Federal Impacts: H.R.1

House Committee on Ways and Means

Senate Committee on Finance

Patrick Titterton, Senior Fiscal Analyst

January 6, 2026

H.R.1 Changes to Personal Income Taxes

H.R.1 Changes to Personal Income Taxes

- H.R.1, the 2025 Reconciliation Act, made several changes to federal personal income taxes.
- These include, but are not limited to the following;
  - A deduction for tipped income subject to AGI limitations
  - A deduction for overtime pay, subject to AGI limitations
  - A deduction for automobile loan interest payments
  - An enhanced deduction for filers ages 65+
  - Expansion of the Child and Dependent Care Credit (CDCC)
- Not all of these changes flow through to Vermont and it is important to distinguish what is "above the line" and "below the line."

H.R.1 Changes to Personal Income Taxes

- H.R.1 creates a new deduction for qualified tipped income that is available for occupations that customarily and regularly receive tips.
  - Filers may deduction up to $25,000 of tipped income if they have AGI of $150,000 (individuals) or $300,000 (joint filers). The deduction is phased out above these income limits.
  - The deduction is temporary and is in effect for tax years 2025 through 2028.
- The bill creates a new deduction for qualified overtime compensation.
  - Filers may now deduct up to $12,500 (individual) and $25,500 (joint filers) of the amount paid in excess of their regular wage rate.
  - The deduction amount phases out for taxpayers with AGI above $150,000 (individuals) and $300,000 (joint filers).
  - The deduction is temporary and is in effect for tax years 2025 through 2028.

H.R.1 Changes to Personal Income Taxes

- The bill creates a new deduction of up to $10,000 for interest paid on a qualified passenger vehicles which is limited to vehicle with final assembly in the U.S.
  - The deduction is phased out for filers with AGI above $100,000 (individuals) and $200,000 (joint filers).
  - The deduction is for interest paid or accrued within the taxable year.
  - The deduction is temporary and is in effect for tax years 2025 through 2028.
- The bill includes an enhanced deduction of $6,000 for senior citizens
  - The deduction is phased out for filers with AGI above $75,000 (individuals) and $150,000 (joint filers).
  - The deduction is temporary and is in effect for tax years 2025 through 2028.

Personal Income Tax Starting Point

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.
If you did not get a Form W-2, see instructions.

Attach Sch. B if required.

1a	Total amount from Form(s) W-2, box 1 (see instructions)		1a
b	Household employee wages not reported on Form(s) W-2		1b
c	Tip income not reported on line 1a (see instructions)		1c
d	Medicaid waiver payments not reported on Form(s) W-2 (see instructions)		1d
e	Taxable dependent care benefits from Form 2441, line 26		1e
f	Employer-provided adoption benefits from Form 8839, line 31		1f
g	Wages from Form 8919, line 6		1g
h	Other earned income (see instructions). Enter type and amount:		1h
i	Nontaxable combat pay election (see instructions)	1i	
z	Add lines 1a through 1h		1z
2a	Tax-exempt interest	2a	b Taxable interest 2b
3a	Qualified dividends	3a	b Ordinary dividends 3b
c	Check if your child's dividends are included in 1 ☐ Line 3a 2 ☐ Line 3b		
4a	IRA distributions	4a	b Taxable amount 4b
c	Check if (see instructions) 1 ☐ Rollover 2 ☐ QCD 3 ☐		
5a	Pensions and annuities	5a	b Taxable amount 5b
c	Check if (see instructions) 1 ☐ Rollover 2 ☐ PSO 3 ☐		
6a	Social security benefits	6a	b Taxable amount 6b
c	If you elect to use the lump-sum election method, check here (see instructions) ☐		
d	If you are married filing separately and lived apart from your spouse the entire year (see inst.), check here ☐		
7a	Capital gain or (loss). Attach Schedule D if required		7a
b	Check if: ☐ Schedule D not required ☐ Includes child's capital gain or (loss)		
8	Additional income from Schedule 1, line 10		8
9	Add lines 1z, 2b, 3b, 4b, 5b, 6b, 7a, and 8. This is your **total income**		9
10	Adjustments to income from Schedule 1, line 26		10
11a	Subtract line 10 from line 9. This is your **adjusted gross income**		11a

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2025) Created 9/5/25

- The federal form 1040 includes the calculation of income that adds up to Adjusted Gross Income (AGI).
- Line 11a is the starting point for Vermont Tax returns so any changes above that line *do* flow through to Vermont.
- Any other changes further down the form are "below the line" and *do not* flow through to Vermont.

