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The One Big Beautiful Bill Act: Analysis of Key Provisions for Private Equity Funds and Their Portfolio Companies

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On July 4, 2025, President Donald Trump signed H.R. 1 into law, the budget reconciliation bill known as the One Big Beautiful Bill Act (the Act). As discussed in our prior alert following the passage by the House of Representatives of the original One Big Beautiful Bill (the Initial House Bill), this legislation includes amendments to the Internal Revenue Code (the Code) that could have significant consequences for private equity funds and their portfolio companies. This alert summarizes certain key tax provisions of the Act that could impact private equity funds, their investors, and their portfolio companies, noting where relevant the differences between the Initial House Bill and the Act as finalized.

As with our prior alert on the Initial House Bill, this summary begins with what the Act does not do, which may in many regards be as important as what it does, and then provides a summary of the changes made by the Act.

What the Act Does Not Do:

- **No Carried Interest Provision**. Despite suggestions in the months leading up to the passage of the Initial House Bill and the enactment of the Act that such legislation could include provisions treating carried interests as ordinary income subject to employment taxes, the Act, like the Initial House Bill before it, does not contain any provision implementing such treatment. This leaves the current treatment of carried interests in place, at least for now. This is good news for sponsors of U.S. private equity funds that benefit from the generally favorable tax treatment of income received pursuant to a carried interest.
- **No Change to the Capital Gains Tax Rate**. Notwithstanding the possibility of an increase to the federal long-term capital gains tax rate discussed for the past several tax seasons, the Act, like the Initial House Bill before it, leaves in place the current maximum tax rate for long-term capital gains. Additionally, the Act does not include the addition of a “millionaire’s” tax, which had been a topic of conversation over the past few months. This will benefit investors in private equity funds upon a sale by the fund of its portfolio companies and sellers of portfolio companies to be acquired by the private equity funds, likely making portfolio company acquisitions simpler to facilitate and potentially less expensive.
- **No Retaliatory Tax on Certain Foreign Investors.** The Initial House Bill added new Code Section 899, which would have imputed a retaliatory tax (from 5% to as high as 20%) on certain types of income of certain non-U.S. persons that are residents of or otherwise have sufficient nexus with “discriminatory foreign countries” that have “unfair foreign taxes.” Bringing good news for private equity funds with foreign investors, Code Section 899 was removed from the Act prior to its enactment.

What the Act Does:

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- **Section 1202 Capital Gain Exclusion Provisions Expanded**. The Act expands in several significant regards the provisions of Section 1202 of the Code, which enables qualified taxpayers to exclude from federal income taxation up to 100% of the gain on the sale of certain corporate stock. (As discussed in our prior alert, the Initial House Bill did not include any change to the provisions of Section 1202.) This enhancement to these provisions, like the retention of the existing long-term capital gains tax rate discussed above, will potentially benefit both investors in private equity funds and sellers of portfolio companies to be acquired by private equity funds.

Specifically, the Act:

- Increases for many taxpayers the cap on the amount of the gain that can be excluded from income under Section 1202 for any given tax year (and also adjusts this new cap in later tax years to index it for inflation).

- Shortens the required holding period for stock to qualify for the Section 1202 exclusion from more than five years to as little as three years (although for holding periods of less than five years, the percentage of gain to be excluded drops to either 50% (for holding periods of less than four years) or 75% (for holding periods of at least four and less than five years)), noting however that the benefit of this provision is somewhat muted by the fact that any non-excluded gain would be generally taxed at an increased 28% capital gains tax rate, and that the 3.8% net investment income tax will apply to such non-excluded gain.

- Increases the gross asset value cap imposed on qualifying corporations able to issue Section 1202 stock from $50 million to $75 million (and also adjusts this new cap in later tax years to index it for inflation).

These expanded rules generally apply to qualifying stock issued after July 4, 2025. The prior provisions of Section 1202 will generally continue to apply to qualifying stock issued on or prior to July 4, 2025.

