State and Local Tax

Redefining the Starting Line

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Welcome to the second issue of *Redefining the Starting Line*, a quarterly guide to navigating the evolving landscape of state tax compliance in the wake of the One Big Beautiful Bill Act (OBBBA). As we continue our journey through the complex environment of state income tax compliance post-OBBBA, we will showcase some recent state legislative updates to specific tax provision conformity and explore how states conform (or don't conform) to one of the most significant OBBBA changes – the change to research and experimental expenditure deductions under Sections 174/174A. Finally, we'll discuss where the state tax compliance landscape is headed as we move into the third quarter.

Our goal remains the same: to empower you with clear insights and practical perspectives as you redefine your state income tax starting line.

In this issue

Legislative round-up—second quarter developments

Most The second quarter (April – June 2026) brought an increase in legislative activity. Specifically, states took a variety of approaches to how they would or would not conform to OBBBA, including updating their general conformity, modifying or decoupling from various OBBBA changes, or both. Below is a sample of how states approached legislative changes this quarter, effective for tax year 2025:

Specific Tax Provisions				
State	General conformity update	Section 163(j) interest expense	Sections 174/174A R&E expense	Section 168(k)/(n) depreciation
Connecticut	N/A	N/A	Decoupled from OBBBA to pre-OBBBA Section 174	
Minnesota	Updated conformity date to 5/1/26	Updated conformity to OBBBA via conformity date change	Modification from 174A to state-specific method	Updated conformity to OBBBA via conformity date change
New York State	N/A	N/A	Modification from 174/174A to state-specific method	Similar to existing modification to Section 168(k), added a modification to Section 168(n)
New York City	N/A	Modified from OBBBA	Modification from 174A to state-specific method	Similar to existing modification to Section 168(k), added a modification to Section 168(n)

The above legislative changes are effective for tax year 2025. Notably, many states enacted significant legislative changes that are effective for tax year 2026 but did not make retroactive changes for the 2025 tax year (e.g., Florida, Kentucky). Further, several states enacted legislation affecting the Section 951A income inclusion and related Section 250 deductions that are also effective for tax year 2026. We will explore the legislative landscape post-OBBBA for 2026 in future issues of Redefining the Starting

Line. For additional information on Q2 state legislative changes, including those that may be effective for tax years after 2025, please see PwC's State Income Tax Digest - Second Quarter.

To 174A or to not 174A—that is the question

As noted above, states have taken a variety of approaches to post-OBBBA conformity to the deduction for research and experimental expenditures pursuant to Sections 174/174A.

What are Sections 174/174A and why does it matter?

Prior to OBBBA, then existing Section 174 governed the deduction for research and experimental (R&E) expenditures. While the deductibility of these expenses has varied over time, immediately prior to the enactment of OBBBA, domestic R&E expenses, including self-developed software, generally were amortized over five years using a mid-year convention, while foreign R&E expenses were amortized over 15 years. To facilitate expensing domestic R&E expenditures, OBBBA altered the existing regime under Section 174 and created new Section 174A, which allows for immediate expensing of domestic R&E expenditures. The legislation also modified existing Section 174, such that post-OBBBA Section 174 only applies to foreign R&E expenditures, which generally are still subject to 15-year amortization. Since federal changes to R&E expensing were made in 2022, states have taken varying conformity approaches to R&E expensing and capitalization, but with the budgetary impact of immediate expensing introduced by Section 174A, many states have opted to decouple or modify from the changes enacted as part of OBBBA. Below, we examine some of the common (and not so common) approaches to state R&E expensing conformity / non-conformity, highlighting the complexity those approaches bring to state tax compliance.

Decoupling to pre-OBBBA Section 174

One approach states have taken is to specifically decouple from the provisions of Sections 174/174A due to specific non-conformity or general I.R.C. conformity date. When states decouple from a provision, generally taxpayers are required to recalculate taxable income for that state. However, as described below, even states that decouple from OBBBA provisions may require different calculations based on their current conformity approaches.

Connecticut

Connecticut generally approaches conformity on a rolling basis and, as a result, would conform to OBBBA changes absent other legislative action. Recently, however, Connecticut enacted legislation decoupling from Section 174A and disallowing those expenses for tax year 2025 (currently, Connecticut will follow federal treatment of these expenses for 2026). Instead, R&E expenditures are required to be deducted pursuant to Section 174 as it existed prior to the enactment of OBBBA.

