Financial Services State and Local Tax Newsletter

Tracking the significant changes in state taxes for financial services

July 2026 / Vol 40

In this issue

Welcome to our latest Financial Services State and Local Tax digest.

As we begin this edition of our Financial Services State and Local Tax newsletter, I am pleased to share a leadership transition within our practice. I am honored to assume leadership of PwC's Financial Services State and Local Tax practice, and I want to begin by thanking Caragh De Luca, whose vision, collaboration, and commitment to our clients and our people have defined this practice for many years. Under her leadership, our team established a strong reputation for delivering practical, connected state and local tax insights to the financial services marketplace, a standard we remain committed to upholding.

Caragh now moves into an expanded role as Managing Partner of PwC's Financial Services Tax Practice, where her guidance will continue to benefit our broader financial services clients. On behalf of the team, thank you, Caragh, for your steady leadership and for positioning us well for the future.

In this issue:

- State conformity to the One Big Beautiful Bill Act, including conformity, decoupling, retroactive effective dates, and related reporting considerations.
- Reporting-season issues for bonus depreciation, domestic research expenditures, and business interest limitations.
- Podcast discussion on millionaire surtaxes and wealth tax proposals affecting high-income and high-net-worth individuals.
- Selected state legislative updates covering high-income surtaxes, corporate conformity, sourcing, credits, pass-through entity taxes, and other planning and compliance developments.

We hope you find this issue useful, and please reach out to me or your local PwC Financial Services State and Local Tax contact with any questions about how these developments may affect your organization.

Best regards,

Joel Bencosme

Spotlight article: Beyond state conformity - OBBBA issues to watch during reporting season

As taxpayers begin preparing 2025 tax returns, many are focused on the federal tax implications created by the One Big Beautiful Bill Act (OBBBA). Specifically, permanent 100% bonus depreciation, immediate expensing of domestic research expenditures, and favorable changes to the business interest limitation rules all have the potential to reduce federal taxable income. However, the state story may be very different.

Certain states automatically follow any federal tax law changes by adopting the Internal Revenue Code on a 'rolling basis.' Others require legislative action before federal provisions become effective. A number of states selectively conform to certain provisions while rejecting others. As a result, taxpayers may find that deductions available on their federal return produce very different results at the state level. Many states have enacted legislation addressing OBBBA conformity; however, others are still evaluating how they will respond to OBBBA.

As reporting season begins, several significant OBBBA provisions deserve particular attention from multistate taxpayers.

Bonus depreciation

Federal rule: One of the most significant OBBBA business tax provisions is the permanent restoration of 100% bonus depreciation for qualified property acquired after January 19, 2025. The legislation also creates a new depreciation benefit for certain qualified production property under IRC Section 168(n). For federal purposes, these provisions may allow taxpayers to deduct the full cost of qualifying property immediately rather than recovering those costs over time.

State considerations: State treatment is often less generous. Many states historically decoupled from federal bonus depreciation found in IRC Section 168(k) because of the immediate revenue impact. These states continue to decouple because the OBBBA changes are found in the same federal section. In those states, taxpayers generally must add back the federal deduction and recover the cost through regular depreciation or state-specific recovery rules. Separately, the new production property provisions under IRC Section 168(n) create a timing-sensitive conformity question because state treatment depends on whether a state's conformity date or decoupling legislation reaches Section 168(n).

Illinois illustrates the timing issue. Illinois' bonus depreciation addback rule for tax year 2025 only mentions IRC Section 168(k), not 168(n). So, for 2025, Illinois still follows the new Section 168(n) deduction, even though it normally decouples from bonus depreciation. For tax years beginning on or after January 1, 2026, Illinois enacted legislation decoupling from IRC Section 168(n), resulting in a timing mismatch for Section

168(n) conformity across 2025 and 2026. As taxpayers prepare 2025 returns, they should carefully evaluate whether and how the new federal production property deduction affects their Illinois, along with other states, filing positions.

Research and experimental expenditures

Federal rule: Beginning in 2025, domestic research and experimental expenditures generally become immediately deductible under new IRC Section 174A and an election is provided to deduct unamortized expenses capitalized in tax years 2022 through 2024. Foreign research expenditures continue to be capitalized and amortized over 15 years under IRC Section 174. For many taxpayers, this change simplifies federal tax reporting and accelerates deductions.