Below the line new federal deductions

Form 1040 (2025) — Page 2

Tax and Credits

11b	Amount from line 11a (adjusted gross income)	11b	
12a	Someone can claim ☐ You as a dependent ☐ Your spouse as a dependent		
b	☐ Spouse itemizes on a separate return **c** ☐ You were a dual-status alien		
d	**You:** ☐ Were born before January 2, 1961 ☐ Are blind		
	Spouse: ☐ Was born before January 2, 1961 ☐ Is blind		
e	**Standard deduction or itemized deductions** (from Schedule A)	12e	
13a	Qualified business income deduction from Form 8995 or Form 8995-A	13a	
b	Additional deductions from Schedule 1-A, line 38	13b	
14	Add lines 12e, 13a, and 13b	14	
15	Subtract line 14 from line 11b. If zero or less, enter -0-. This is your **taxable income**	15	
16	**Tax** (see instructions). Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐	16	
17	Amount from Schedule 2, line 3	17	
18	Add lines 16 and 17	18	
19	Child tax credit or credit for other dependents from Schedule 8812	19	
20	Amount from Schedule 3, line 8	20	
21	Add lines 19 and 20	21	
22	Subtract line 21 from line 18. If zero or less, enter -0-	22	
23	Other taxes, including self-employment tax, from Schedule 2, line 21	23	
24	Add lines 22 and 23. This is your **total tax**	24	

Standard deduction for—
- Single or Married filing separately, $15,750
- Married filing jointly or Qualifying surviving spouse, $31,500
- Head of household, $23,625
- If you checked a box on line 12a, 12b, 12c, or 12d, see inst.

- Schedule 1-A includes the new deductions for:
  - tipped income,
  - overtime pay,
  - car loan interest, and
  - enhanced deduction for seniors.
- These changes are “below the line” meaning they occur after the starting point for Vermont personal income taxes.

Vermont's Personal Income Tax

From federal form 1040

Federal adjusted gross income

plus

Additions to adjusted gross income
Bonus depreciation, interest from non-Vermont state and local bonds

minus

Subtractions from adjusted gross income

Standard deduction*
$7,400 for single filer, $14,850 for married filer

Personal exemptions*
$5,300 for taxpayer, spouse, and any dependents

Other subtractions
- Interest income from U.S. bonds
- Capital gains exclusion
- Social Security exemption
- Medical expenses

equals

Vermont taxable income

Note: Amounts for Tax year 2025; indexed annually for inflation

Vermont's Personal Income Tax

Vermont taxable income (VTI)

Multiplied by

Income tax rates at various brackets of income

Single Individuals, Schedule X
Use if your filing status is:
Single

If VT Taxable Income is Over	But Not Over	VT Base Tax is	Plus	of the amount over
0	47,900	0.00	3.35%	0
47,900	75,000	1,605.00	6.60%	47,900
TAXABLE INCOME UNDER $75,000 USE THE TAX TABLES				
75,000	116,000	3,393.00	6.60%	75,000
116,000	242,000	6,099.00	7.60%	116,000
242,000	-	15,675.00	8.75%	242,000

Married Filing Jointly, Schedule Y-1
Use if your filing status is:
Married Filing Jointly; Qualifying Widow(er); or Civil Union Filing Jointly

If VT Taxable Income is Over	But Not Over	VT Base Tax is	Plus	of the amount over
0	75,000	0.00	3.35%	0
TAXABLE INCOME UNDER $75,000 USE THE TAX TABLES				
75,000	79,950	2,513.00	3.35%	75,000
79,950	193,300	2,678.00	6.60%	79,950
193,300	294,600	10,159.00	7.60%	193,300
294,600	-	17,858.00	8.75%	294,600

