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Eye on Washington

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One Big Beautiful Bill Act (OBBBA) Enacted to Largely Maintain Income Tax Status Quo

President Trump signed the One Big Beautiful Bill Act (OBBBA) [H.R. 1 reconciliation bill of the 119th Congress] on July 4th, 2025, fulfilling a number of campaign promises in what is likely to be a signature legislative accomplishment of his second term in office. While the bill's beauty doth of itself persuade, little in the legislation will come as a major surprise. The bill largely maintains the current income tax status quo, avoiding a sunset on many of the main provisions in the Tax Cuts and Jobs Act (TCJA) of 2017 as was scheduled for 2026. **Income tax rates and brackets will continue at current levels**, while various and sundry tax breaks (some temporary) are included as well.

What does the bill primarily accomplish?

The legislation was largely focused on forestalling a large and nearly across the board income tax increase on most individual taxpayers that would have occurred automatically on January 1, 2026, when the TCJA was scheduled to "sunset." More significantly perhaps, the law does not include any future sunset on income tax rules as has been the norm for income and estate tax legislation over the last 25 years. The law also permanently extends the current larger standard deduction (with an additional increase), modified alternative minimum tax threshold, as well as the TCJA's limits on some itemized deductions, such as for mortgage interest. Lastly, the **§199A Qualified Business Income (QBI) tax deduction for pass-through business entities was made permanent**, preserving the 20% deduction rate for pass-through business income. Although an increase to 23% was proposed in earlier drafts, it was not adopted. The final law also expands the income phase-in range beginning in 2026, while continuing to apply phaseout limitations to Specified Service Trades or Businesses (SSTBs).

A major sticking point during negotiations was whether the state and local tax (SALT) deduction cap should be increased. A $10,000 per tax return cap was introduced under the TCJA, removing a large benefit for taxpayers in states with high state level income taxes. Starting in 2025, the **SALT cap has been increased to $40,000** (married or single), with several additional tweaks:

- The cap increases 1% annually through 2029, *however it reverts back to $10,000 in 2030 and beyond.*
- The maximum deduction phases down once a taxpayer's income crosses $500,000 ($250,000 married filing separately), while the income threshold increases 1% every year through 2029. The phaseout is equal to 30% of such excess but only down to $10,000 of SALT (therefore, the increased cap is completely lost once one's income is $100,000 over the income phaseout level).
- The use of pass-through business entities in many states to effectively fully deduct state income taxes remains a viable strategy — provisions to eliminate or curtail this practice were left out of the final bill.
- Also, the use of non-grantor trusts as a planning strategy was not curtailed—such trusts (as separate taxable entities) can claim separate SALT deductions and may enable some taxpayers to stack deductions.

The federal estate tax exemption was scheduled to sunset on January 1, 2026, as well, reducing the amount that can be passed free of estate, gift, or GST tax to approximately $7 million per person. The new law **increases the federal exemption to $15 million per person starting in 2026**, with increases for inflation continuing on a permanent basis. The federal estate tax rate remains at 40% for taxable estates.

Other notable line items

- The value of itemized deductions for top earners is curtailed slightly, capping deductions at a 35% tax rate (vs. 37% for the highest bracket); e.g., a $10,000 itemized deduction will save $3,500 in taxes rather than $3,700 for taxpayers in the highest bracket. This replaces the reintroduction of the Pease limit on itemized deductions that was suspended through 2025 under the TCJA and is effective starting in 2026.
- The bill makes permanent the 60% AGI limit for cash gifts, although it also introduces a 0.5% AGI floor for itemized charitable deductions starting in 2026 (unused amounts subject to the floor will be eligible for a five (5) year carryforward). Under the new framework, the 60% ceiling for cash gifts may be layered on top of deductions for noncash gifts to the same category of donees, allowing donors to maximize the use of both types of contributions without forfeiting deductibility under lower-tier limitations.
- The above-the-line charitable deduction for non-itemizers has been made permanent and increased from $300 ($600 married) to $1,000 ($2,000 married) beginning in 2026.
- The child tax credit is increased to $2,200 from $2,000 starting in 2026, indexed for inflation moving forward (permanently).
- The bill retains the AMT exemption thresholds but increases the phaseout rate from 25% to 50%, steepening the marginal tax impact for higher-income individuals subject to AMT.
- New "Trump Accounts" will allow individuals to contribute (starting July 4, 2026 (on an after-tax basis)) up to $5,000 per year through the year before the beneficiary reaches age 18. Accounts grow tax-deferred while distributions can only begin the first day of the calendar year the beneficiary turns 18. Upon reaching age 18, the Trump account is transitioned to IRA-like treatment under Section 408(a), though not technically classified as traditional IRAs (and subject to similar rules regarding income taxes and early distribution penalties, etc.). For children born between 2025 and 2028, accounts may be eligible for a one-time government contribution of $1,000 as well. Investments are generally restricted to certain mutual funds and indexed ETFs until IRA conversion. *Note that many questions regarding such accounts are expected to arise as the legislation is examined and further regulations are promulgated*.