State considerations: State conformity varies; some states may conform to the new federal treatment while others may continue to apply prior law or maintain state-specific rules governing research expenditures. New York, for example, will continue to require five-year amortization for both domestic and foreign research and experimental expenditures for 2025 and forward. In addition, New York also does not conform to the federal catch-up deduction for domestic expenses capitalized in tax years 2022 through 2024, which must continue to be amortized over five years for domestic expenditures and 15 years for foreign expenditures. New York City similarly continues to conform to the Tax Cuts and Jobs Act (TCJA) treatment, requiring five-year amortization for domestic research expenditures and 15-year amortization for foreign research expenditures. As a result, taxpayers may be able to deduct domestic research expenditures currently for federal purposes while continuing to amortize those amounts for New York and New York City purposes.

Taxpayers should also consider whether differences between federal and state treatment affect related items such as research credits, basis calculations, and capital account reporting.

Business interest limitations

Federal rule: OBBBA permanently changed the calculation of adjusted taxable income (ATI) for purposes of calculating the limit on deductibility of business interest expense under IRC Section 163(j). Under the OBBBA changes, the calculation of the business interest expense limitation returns to a more favorable EBITDA approach rather than an EBIT approach under the TCJA.

State considerations: For state purposes, however, taxpayers may encounter several different approaches:

- States that conform to the OBBBA version of IRC Section 163(j).
- States that continue to follow TCJA-era rules.

- States that partially conform but provide state-specific modifications.
- States that decouple from IRC Section 163(j).

Examples to watch: Virginia recently modified its overall conformity method from rolling conformity to fixed conformity, now conforming to the IRC as of December 31, 2025, and does not decouple from Section 163(j). Separate and apart from this conformity to the federal Section 163(j) limitation, Virginia law provides its own, state-specific additional subtraction for a portion of the business interest expense disallowed under Section 163(j) on the federal return. HB 29 reduced this Virginia-specific subtraction percentage from 50% to 20% of the disallowed amount, effective for tax years beginning on or after January 1, 2025.

California also illustrates why this analysis can be more nuanced than a simple conformity question. California historically has decoupled from the federal business interest expense limitation, generally allowing a full deduction for business interest expense. However, legislation enacted in 2025 created a distinction for personal income tax purposes, including the computation of partnership income, by conforming to the TCJA version of IRC Section 163(j) but continuing to decouple for corporate income tax purposes. Pending legislation (S.B. 1435) would clarify that California also decouples from IRC Section 163(j) for personal income tax purposes, retroactive to tax years beginning on or after January 1, 2025. Until that legislation is finalized, taxpayers with California partnership or other pass-through income should closely monitor developments and consider the potential reporting, partner-level, and amended return implications.

Reporting season considerations

As reporting season begins, taxpayers should closely monitor state legislative and administrative developments addressing OBBBA conformity. Federal tax changes may create new planning opportunities, but the state consequences will depend on how each state responds, including whether states adopt federal changes retroactively, require state-specific addbacks or adjustments, or provide relief for taxpayers affected by late-enacted legislation. Recent penalty relief provided by states such as New York and Massachusetts for retroactive legislation changes underscores the importance of tracking these developments in real time.

Spotlight podcast: Millionaire surtaxes and wealth tax proposals: What high-income taxpayers need to know

States are increasingly looking to high-income and high-net-worth individuals as a source of new revenue, but these proposals often raise planning, compliance, and mobility questions that go well beyond the headline rate change.

In this episode, Brian Rebhun and Ben Muilenburg, PwC State and Local Tax Partners, discuss the growing wave of millionaire taxes, billionaire surcharges, and wealth tax proposals in states including California, New York, Massachusetts, and Maryland. They also explain why taxpayers should pay close attention to both enacted changes and emerging proposals.

Listen to the episode.

State legislative updates

The podcast conversation provides useful context for the legislative activity summarized below. Across the states, policymakers continue to advance proposals involving high-income surtaxes, corporate conformity, sourcing, credits, and pass-through entity taxes. While not intended to capture every state tax legislative development, the following summaries highlight selected items most relevant to financial services taxpayers and the practical issues they should be watching.

