H.R.1, Federal Tax Conformity Decisions, and Considerations for Vermont

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As a resource for the VT House Ways and Means Committee meeting
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Agenda:

- H.R.1 Impacts to the State Tax Landscape
- State revenue implications
- State Conformity Actions in response and in advance of H.R. 1 ("OBBBA")
- Vermont in context

See NCSL Conformity Report:
https://www.ncsl.org/fiscal/2025-tax-conformity-changes

What H.R.1 (“OBBBA”) Changed for Businesses

- **Domestic research costs can be deducted immediately** under Internal Revenue Code (IRC) Section 174A (foreign research stays 15-year).
- **Permanent 100% “bonus” first-year depreciation** for eligible property under IRC Section 168(k); IRS Notice 2026-11 provides interim rules and elections.
- **More generous business interest cap:** Deduction measured against earnings before interest, taxes, depreciation, and amortization (EBITDA) / IRC Section 163(j)
- **The qualified business income (QBI) deduction,** §199A, an individual-level deduction that lets pass-through business owners exclude a portion of their business income from tax, was made permanent under H.R. 1, expanded phase-in ranges and added a new minimum deduction.
- **Pass Through Entity Tax (PTET)** remains fully available; despite the higher $40,000 SALT cap through 2029 and continues to provide federal deductibility benefits for many businesses.

H.R.1: Individual taxpayer impacts

Above the Line (affects Adjusted Gross Income on IRS 1040)

- **Higher federal standard deduction** (permanent) with an additional temporary senior increase (2025–2028)
- **Higher federal SALT deduction cap**, generally $40,000 for 2025–2029, then scheduled to revert; includes high-income phase-down (state add backs may limit impact)

Below-the-line (affects federal taxable income, not AGI):

- **Tip income:** up to $25,000 excluded from federal taxable income.
- **Overtime pay**: up to $12,500 (single) / $25,000 (joint) excluded.
- **Personal car-loan interest:** newly deductible (though many restrictions to access)
- **Enhances the Child and Dependent Care Tax Credit** by raising the maximum credit rate to 50% of qualifying expenses (up from 35%) for taxpayers with AGI of $15,000 or less.

Note: Below-the-line taxes may still impact state revenue depending on what starting point is used for taxable income and/or specific tax deduction adoptions.

Revenue Implications for States

Estimates of State revenue impacts:

- **District of Columbia:** Estimated to lose over $593 million according to the D.C. Chief Financial Officer as a result of H.R. 1, prompting emergency decoupling that increased revenues by $179M in FY26 and $593M over the four-year financial plan.
- **Oregon:** Estimated to lose $900 million according to Oregon legislative budget analyses due to H.R. 1's federal tax changes reducing projected state revenue.
- **Delaware**: Department of Finance shows that without decoupling legislation, the state could face a loss of about $222 million in fiscal year 2026, $107 million in FY 2027 and nearly $80 million in FY 2028
- **Note:** some states have voluntarily adhered to the tips and overtime deductions increasing revenue loss, but not explicitly due to H.R.1 (example: Michigan)

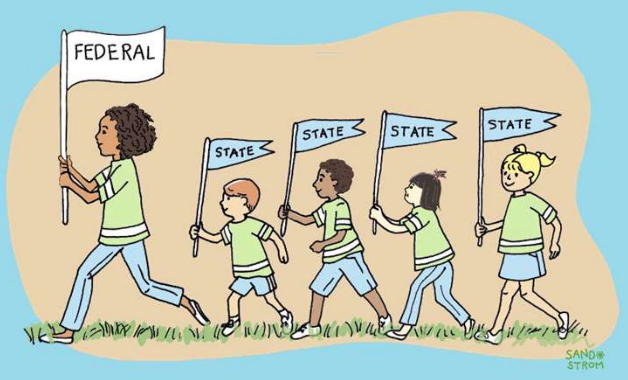
Vermont: Potential Revenue Impacts

(Source: Vermont JFO Report)