Equals

Initial Vermont Tax Liability (Before Credits)

2024 tax brackets

Vermont's Personal Income Tax

Initial Vermont Tax Liability (Before Credits)

minus

Non-Refundable Credits

Credit for elderly and disabled, investment tax credit, Charitable Tax Credit

minus

Refundable Credits

Earned Income Tax Credit, Child Tax Credit, Child and Dependent Care Credit

Federal changes to the CDCC show up here

Multiplied by

Vermont Apportionment Percentage

The percentage of income based in Vermont

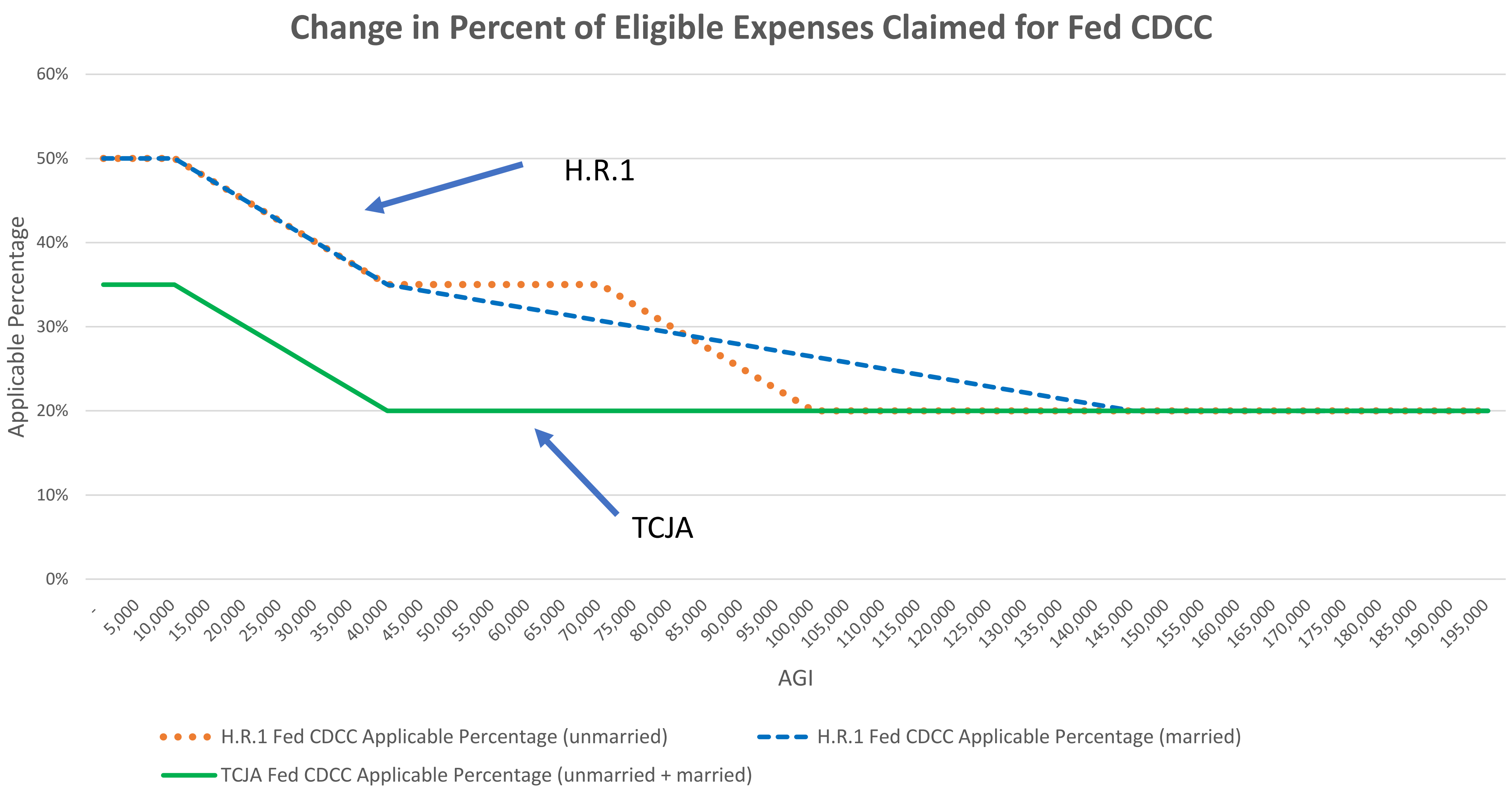
Equals

Final Vermont Tax Liability (or Refund)

Federal changes to Child and Dependent Care Credit

- H.R.1 expanded the phase out for the federal CDCC and increased the maximum credit rate to 50% from 35%.
  - Meaning qualifying expenses can be claimed for the credit at a rate of 50 cents per dollar.
- Vermont has a State CDCC that is refundable and set equal to 72% of what the claimant receives on their federal return.
  - Vermont does this for certain other State level credits like the Earned Income Tax Credit.
- Typically, because federal credits are calculated “below the line” they do not flow through to Vermont unless there is a State level credit linked directly to the federal calculation.
- **The federal expansion of the CDCC is estimated to result in approximately $1 million in forgone revenue annually starting in FY 2027.**
- The 2025 Tax Expenditure Report projected the CDCC to result in $4.8 million in forgone revenue in FY 2026 under previous law.

Federal changes to CDCC



H.R.1 Changes to Business and Corporate Income Taxes

Corporate Income Taxes

H.R.1 Changes to Business and Corporate Income Taxes

- H.R.1 made many changes to many business and corporate income taxes.
- This presentation focuses on the changes made that *do* flow through to Vermont, but note that there are many others.
- Determining whether a change in federal business or corporate income tax policy will flow through to Vermont follows a similar exercise as shown previously with PIT.