Alaska

On June 18, Gov. Mike Dunleavy vetoed H.B. 280, which would have replaced cost-of-performance sourcing with market-based sourcing for corporate income tax apportionment, mirroring MTC model rules. This would have been effective for tax years beginning on or after January 1, 2027, if enacted.

Arizona

Enacted on June 13, 2026, H.B. 4168 provides that for tax years beginning from and after December 31, 2025, "Internal Revenue Code" means the Code, as amended, in effect on January 1, 2026, including those provisions that became effective during 2025 with the specific adoption of all retroactive effective dates, but excluding any changes to the Code enacted after January 1, 2026. In addition, for tax years beginning from and after December 31, 2024 through December 31, 2025, "internal revenue code" means the Code, as amended, in effect on January 1, 2025, including those provisions of Public Law 119-21 that are retroactively effective during tax years beginning from and after December 31, 2024 through December 31, 2025.

California

The 2026 Billionaire Tax Act (Initiative No. 25-0024) qualified for the ballot for November 3, 2026. The Billionaire Tax would levy a one-time 5% excise tax on residents with net worth over $1 billion, measured as of December 31, 2026. There are two counter-initiatives that have qualified: (1) Retirement and Personal

Savings Protection Act; (2) Improving Transparency Act. Both contain conflicting-measure provisions that could invalidate the Billionaire Tax if triggered.

Florida v. California: On June 1, the US Supreme Court declined to hear Florida's challenge to California's rule excluding occasional asset sales from the sales factor, which Florida asserted, unlawfully favors California-based corporations, overtaxes out-of-state companies, and causes Florida to lose tax and investment revenue.

OBBBA Conformity: S.B. 1435 would retroactively decouple California personal income tax from federal Section 163(j) for tax years beginning on or after January 1, 2025. A hearing on the bill was held on June 29.

Credit limitation extended: S.B. 122, enacted June 29, 2026, extends the current $5 million business tax credit cap and "refundable" credit election under both the personal income and corporate tax law through the 2029 tax year, while instituting a permanent limitation of the greater of $5 million or 70% of the aggregate amount of tax liability beginning in 2030. The legislation also sunsets the current NOL suspension, which applies to tax years beginning on or after January 1, 2024, and before January 1, 2027, for taxpayers with net business income or modified adjusted gross income of at least $1 million for the tax year.

First year annual tax relief for new entities (2027 through 2029): S.B. 122 also provides that for tax years beginning on or after January 1, 2027, and before January 1, 2030, the first-year annual tax for limited partnerships, limited liability partnerships, and limited liability companies is reduced from $800 to $400.

Sales tax on digital products and prewritten software: S.B. 122 also enacts a sales and use tax on digital products, including prewritten software delivered on physical media, downloaded, or accessed remotely through SaaS. Custom software remains non-taxable. For those in financial services, the primary exposure is likely to arise at the portfolio-company level or through a management company's own software and SaaS purchases. Large purchasers with more than $5 million in annual digital-product purchases from a retailer must self-assess use tax under a direct-pay permit, shifting liability away from the retailer. While California provides an exemption for certain digital products that represent human-effort services, that exemption does not apply to SaaS. A certificate-based exemption may apply to digital products purchased solely for use outside California or in interstate or foreign commerce, with allocation available for licenses used across multiple locations. The tax is effective January 1, 2027.

San Francisco: San Francisco's June 2026 ballot measures addressing the Overpaid Executive Tax both failed. Measure D, the union-backed "Overpaid CEO Act," would have substantially increased OET rates beginning in 2027, including a significant increase for companies with executive pay ratios above 600:1. Measure C, positioned as a countermeasure to Measure D, also failed. Rather than imposing a major tax increase, Measure C would have largely preserved the existing Prop M rate structure while increasing the small-business exemption threshold from $5 million to $7.5 million in gross receipts.

