$1,000,000 (indexed for inflation). The maximum amount of deduction is reduced after a certain amount of investment, which means this deduction is only used by “small business” taxpayers with no more than a few million dollars of investment.

Analysis: The increased maximum amount for expensing qualifying depreciable business assets flows through to Vermont and will negatively impact revenue.

SPECIAL DEPRECIATION ALLOWANCE FOR QUALIFIED PRODUCTION PROPERTY (SEC. 70307)

Summary: Allows an additional first-year depreciation deduction equal to 100 percent of the adjusted basis of qualified production property.⁴ Allows a taxpayer to claim the deduction for certain nonresidential real property acquired after January 19, 2025, and before January 1, 2029.

Background: The section allows a taxpayer to claim 100 percent bonus depreciation for nonresidential property used in manufacturing, production, or refining of tangible personal property. It is limited to properties that are being used for the first time for a qualified production purpose and is limited mostly to agricultural and chemical

³ Fifty percent of certain food and beverage expenses are allowed to be deducted.

⁴ Essentially, this means the deduction is equal to what was paid for the property.

production.⁵ These properties are usually depreciated over 39 years instead. Depreciation is recaptured in full if the property is sold, which means the depreciation amount is added to the income from the sale of the property and is taxed.⁶

Analysis: Vermont is not decoupled from 26 U.S.C. § 168(n), which means the new depreciation allowance for qualified production property will flow through. The special depreciation allowance sunsets after 2028.

FOREIGN-DERIVED INTANGIBLE INCOME AND GLOBAL INTANGIBLE LOW-TAXED INCOME (Secs. 70312, 70321, 70322, and 70323)

Summary: These sections change how the U.S. taxes the global operations of U.S. multinational corporations. Starting in 2026, foreign-derived intangible income (FDII) will be called foreign-derived deduction eligible income (FDDEI). The policy purpose of FDII/FDDEI is to reduce federal taxes imposed on foreign-sourced income derived from foreign markets. These sections reduce the amount that can be deducted as FDDEI and streamline the calculation. Also starting in 2026, global intangible low-taxed income (GILTI) is changed to Net CFC Tested Income (NCTI). The policy purpose of GILTI/NCTI is to impose additional tax on foreign corporate income. These sections also streamline the calculation and reduce how much can be deducted before that income is taxed.

Background: Before the TCJA, U.S. shareholders with interests in foreign corporations would not generally pay income tax on earnings from those interests until the income was distributed to them. Starting in late 2017, the TCJA created FDII and GILTI as a way to tax some of that income in the current year. It also broadened the types of income from foreign corporations that would be taxed. A U.S. taxpayer with an interest in a controlled foreign corporation (CFC⁷) had to start including GILTI (which was a new concept and a new type of taxable income) in its taxable income in the current year. Income characterized as GILTI was then reduced by a 50 percent deduction under section 250 of the federal tax code. Section 250 additionally allowed a domestic corporation to deduct 37.5 percent of the corporation's income from certain export sales to foreign markets (what FDII represents).

The calculations for GILTI and FDII included a deduction for 10 percent of the tax basis of qualified tangible assets in other countries (called qualified business asset investment (QBAI)). These sections eliminate QBAI from the calculation, which reduces the amount of earnings that may be deducted. The policy purpose of this change is to incentivize taxpayers to locate manufacturing operations in the U.S. because there is no longer a tax reduction for foreign business assets. This tax reduction for tangible assets was why GILTI and FDII were considered concepts that tax intangible property (like copyrights). Now that QBAI and other references to intangible income are removed from the calculation, the names were changed to exclude references to intangible income.

⁵ This avoids a loophole where a taxpayer could claim bonus depreciation on a property already owned by them and used for production.

⁶ When recaptured, it is taxed as ordinary income but not at lower capital gains tax rates.

⁷ Put simply, a controlled foreign corporation (CFC) is a foreign corporation with U.S. shareholders owning 50 percent or more of its stock.