Net Estimated Changes to State Revenue

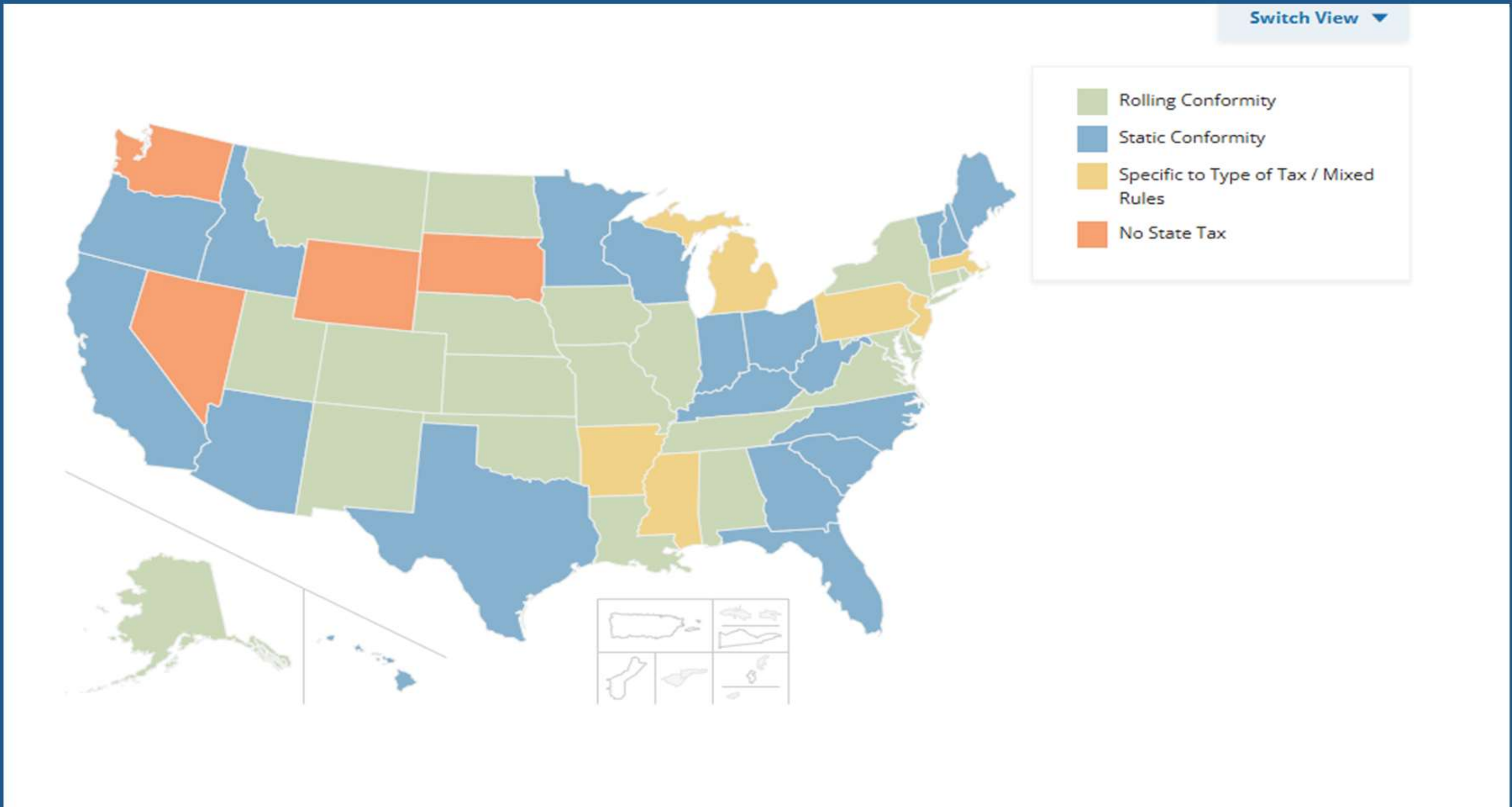
H.R.1 Changes that will flow through if Vermont "Links Up"	**FY26** *(Millions)*	**FY27** *(Millions)*
Child and Dependent Care Tax Credit expansion	0.00	-1.00
Full Expensing of Domestic Research and Expermential Procedures	-2.30	-2.30
Amended Limitation on Business Interest Deduction	-1.00	-1.00
Increased 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**