IRS Form 1120 – Determining Total Income

Income	1a	Gross receipts or sales	1a			
	b	Returns and allowances	1b			
	c	Balance. Subtract line 1b from line 1a			1c	
	2	Cost of goods sold (attach Form 1125-A)			2	
	3	Gross profit. Subtract line 2 from line 1c			3	
	4	Dividends and inclusions (Schedule C, line 23)			4	
	5	Interest			5	
	6	Gross rents			6	
	7	Gross royalties			7	
	8	Capital gain net income (attach Schedule D (Form 1120))			8	
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)			9	
	10	Other income (see instructions—attach statement)			10	
	11	**Total income.** Add lines 3 through 10			11	

- Total income does not equal taxable income.
- Corporations are eligible to take deductions before determining taxable income as seen on the next slide.

IRS Form 1120 – Determining Taxable Income

Deductions (See instructions for limitations on deductions.)

12	Compensation of officers (see instructions—attach Form 1125-E)			12	
13	Salaries and wages (less employment credits)			13	
14	Repairs and maintenance			14	
15	Bad debts			15	
16	Rents			16	
17	Taxes and licenses			17	
18	Interest (see instructions)			18	
19	Charitable contributions			19	
20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)			20	
21	Depletion			21	
22	Advertising			22	
23	Pension, profit-sharing, etc., plans			23	
24	Employee benefit programs			24	
25	Energy efficient commercial buildings deduction (attach Form 7205)			25	
26	Other deductions (attach statement)			26	
27	**Total deductions.** Add lines 12 through 26			27	
28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.			28	
29a	Net operating loss deduction (see instructions)	29a			
b	Special deductions (Schedule C, line 24)	29b			
c	Add lines 29a and 29b			29c	

- Line 28 is the starting point for determining Vermont taxable corporate income.
- All changes made at the federal level that affect lines 1 through 27 do flow through to Vermont, while those further down the form do not.