- **Section 199A Expanded**. Section 199A of the Code (originally enacted by the Tax Cuts and Jobs Act of 2017 (TCJA)) provides an effective tax rate reduction to noncorporate owners of pass-through entities (*e.g.*, partnerships and S corporations), serving as somewhat of a parallel to the corporate tax rate reduction enacted by the TCJA. The provision generally entitles qualified business owners to a deduction equal to 20% of the taxpayer's allocable share of the business's "qualified business income" (QBI), and was previously scheduled to sunset at the end of 2025. The Act, like the Initial House Bill, eliminates this sunset provision, thus making this provision permanent. Unlike the Initial House Bill, the Act leaves the deduction rate for this provision at 20% (while the Initial House Bill would have increased this percentage to 23%). In addition, the Act increases certain phase-out income thresholds intended to provide for a reduction to or elimination of an otherwise permitted deduction for higher income taxpayers, a taxpayer-favorable change that increases the number of taxpayers potentially eligible for a deduction under the provision. While the Initial House Bill also included a taxpayer-favorable provision related to these phase-out provisions, the mechanics of the Act differ from those set forth in the Initial House Bill. Finally, the Act implements a $400 minimum deduction for certain active business income (with such amount indexed for inflation in later years), but does not include a provision, as contained in the Initial House Bill, making certain dividends from electing "business development companies" (essentially, certain regulated investment companies) potentially includible within QBI. The changes made by the Act to Section 199A apply generally to taxable years beginning after 2025.
- **Section 163(j) Limitation on Interest Deductions Permanently Relaxed**. Section 163(j) of the Code, originally enacted by the TCJA, generally limits the deduction for business interest expense to 30% of a taxpayer's "adjusted taxable income," calculated prior to enactment of the Act in a manner similar to earnings before interest and taxes (EBIT). The Act, as did the Initial House Bill, adjusts the definition of "adjusted taxable income" for this purpose, returning to an earlier iteration which was based on a calculation of earnings before interest, taxes, depreciation, and amortization (EBITDA). This revision generally will increase the base amount to which the 30% limitation applies, thus increasing the amount available to be taken as an interest expense deduction. Like the Initial House Bill, the Act's change here applies generally to taxable years beginning after December 31, 2024. Unlike the Initial House Bill, which provided only for a temporary change (ending for

taxable years beginning on or after January 1, 2030), the Act's change in this regard is permanent. The Act, however, also includes a potentially offsetting reduction in the calculation of "adjusted taxable income" for certain foreign-source items of income, applicable to taxable years beginning after December 31, 2025. Portfolio companies utilizing significant leveraging will need to calculate the net impact of these changes to determine whether there is a net benefit or detriment.