Conformity and Decoupling

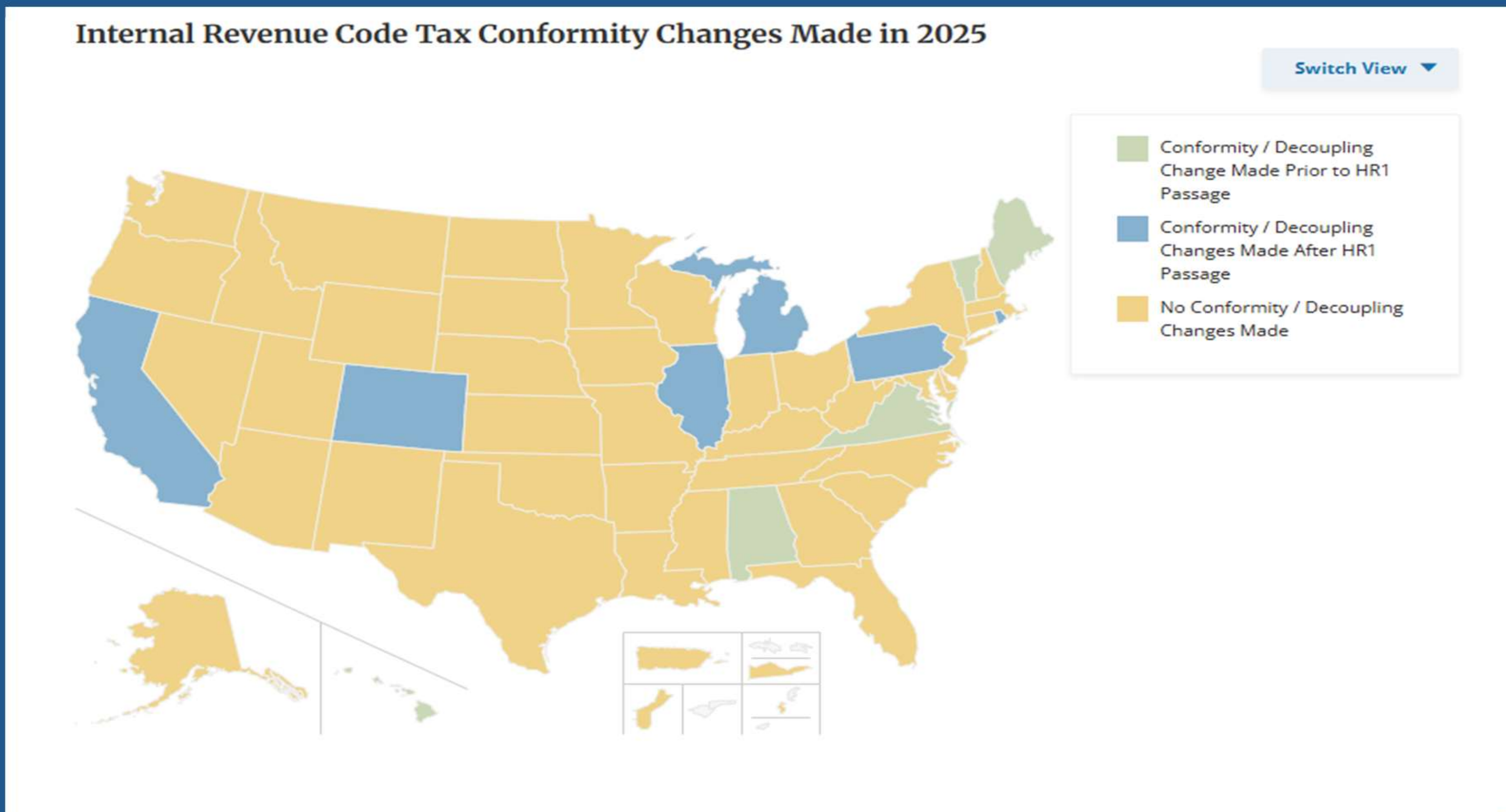


- **Tax conformity: the practice of state governments aligning their tax laws, definitions of income, and regulations with the federal Internal Revenue Code (IRC)**
  - Conformity decisions are made for purposes of revenue and administrative simplicity
  - Rolling: Changes made automatically as the IRC changes
  - Static: Based on a particular date of the IRC
- **Decoupling in taxation is the process where a state acts to prevent its tax code from automatically changing in response to amendments in federal tax law.**
  - Many states decouple from individual provisions
- **Individual state deductions and tax policies make conforming and decoupling revenue impacts very unique**

50-State Conformity Picture (2025)



State Conformity Changes Made in 2025



State Conformity Actions in 2025

Actions by States:

- **Held fixed IRC dates (often Dec. 31, 2024)**
- **Broad conformity paused until fiscal projections stabilized**
- **Targeted decoupling, especially for:**
  - Research expensing (IRC §174A)
  - 100% bonus depreciation (IRC §168(k))
  - EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) (IRC §163(j))

Examples:

- **California:** SB 711 (Oct 2025) updates conformity to Jan 1, 2025 and decouples from HR 1 research expensing and bonus depreciation.
- **Colorado:** Special session (Aug 2025) added a permanent QBI addback and decoupled from the federal FDDEI deduction in response to HR 1 revenue losses.
- **Delaware:** HB 255 (Nov 2025) decouples from HR 1 R&D expensing and limits bonus depreciation through 2030, restoring conformity in 2031.