H.R.1 Changes to Business and Corporate Taxes

- There were many changes made to business and corporate income taxes that are considered “above the line” which are expected to flow through to Vermont.
- These include changes to:
  - The deduction for domestic research and development expenses,
  - limitation on business interest deduction,
  - exceptions from limitations on business meals deductions,
  - limitation on expensing for depreciable business assets,
  - special depreciation allowance for qualified production property,
  - foreign derived intangible income and global intangible low-taxed income,
  - changes to pro rata share rules,
  - renewal and expansion of opportunity zones,
  - charitable deduction for corporations,
  - accounting changes for certain residential construction, and
  - expanded exclusion of gains from qualified small business stock.

The Deduction for Domestic Research and Development Expenses

- H.R.1 changes how corporations calculate their R&D deduction amount.
- Starting in 2022 (TCJA), these expenses were required to be amortized over five years, which meant the benefit from the deduction was realized incrementally over that period.
- Prior to TCJA, incurred R&D expenses could be deducted immediately. The H.R.1 changes revert back to pre-TCJA treatment.
- H.R.1 also makes this change retroactively to include any R&D expenses that have not been already deducted since 2022.
- This will likely front-load the cost of the deduction for R&D expenses.
- **This change is expected to reduce State revenues by approximately $2.3 million in FY 2026 and 2027, but the impact is expected to decrease over time.**

Amended Limitation on Business Interest Deduction

- H.R.1 expanded the limit to which corporations can deduct interest paid on loans for a business purpose.
- The limit on business interest deductions is limited by the sum of its business interest *income*, floor plan financing interest, and 30% of their adjusted taxable income.
- H.R.1 expanded the amount of business interest paid that can be deducted from 30% to 50%.
- Because Vermont is coupled to this provision this expansion will flow through to the State.
- **This change is estimated to reduce State revenue by approximately $1 million annually starting in FY 2026.**

Exceptions from Limitation the Business Meals Deductions

- In 2022, TCJA eliminated a general deduction on business entertainment expenses, but still kept a more limited deduction for food and beverages provided by employers to employees.
- H.R.1 kept these restrictions but created a few new exceptions to the deduction limitation including when employees pay the same price for the meal as the general public, meals provided to crews on commercial vessels and oil platforms, and meals provided on certain fishing vessels and facilities.
- This expansion of exceptions from TCJA will flow through to Vermont, but is expected to have a de minimis impact.

Limitation on Expensing For Depreciable Business Assets

- H.R.1 increases the maximum amount that a taxpayer may expense for the cost of a qualifying depreciable business asset in lieu of recovering the costs through depreciation.
- The maximum amount that can be expensed increased from $1 million to $2.5 million and will be indexed for inflation annually.
- Vermont is coupled to the federal treatment of this deduction so it *does* flow through to the State.
- **This change is estimated to decrease State revenues by approximately $250,000 in FY 2026 and potentially grow to an approximately $600,000 reduction in future years.**

Special Depreciation Allowance for Qualified Business Assets

- H.R.1 now allows a deduction for qualified production property of 100% of its adjusted cost basis.
- This 100% bonus depreciation can be used for qualified nonresidential property used in manufacturing or production of tangible personal products. Further, this is largely limited to agricultural and chemical production.
- These properties are typically depreciated over 39 years, but this change would allow that amount to be fully claimed up front.
- This change applies to properties built or bought after January 19, 2025 and before January 1, 2029.
- **This is estimated to reduce State revenue by approximately $250,000 in FY 2026, but rise significantly to approximately $3.5 million in FY 2027 and $5.2 million in FY 2028.**

Foreign Derived Intangible Income and Global Intangible Low-Taxed Income

- H.R.1 increased the base used to calculate foreign derived intangible income (FDII) while also increasing the percentage of this income that can be deducted, effectively lowering the effective tax rate.
- The bill also eliminated a deduction of 10% of the tax basis of qualified tangible assets in other countries (QBAI) used to calculate global intangible low-taxed income (GILTI), which increases the base amount of this income.
- FDII was renamed foreign-derived deduction eligible income and GILTI was renamed net controlled foreign corporation tested income.
- Vermont is coupled to the federal treatment of this kind of income so this change *does* flow through to the State.
- **These changes are estimated to *increase* revenue to the State by approximately $2.5 million in FY 2026 and increase to about approximately $3.2 million in future fiscal years.**