These sections also increase the credit allowable for foreign taxes imposed on controlled foreign corporations of the taxpayer. Starting in 2026, 90 percent of the foreign taxes deemed paid on NCTI are eligible for a foreign tax credit. That percentage was increased from 80 to 90.⁸

These sections further change how deduction eligible income (DEI) is determined for FDDEI by excluding certain income and gains from DEI.⁹ These changes could lead to a greater FDII deduction for some taxpayers, although the deduction is limited by the Section 250(a)(2) taxable income limitation.

Analysis: Starting in tax year 2026, these sections create an effective federal tax rate for both FDII and GILTI that is higher than the previous law. The change relating to QBAI deduction flows through to Vermont but the changes to the foreign tax credit do not. The QBAI changes result in an increase in taxes paid, therefore, there is expected to be a revenue increase for Vermont.

CHANGES TO PRO RATA SHARE RULES (Sec. 70354)

Summary: Provides that if a foreign corporation is a controlled foreign corporation (CFC) at any time during a taxable year, each U.S. shareholder that owns stock in the corporation must include in gross income their pro rata share of the corporation's passive income¹⁰ for the CFC's tax year. Similar provisions also apply to GILTI/NCTI income.

Background: This section requires U.S. shareholders that own stock in a CFC to include in their own income their pro rata share of the CFC's Subpart F income. Overall, taxpayers with stock in CFCs will have to report more gross income from those stocks than they would under the previous law.

Analysis: The changes will flow through to Vermont and increase revenue.

RENEWAL AND EXPANSION OF OPPORTUNITY ZONES (Sec. 70421)

Summary: Permanently renews and modifies the opportunity zones system created by TCJA. Starting in 2027, OZ designations will be implemented on a 10-year rolling basis. It also changes some definitions relating to OZs.

Background: Opportunity zones were created by the TCJA in 2017. It allowed investors to invest in a Qualified Opportunity Fund to support real estate development in areas designated as opportunity zones. A taxpayer can elect to defer the gain from these investments as long as they hold them. The longer an investor holds the investment before selling or exchanging it, the greater the tax benefit. It's possible to completely exclude the gain if the investment is held for at least 10 years.

⁸ This is referred to as the NCTI haircut or 10 percent haircut. It means there is no credit for 10 percent of the foreign taxes paid. It is also referred to as the inclusion percentage.

⁹ The following items will not be deduction eligible: income or gain from the sale of property that provides rents or royalties, any other property that is subject to depreciation, amortization, or depletion by the seller, and expenses and deductions, other than interest expenses and research or experimental expenditures properly allocated to such income.

¹⁰ This generally passive income is called Subpart F income. Subpart F includes income from dividends, interest, royalties, annuities, rent, and income from issuing insurance contracts.

Opportunity zones were set to expire at the end of 2026, but this act made them permanent. After these changes, state governors will propose new qualified opportunity zones every 10 years, which will require certification by the U.S. Treasury Secretary. The qualification requirements for what areas qualify were slightly tightened and some new reporting requirements were added.

This section also creates Qualified Rural Opportunity Funds, which involve larger tax benefits for investing in certain zones that meet the requirements.

Most of the changes take effect on January 1, 2027.

Analysis: The permanent renewal of opportunity zones flows through to Vermont and will have an impact after 2027. These zones exist now but may be expanded and have a greater revenue impact later.

CHARITABLE DEDUCTION FOR CORPORATIONS (Sec. 70426)

Summary: Charitable contributions are now allowed only to the extent that the aggregate of the contributions made during the taxable year exceeds one percent of the corporation's taxable income. In other words, the first one percent of taxable income worth of charitable contributions cannot be deducted.

Background: Previously, corporations could make deductible contributions of up to 10 percent of taxable income. This change means that a corporate taxpayer may only claim deductions that exceed one percent of taxable income (floor) and that do not exceed 10 percent of taxable income (ceiling). Deductions that exceed the ceiling may be carried forward five years, but contributions that are disallowed because of the floor can only be carried forward if the ceiling was exceeded in that year.