- **District of Columbia:** Emergency B26-0457 (Dec 2025) temporarily decouples from HR 1 bonus depreciation, R&E expensing, interest rules, and tip/overtime/car-loan provisions;
- **Hawaii:** SB 1464 (May 2025) updates conformity to Dec 31, 2024.

State Conformity Actions in 2025

2025 State Decoupling Highlights

- **Research and Development – Decoupled or Restricted:** AL (flexible deduction), CA, DC, DE, ME, MI, PA
- **Bonus Depreciation – Limited or Blocked:** CA, DC, DE, ME, MI, PA, IL
- **Qualified Business Income (§199A) –** Add-Back: CO (indefinite add-back)
- **International (Net Controlled Foreign Corporations Tested Income (NCTI):** CO (Foreign-Derived Intangible Income add-back), IL (50% NCTI taxed)
- **Business Interest / EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) Rules:** DC (decouple), PA (pre-HR 1 EBITDA), ME (conform on interest)
- **Individual Income Items – Not Adopted or Modified:** DC, ME, MI, RI (overtime, tips, car-loan interest, std. deduction)
- **Static Conformity Dates Updated:** CA (1/1/25), HI (12/31/24), MI (12/31/24), VT (4/1/25 retro)
- **Emergency / Temporary Measures:** DC (90-day emergency), ME (assessor discretion)
- **Global Moratorium on Internal Revenue Code (IRC) Changes:** VA (no adoption of 2025–2027 federal changes if revenue-impacting)

Vermont: 2025 Conformity Change

- Vermont adopted a fixed-date conformity to the Internal Revenue Code as of December 31, 2024, through H.493 (Act 27)
- Federal H.R. 1 (2025 changes do not flow into Vermont under this date), unless the Legislature updates the conformity date again.
- Vermont begins from federal taxable income, so conformity decisions directly affect the state base.