Colorado

On June 3, Colorado enacted legislation providing for default worldwide unitary combined reporting with a 10-year water's-edge election. The legislation also repeals the 80/20 rule, under which a C corporation is excluded from the unitary combined return if 80% or more of its property and payroll are assigned to locations outside the United States. These changes are effective for tax years beginning on or after January 1, 2027. [H.B. 1289, enacted 6/3/26]

This legislation continues a significant shift in Colorado's unitary combined reporting regime. Under 2024 legislation, Colorado replaced its historic "3 of 6" unitary test with a statement of constitutional principles for determining if a unitary business exists, effective for tax years beginning on or after January 1, 2026, among other unitary combined reporting changes. (Click here for PwC's Insight on the changes.) Now, for the 2027 tax year and forward, Colorado unitary combined groups will need to determine whether to compute income and apportionment on a worldwide basis or make a water's-edge election that is binding for 10 years (unless otherwise allowed by the Department of Revenue). Learn more about these recent legislative changes in our Insight.

Connecticut

Subst. S.B. 1, enacted on May 26, requires an adjustment for Section 168(n) for the 2026 tax year and forward, leaves in place the required adjustment for Section 168(k), and requires application of Section 174 pre-OBBBA for the 2022-2024 catch up election and the 2025 tax year, with Section 174A conformity starting with the 2026 tax year and forward. Due to the state's rolling conformity, Connecticut will not require an adjustment for Section 168(n) for 2025. Additionally, estimated tax requirements do not apply to additional tax from these changes for pre-enactment income years; interest and penalties will be waived if paid by the later of November 15, 2026, or the return due date.

Florida

H.B. 7031, signed into law on June 11, 2026, updates Florida's conformity date to January 1, 2026, for tax years beginning January 1, 2026. However, Sections 174(a), 163(j), and 168(k) of the Code are included as amended and in effect on January 1, 2025, but Section 168(n) and Section 174A are not included.

Hawaii

H.B. 2329, enacted on May 26, updates conformity to the IRC from December 31, 2024 to December 31, 2025, for all tax years beginning after December 31, 2025, except with respect to certain provisions (e.g., Hawaii retains prior nonconformity to Sections 168(k), 250, and 951A). The 2025 tax year generally remains tied to the December 31, 2024 IRC (i.e., pre-OBBBA).

For tax years beginning after December 31, 2025, the legislation decouples from certain IRC provisions, including Section 174A, which addresses domestic research or experimental expenditures, and Section 168(n), which addresses qualified production property. The legislation also provides that Section 174 remains operative as it existed on December 31, 2024. As a result, pre-OBBBA Section 174 applies for Hawaii purposes for the 2025 tax year and for tax years beginning in 2026 and thereafter. In addition, federal elections made under Section 168(n) do not apply for Hawaii purposes for the 2025 tax year or for tax years beginning in 2026 and thereafter.

Kentucky

H.B. 757, enacted April 14, 2026, updates IRC conformity to December 31, 2025, for tax years beginning on or after January 1, 2026. The legislation requires addback of Section 174A deductions and allows deduction of Section 174 as it existed on December 31, 2024 (pre-OBBBA). The legislation also maintains the pre-OBBBA Section 163(j) interest expense limitation for corporations.

Massachusetts

Massachusetts' supplemental budget enacted on June 12 requires an addback for certain amounts deducted under P.L. 119-21 (the OBBBA), including for domestic R&E in 2025, the enhanced interest deduction in 2025 and 2026, and the qualified production property deduction in 2025 and 2026. Further, the legislation will allow each of these deductions for future years *unless* a proposed November 2026 ballot initiative to lower the personal income tax rate passes. However, on June 18, the Massachusetts Supreme Judicial Court issued an opinion enjoining the Secretary of the Commonwealth from placing the initiative on the ballot. As a result, these modifications will not apply to future years.

PTET expansion: The legislation also expands the pass-through entity tax (PTET) to account for the state's "Millionaire's Tax," effective for tax years beginning in 2026, in addition to other changes. The bill creates new "Chapter 63E," which essentially mirrors the original PTET statute found in Chapter 63D. However, under this "second" PTET (1) the tax rate is 4%; (2) the definition of a "qualified member" does not include a shareholder, partner, or member whose allocable share of income included in their Massachusetts taxable income does not exceed the $1 million surtax threshold; and (3) the definition of "qualified income taxable in Massachusetts" is limited to the sum of the amounts by which the amount allocated to each qualified member exceeds the $1 million surtax threshold. The credit is still 90% of each qualified member's share of this "second" PTET paid by the pass-through entity.