Florida

Florida is an annual conformity state and while it recently enacted legislation to update its I.R.C. conformity date for the 2026 tax year, for tax year 2025, Florida conforms to the I.R.C as of January 1, 2025 (i.e., pre-OBBBA). As a result, Florida does not conform to Sections 174/174A post-OBBBA and conforms to pre-OBBBA Section 174.

In both cases, each state requires taxpayers to recalculate federal taxable income employing Section 174 as it existed prior to OBBBA. Importantly, this recalculation could affect other tax attributes, such as the amount of income included under Section 951A. Further, Connecticut's general conformity is on a rolling basis to the I.R.C., including OBBBA changes, while Florida's overall conformity is to a pre-OBBBA tax code. As a result, Connecticut's 2025 return will require a recalculation applying the pre-OBBBA Section 174 regime to what is otherwise an OBBBA base, while Florida's 2025 tax return will require an entire recalculation of income utilizing a full pre-OBBBA code, including the pre-OBBBA Section 174. As a result, states that take a decoupling approach could have significant differences in how the decoupling is taken into account from a starting point perspective.

State-specific modifications

Several states have addressed Sections 174/174A post-OBBBA via state-specific modifications. We compare those states below and note how these modifications increase compliance complexity.

New York State

New York State's general conformity approach is to utilize federal taxable income without specific I.R.C. adoption. As a result, until New York passed recent legislation, New York conformed to the changes for both Sections 174 and 174A. However, with this legislation, New York adopted a new state -specific modification under which both domestic and foreign R&E expenditures are treated as if the amortization election in Section 174A(c) applied to those R&E expenditures and as if the election were made for a 60-month period beginning with the month in which the taxpayer first realizes benefits from those expenditures. Both federal deductions under Section 174 and immediate expensing and other deduction elections for domestic R&E under Section 174A must be added back.

Pennsylvania

Pennsylvania also enacted legislation in response to the OBBBA R&E changes. Specifically, Pennsylvania's modification provides that any R&E expenditures deducted under Sections 174/174A must be included in taxable income for Pennsylvania purposes. To the extent that any R&E expenditures were included in federal taxable income, taxpayers are allowed to deduct 20% of those expenditures until the total amount deductible pursuant to Sections 174/174A has been claimed.

While these modifications generally may be less complex than recalculating taxable income due to decoupling, the different approaches to each state's modification for Sections 174/174A still add significant intricacy to state tax compliance. On their face, the New York and Pennsylvania modifications seem similar–-they both appear to modify Sections 174/174A to allow for both foreign and domestic R&E expenditures to be deducted over five years, as compared to their federal treatment. However, when looking closer, there are significant differences even in these seemingly similar approaches. For example, New York provides for an expenditure over a 60-month period, starting with the month when the taxpayer first realizes benefits from the expenditures. Due to the nature of R&E expenditures, the month when benefits are realized could be different than when the expenditure was incurred. Conversely, Pennsylvania does not impose the same restriction on timing of the deduction, but rather provides for a 20% deduction annually of disallowed expenses until the full amount is expensed. Further, Pennsylvania does not provide for a half-year or mid-quarter convention, so even if the expenses can be deducted in the same year for both states, the timing for when it is deductible for New York may differ, causing a further divergence in the amounts.

Why does it matter?

As discussed, the state treatment of Sections 174/174A post-OBBBA is complex. The above examples show how different approaches to decoupling and modification across the states complicate not only the amount that is deductible, but also the starting-point calculation (e.g., federal taxable income). However, these are just a few instances, and there are other, potentially more complex, scenarios to consider (e.g., state-specific modifications in states such as Minnesota). As a result, there could be different starting points based both on how states conform to Sections 174/174A and whether they decouple or modify. These determinations affect both the compliance process for 2025 as well as the calculation of estimates, tax provisions, and potential carryovers for 2026. Given this complexity, it is imperative that taxpayers and tax preparers understand the differences in state treatment for Sections 174.174A and how they affect each state's starting line.

What's next?

Understanding and redefining the starting line has been fundamental to 2025 state income tax compliance. As we move into the third quarter and continue the 2025 compliance cycle, taxpayers also must begin to look forward to the 2026 compliance season from both a planning and preparation perspective. Specifically, taxpayers will need to examine the difference in treatment of specific tax provisions between tax years 2025 and 2026. In addition, taxpayers will need to be fully aware of any state tax ramifications as we shift from the global intangible low-taxed income (GILTI) regime to the net controlled foreign corporation tested income (NCTI) regime. As the regulatory environment continues to change, count on us to support you in navigating and redefining your starting line at every turn.

Let's talk

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