- **Permanent Deductibility of R&D Expenses**. The TCJA required certain qualifying research and experimental (R&D) expenses (immediately deductible under prior law) to be capitalized and taken into account over a period of years. The Act, like the Initial House Bill, reinstates the ability to currently deduct qualifying domestic R&D expenses (including certain software development costs) for tax years beginning on or after January 1, 2025. However, while the Initial House Bill provided this change only on a temporary basis (sunsetting for tax years beginning on or after January 1, 2030), the Act makes this change permanent. In addition to the immediate expensing for domestic R&D, the Act creates two key elections that can provide retroactive relief for certain taxpayers and flexibility regarding unamortized amounts for prior years' capitalized domestic R&D expenses. Under the Act, certain eligible taxpayers can now elect to retroactively deduct domestic R&D expenses paid or incurred in tax years that began after 2021. In addition, for any domestic R&D expenses paid or incurred after 2021 and prior to January 1, 2025, that were capitalized, taxpayers can now elect to deduct any remaining unamortized amount either (i) in the first taxable year beginning after December 31, 2024, or (ii) ratably over the first two taxable years beginning after December 31, 2024. Foreign R&D expenditures will remain subject to the existing capitalization/amortization requirements under the Act, as was the case under the Initial House Bill. Portfolio companies with significant domestic R&D expenditures will likely benefit from these changes.
- **Permanent Deductibility and Expansion of Bonus Depreciation/Immediate Expensing**. The Act permanently reinstates the ability for qualifying businesses to claim 100% bonus depreciation under Section 168(k) of the Code for qualified property acquired and placed in service after January 19, 2025 (whereas the Initial House Bill would have allowed 100% bonus depreciation to sunset after 2029). In addition, the Act, like the Initial House Bill before it, increases certain ceilings on the maximum amount available to be immediately expensed under Section 179 of the Code. Further, as first set forth in the Initial House Bill, the Act includes a new 100% bonus depreciation for the cost of certain "qualified production property" used in connection with the manufacturing, production, or refining of tangible personal property that is newly acquired or the construction of which begins after January 19, 2025, and before January 1, 2029, and that is placed in service after July 4, 2025, and before January 1, 2031 (accelerated from 2033 under the Initial House Bill). The Act generally follows the bonus depreciation rules for qualified production property originally introduced in the Initial House Bill but adds rules relating to acquired property not previously used in qualified production activities, precludes lessors from relying on the lessee's activities for purposes of determining the lessor's use of property in qualified production activities and excludes from "qualified products" food or beverages prepared in the same building as the retail establishment in which it is sold. Portfolio companies with significant capital expenditures will likely benefit from these changes.
- **Deductibility of Fund Management Fees**. The Act, like the Initial House Bill before it, permanently disallows miscellaneous itemized deductions for individuals. This change makes permanent the TCJA's suspension of such deductions, which was otherwise set to expire after 2025. Generally, an investor's allocable share of a general partner's management fee and similar investment expenses are considered miscellaneous itemized deductions. As a result, individual investors in private equity funds will generally no longer be able to deduct management fees or similar investment expenses allocated to them by the fund. This effectively increases the after-tax cost of investing in private equity for individuals.
- **Impact on Portfolio Companies – BEAT.** In many PE structures, a U.S. portfolio company is owned by a non-U.S. holding company, directly or indirectly. Often, the U.S. company is paying deductible amounts to a related foreign person, such as service fees or royalties. Under existing law prior to enactment of the Act, the U.S. company could be subject to an incremental U.S. corporate tax under the Base Erosion and Anti-Avoidance Tax (BEAT) — but BEAT applied only to U.S. groups with revenues in excess of $500 million. Under the Initial House Bill, this $500 million threshold would have been removed for U.S. companies owned directly or indirectly by a company resident in certain foreign countries, a change that would have significantly expanded the scope of U.S. companies subject to BEAT. However, under the Act as signed into law, the $500 million threshold remains in place. Additionally, the Act as signed into law increases the BEAT tax rate to 10.5% (as compared to 10% when originally passed under the TCJA, 10.1% under the Initial House Bill, and the 12.5% that would have gone into effect in 2026 under the TCJA).

- **Impact of Tax Rate Increases for Certain Private University Endowments**. The Initial House Bill included several provisions increasing the potential tax liability applicable to investments made by large private college and university endowments (increase to the excise tax on net investment income from 1.4% to as high as 21%), and private foundations (increase to excise tax on net investment income from 1.39% to as high as 10%). The Act as signed into law reduces the maximum rate for investments made by large private college and university endowments from the threatened 21% rate under the Initial House Bill to 8%, a substantial reduction but still much higher than the 1.4% that was the law before the Act was enacted. The Act did not increase the excise tax rate on net investment income on private foundations, despite the Initial House Bill's attempt to do so. In the end, while this new Act does not directly restrict the large private college and university endowments in investment activities, this increased tax exposure would almost certainly reduce after-tax returns on these investments for the affected institutions, potentially leading to adjustment in investment preferences for such institutions.

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