Minnesota

H.F. 2438, enacted on May 28, extends Minnesota PTET for tax years ending on or before December 31, 2027. Additionally, the legislation updates the state's conformity to the IRC to mean the IRC as amended through May 1, 2026 (formerly May 1, 2023), effective "retroactively at the same time the changes were effective for federal purposes." As a result, Minnesota generally conforms to the OBBBA, including Section 168(n) and Section 163(j), but not Section 168(k) bonus depreciation. The legislation also requires a corporate modification equaling an 80% addition of domestic research and experimental (R&E) deduction under Section 174A(a), with subtraction over the following four tax years. The legislation also addresses catch-up elections for 2022–2024 for R&E.

Notably, H.F. 4616, which would provide a 1% wealth tax on taxable wealth over $10 million, was laid over in April for future consideration.

New York

New York has enacted budget revenue legislation extending the state's temporary top corporate tax rate by three years and amending conformity to P.L. 119-21, or the One Big Beautiful Bill Act (OBBBA), particularly with respect to IRC Sections 168(n) and 174/174A (and for New York City, with respect to Section 163(j)). The legislation also includes a vendor sales tax reregistration program and limited amnesty, as well as a novel New York City tax on certain high-value residential property that does not serve as a primary residence.

The budget is also notable for what it did not include. The legislation did not increase tax rates for the personal income tax, unincorporated business tax, or corporate tax (other than extending the state top rate), reduce the state or city pass-through entity tax (PTET) credit, or impose a tax on home sales paid in cash. The bill also did not include an extension to the deadline for making the annual PTET election.

The budget's federal conformity provisions for both state and city purposes will impact many taxpayers' 2025 tax year compliance. The final budget notably included interest and penalty relief for taxpayers affected by this retroactive conformity legislation. Taxpayers subject to sales tax reregistration may be able to take advantage of amnesty covering penalties and one-half interest for certain final liabilities. The "pied-a-terre tax" introduces uncertainty for New York property tax determinations, including what may be deemed a “primary residence” and valuation issues for covered properties. Learn more about the budget enactments in our prior Insight.

Zelinsky v. Commissioner of Taxation and Finance: On July 2, the New York Appellate Division upheld taxing a Connecticut-based law professor’s 2020 remote-work salary as New York source income under the state’s “convenience of the employer” rule, finding that COVID-related remote teaching did not satisfy the rule’s employer-necessity exception. The court also rejected the taxpayer’s constitutional challenges, and an appeal is expected.

Rhode Island

On June 12, 2026, Governor Daniel McKee signed House Bill 7127 into law that contains a number of tax changes, including the phase-in of a “high-income surtax” over the three-year period. Specifically, for tax years beginning on or after January 1, 2027, a 1% tax is imposed on Rhode Island taxable income over $1 million. This tax will increase to 2% for tax years beginning on or after January 1, 2028, and to 3% for tax years beginning on or after January 1, 2029, and thereafter. Prior to the legislation, the highest individual income tax rate was 5.99%.

H.B. 7127 also provides, for tax years beginning on or after January 1, 2026, an addback adjustment for the deduction taken under Section 174A less what would have been allowed as a deduction under Section 174 immediately prior to P.L. 119-21. In addition, for tax years beginning on or after January 1, 2027, the bill provides an addback adjustment for the amount of any deduction allowable pursuant to Section 163(j)(8)(A)(v).

Vermont

H.933, enacted June 18, 2026, updates IRC conformity in 32 V.S.A. §5824 to December 31, 2025, retroactive to January 1, 2026, and applies to tax years beginning on or after January 1, 2025, with the addition modifications for both corporate and individual taxpayers equal to the deduction taken under Section 174A and P.L. 119-21 § 70302(f)(2). There is a corresponding subtraction for the deduction that would be allowed under Section 174 as in effect December 31, 2024. Note that these modifications exclude "eligible taxpayers."

Let's talk

For a deeper discussion of how these developments might affect your business, please contact your Financial Services State and Local Tax team member.

Joel Bencosme
Financial Services State and Local Tax Leader
+1 347-803-6409
joel.bencosme@pwc.com