Promises kept?

President Trump campaigned very specifically on eliminating taxation on Social Security, tip and overtime income. For obvious practical reasons, blanket exemptions are not in the bill, however, certain tax breaks were provided, but **only for the 2025-2028 tax years**:

- People over 65 can deduct up to $6,000 from their taxable income if they make $75,000 or less, or $150,000 or less for married couples. The maximum deduction phases out beyond such threshold and is completely eliminated once income crosses $175,000 per person or $250,000 per couple.
- Workers can deduct up to $25,000 of tips from their taxable income for federal income tax purposes (but not state or payroll taxes). The maximum deduction is phased out once income surpasses $150,000 single/$300,000 married, and only certain professions qualify — the Treasury is required to publish the list within 90 days of enactment.
- Lastly, the bill adds a "no tax on overtime" deduction (capped at $12,500 for individuals or $25,000 for married couples), phased out for income in excess of $150,000 single/$300,000 married, and likewise only applying to federal income taxes, not state or payroll taxes.

Business tax incentives

A number of favorable and pro-growth business tax provisions were included to extend or restore certain popular tax benefits, including:

- Permanent extension of 100 percent bonus depreciation (under Section 168(k)) for qualified property acquired and placed in service after Jan. 19, 2025, with an additional first year depreciation deduction available for manufacturing, production and refining property;
- Restoration of the deduction for research or experimental expenditures (under Section 174) paid or incurred after Dec. 31, 2024, but only for domestic companies. Furthermore, small businesses (with revenue of $30 million or less) can apply this change retroactively to expenditures after Dec. 31, 2021 through amended returns, and others can accelerate remaining deductions; and
- An increase in the gain exclusion for qualified small business stock sales under Section 1202 to $15 million (from $10 million) with an inflation adjustment after 2026. A new tiered exclusion structure applies to QSBS issued on or after the OBBBA enactment date (July 4, 2025), based on holding period:
    - 50% exclusion for QSBS held for at least three years.
    - 75% exclusion for QSBS held for at least four years.
    - 100% exclusion for QSBS held for at least five years.

Other provisions in the OBBBA

- Student loan modifications cap the Parent Plus student loan program at $65,000 total per student, with annual caps of $20,000 per student. Parent Plus loans will not be eligible for income-driven repayment programs after July 1, 2026. The bill also eliminates the Grad Plus program that lets graduate students borrow as much as the cost of attendance, creating new borrowing limits of $20,500 a year for graduate students and $50,000 a year for professional students—e.g., those in fields such as medicine and law—starting July 1, 2026. Aggregate loan limits of $100,000 for graduate students and $200,000 for professional students will apply.
- Endowments on private colleges with more than 3,000 students will be subject to higher taxes on their endowments.

- Tax credits for buying an electric vehicle will expire September 30, 2025, while the credit for buying and installing a home charging station will end June 30, 2026.
- For the 2025 to 2028 tax years, taxpayers may deduct up to $10,000 in auto loan interest for purchases of US-made cars (with a phase-out for those with income in excess of $100,000).
- Another major sticking point during negotiations in Congress involved modifications to Medicaid—new work requirements and more frequent eligibility checks for Medicaid enrollees are included as well as limits on a tax mechanism that states use to attract matching federal funds.

What does the future hold?

While legislators rightly hail the fact that much of tax bill avoids a future sunset, the "air quote" gesture may be entirely suitable when describing the "permanence" of any tax legislation. Given the increasing divergence of the two major political parties regarding tax policy coupled with the extremely narrow margins either party seems able to muster, a minor shift in the political balance could bring a major shift in future tax rules. A mere four (4) years ago, another bill with three B's in its title (Build Back Better) narrowly avoided passage and would have introduced a higher top marginal income tax rate and massive changes to estate and gift tax rules that would have increased exposure significantly. The OBBBA itself passed the House by effectively two votes (at a final tally of 218-214) and required a tiebreaking vote by the Vice President to get passed in the Senate.

Notable among the stresses causing such slim vote margins in the House and Senate (where Republicans hold unified control) was the pressure of the federal deficit. Current federal debt remains near historical highs (around 121% of GDP), while annual federal deficits are projected to remain at trillion dollar plus levels for the foreseeable future. Coupled with projected insolvencies and mandatory cuts to entitlement programs (the primary drivers of deficits) as early as 2033, hard decisions will continue to loom over future tax policy. By passing under budget reconciliation, the OBBBA itself is projected to add between $3.0 and $3.4 trillion to the deficit over the next 10 years. While neither political party seems interested in fiscal responsibility at the federal level, Herbert Stein's law of economics holds that something that cannot go on forever, will stop. Whether that stoppage involves higher taxes, lower spending, or a combination of the two is anyone's guess. Needless to say, work done by Democrats on prior tax proposals, particularly in the wealth transfer arena, are largely fully formed and simply await the inevitable shift in political power.

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