Changes to Pro Rata Share Rules

- H.R.1 changes the treatment of controlled foreign corporation (CFC)
  - A foreign corporation is a CFC if at least 50% of voting power or value of the stock are held by U.S. shareholders.
- Each U.S. shareholder must include in their gross income their pro rata share of the CFC’s passive income in that tax year.
- Taxpayers that hold stock in CFC’s will have to report more gross income than they would have previously, and this *does* flow through to Vermont.
- **This change is not expected to change State revenue in FY 2026, but is estimated to increase revenue by approximately $100,000 in FY 2027 and increase to approximately $240,000 in FY 2027 and grow gradually thereafter.**

Renewal and Expansion of Opportunity Zones

- H.R.1 makes permanent the creation of opportunity zones created by TCJA.
  - Opportunity zones encourage investment in a Qualified Opportunity Fund to support real estate development in opportunity zones.
  - Investors can elect to defer gains from these investments as long as they hold them, so the longer they hold them the greater the tax benefit.
  - Vermont currently has 25 opportunity zones.
- H.R.1 also created Qualified Rural Opportunity Funds, which provide larger tax benefits for investing in these newly created zones.
- **These changes flow through to Vermont, but the implementation date is delayed until 2027.**

Charitable Deductions for Corporations

- Previously, corporations could deduct charitable contributions equal to up to 10% of their taxable income.
- H.R.1 makes a change so that only contributions made in excess of 1% and up to 10% of taxable income can be deducted.
- This changes reduces the amount that can be claimed by 1%, thus reducing the maximum deductible amount.
- **This is not expected to change State revenues in FY 2026 but is estimated to increase revenue by approximately $140,000 in FY 2027 and increase gradually on an annual basis in future years.**

Business Income Taxes

Accounting Changes for Certain Residential Construction

- Previously, income from certain home construction contracts was reported at the end of the contract rather than based on the percentage of completion over the life of the contract.
- This was limited to construction projects with four or fewer units, or contracts completed within two years by taxpayers with $31 million or less in gross receipts.
- H.R.1 expands this treatment of income reporting to all residential construction contracts completed within two years.
- This change, amends the timing of when this income needs to be reported and *does* flow through to Vermont.
- **This change is not estimated to change State revenue in FY 2026, and is not estimated to exceed $100,000 in future years.**

Expanded Exclusion on Gains from Qualified Small Business Stock

- H.R.1 allows stock for corporation issued after July 5, 2025 with aggregate gross assets (AGA) below $75 million to qualify as a Qualified Small Business Stock (QSBS).
  - This is an increase from the previous $50 million in AGA and will allow more businesses to qualify to issue QSBS.
- Investors who buy these shares can exclude 50% of capital gains if held for 3 years, 75% if held for 4 years, and 100% if held for 5 years.
- H.R.1 also increase the per-issuer exclusion cap from $10 million to $15 million.
- This change *does* flow through to Vermont.
- **These changes are not estimated to change State revenue through FY 2029, but could decrease revenues after that.**

Summary

Net Estimated Changes to State Revenue

H.R.1 Changes that will flow through if Vermont "Links Up"	**FY26** *(Millions)*	**FY27** *(Millions)*
Child and Dependent Care Tax Credit expansion	0.00	-1.00
Full Expensing of Domestic Research and Expermential Procedures	-2.30	-2.30
Amended Limitation on Business Interest Deduction	-1.00	-1.00
Increased Limitation on Expensing of Depreciable Business Assets	-0.25	-0.60
Special Depreciation Allowance for Qualified Production Property	-0.25	-3.50
International Tax Provisions	2.50	3.20
Pro Rata Share Rules	0.00	0.10
Charitable Deductions for Corporations	0.00	0.14
Misc other business and corporate income provisions	0.00	0.10
Total	**-1.30**	**-4.86**

Questions?