Analysis: The one percent floor on a corporation's charitable contributions will flow through and slightly increase revenue. This flows through because Vermont net income for corporate taxpayers is not decoupled from the charitable deduction available for federal corporate income tax.

ACCOUNTING CHANGES FOR CERTAIN RESIDENTIAL CONSTRUCTION (Sec. 70430)

Summary: Allows certain residential construction contracts to use uniform capitalization rules for accounting rather than the percentage of completion method.

Background: Previously, the law allowed income from certain home construction contracts to be reported at the end of the contract (uniform capitalization) instead of when the income accrues (percentage of completion). The treatment was limited to home construction contracts for building four or fewer dwelling units or contracts completed within two years by taxpayers with \$31 million or less of gross receipts. This section expands that treatment to all residential construction contracts and all contracts completed within two years.

Analysis: This change will flow to Vermont and will change the timing of when income is taxed so that it is taxed later than it would have under previous law.

EXPANDED EXCLUSION OF GAINS FROM QUALIFIED SMALL BUSINESS STOCK (Sec. 70431)

Summary: This change applies to the personal income taxes of individuals, trusts, and pass-through entities that hold qualified small business stock (QSBS) and receive income

by selling it. Taxpayers who hold QSBS can exclude gains from sales of the stock on their federal tax returns, if they held it for long enough, up to a certain cap. This section expands the federal exclusion for gains from QSBS to allow a 50 percent exclusion for QSBS held for three years, 75 percent exclusion for QSBS held for four years, and 100 percent exclusion for QSBS held for five years. A taxpayer may only exclude gains up to a certain amount for each business that issued QSBS. This section increases the per-issuer exclusion cap for QSBS from \$10,000,000 to \$15,000,000. Further, the aggregate-asset ceiling to be recognized as a “Qualified Small Business” is increased to \$75,000,000 in assets. This means more businesses will qualify to issue QSBS.

Background: Previously, taxpayers were eligible to exclude 100 percent of the gain received from the sale of qualified small business stock acquired after 2010 and held for at least five years. The small business issuing the stock had to meet several requirements relating to the amount of assets owned and the industry in which it operated. There was a cap of \$10 million, or 10 times the basis per issuer, that could be excluded.

This section requires the stock to be held for at least five years to use the 100 percent exclusion and increases the per-issuer cap to \$15 million. The section also increases the amount of assets that can be owned by an issuer to \$75 million and is indexed for inflation.

Analysis: Vermont has not decoupled from federal law relating to the treatment of gains from qualified small business stock. The expanded exclusion and increased exclusion cap flow through to Vermont.

CAPITAL GAINS FROM SALE OF FARMLAND PAID IN FOUR INSTALLMENTS (SEC. 70437)

Summary: Allows the portion of tax due for capital gains from the sale of qualified farmland property to a qualified farmer to be paid in four installments across four successive tax years.

Background: Taxable capital gains from the sale of land are usually taxable in the year of the sale. Capital gains are calculated by subtracting the seller’s basis (usually that was the amount originally paid for the land) from what is received in the current sale. This section allows the tax for a capital gain to be paid across four years instead of one if certain requirements are met. The land must be qualified farmland, which means it must be in the United States and have been used for farming for the 10 years before the sale and must be subject to a covenant that it will continue to be used for farming for 10 years after the sale. The sale must also be to a qualified farmer, which is a person or entity that is actively engaged in farming, usually demonstrated by active participation in the business of the farm. Eligible farming activities are defined broadly and include nurseries, greenhouses, orchards, and woodlands.

Analysis: It is currently unclear how the option for some taxpayers to pay capital gains in four installments at the federal level will affect Vermont tax returns. The impact may become clear when the IRS publishes new returns. Assuming it may cause taxpayers to also pay Vermont in four installments, it’s possible that it would cause some taxpayers to become subject to Vermont’s alternative minimum tax. It may also cause administrative issues when taxpayers leave the State before all installments are paid.