Vermont: Considerations in Conforming to HR1

- **Most of the revenue loss in Vermont related to H.R.1 Impact is on the corporate side**
- **Decoupling actions that would be in similar company to several other states:**
  - Research expensing (IRC §174A)
  - 100% bonus (IRC §168(k))
  - EBITDA-based interest (IRC §163(j))
  - Not adopting individual below-the-line tax measures

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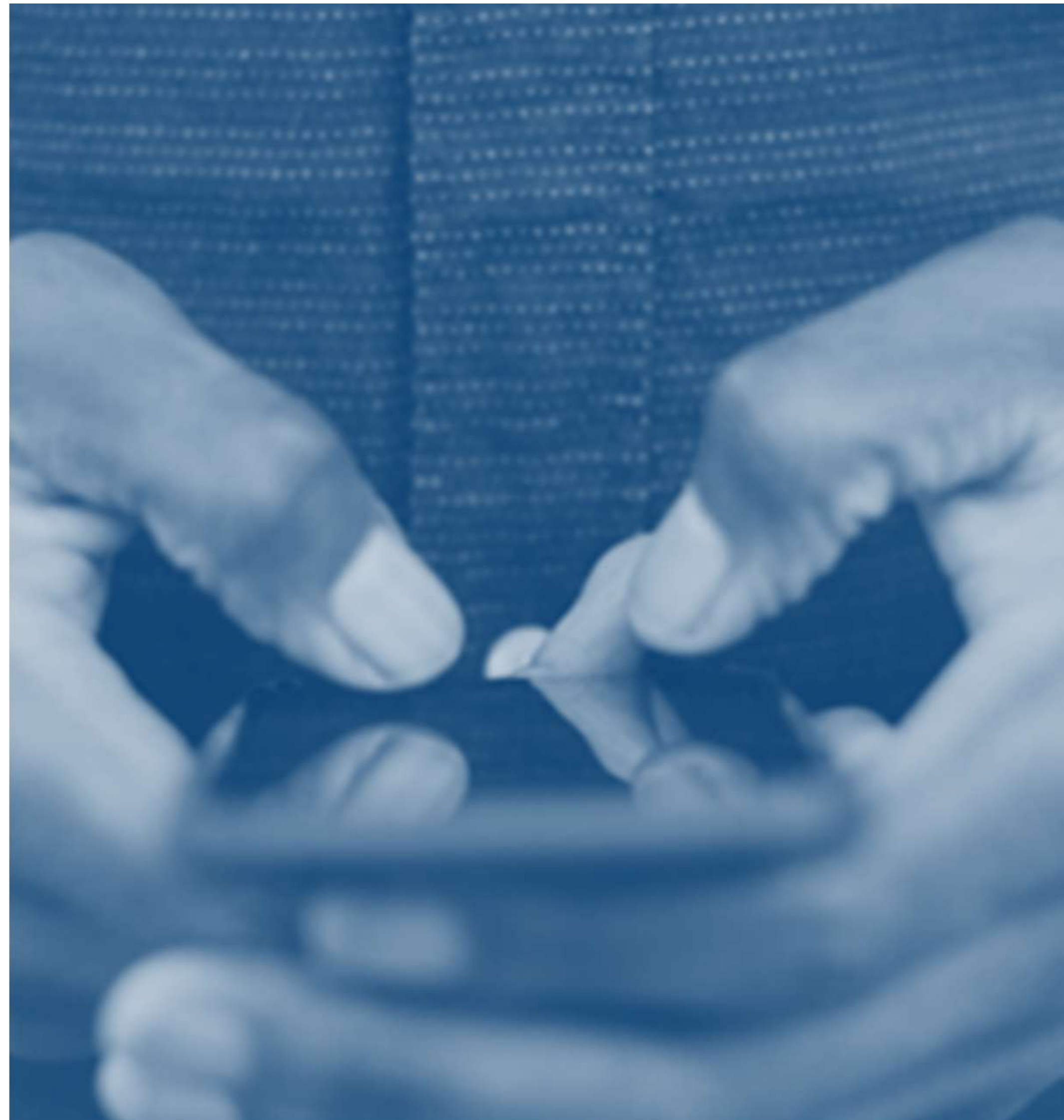

Thank You

Contact statefiscal-info@ncsl.org anytime with your questions and comments

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