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Featured article: California budget legislation includes permanent business tax credit limitation

California budget “trailer” legislation (S.B. 122) enacted on June 29 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. [S.B. 122, enacted 6/29/2026]

Extension of temporary credit limitation, "refundable" credit election. California in 2024 limited credit utilization for 2024-2026 (S.B. 167) and provided for the elective recovery of credits limited by the provision (S.B. 175). S.B. 122 extends these provisions through the 2029 tax year.

Specifically, S.B. 167 limited the aggregate use of otherwise allowable business credits to $5 million for each tax year beginning on or after January 1, 2024 and before January 1, 2027 (except for certain credits not subject to the limitation). S.B. 122 extends this limitation through tax years beginning before January 1, 2030.

For combined reports, the $5 million credit limitation is applied to the aggregate amount of "tax," as defined in Cal. Rev. and Tax. Code Section 23036, of all combined group members. The carryover period for any credit that is not allowed due to the application of the $5 million limitation is increased by the number of tax years the credit or any portion thereof was not allowed.

S.B. 175 allowed taxpayers to make an irrevocable election on an original timely filed return for each tax year beginning on or after January 1, 2024, and before January 1, 2027. S.B. 122 extends this election period through tax years beginning before January 1, 2030.

The election provides taxpayers with an annual refundable credit during the five-year refundable period equal to 20% per year of the credit that otherwise would have been available to reduce net tax in the tax year of the election but for the above limitations. The "refundable period" is the first five consecutive tax years beginning the third tax year after the tax year for which the taxpayer makes the election.

In each tax year of the refundable period, the annual refundable credit amount will be allowed as a credit against the tax computed for the tax year, and the excess, if any, will be credited against any other amounts due. Any remaining balance then will be paid to the taxpayer. S.B. 122 provides that the refundable credit will not be included for purposes of applying the credit limitation above.

New permanent credit limitation. S.B. 122 provides that for each tax year beginning on or after January 1, 2030, the total of all business tax credits otherwise allowable, including the carryover of any business tax credit, may not reduce the "net tax" for the tax year by more than 70% or $5 million, whichever is greater. For combined reports, the 70% or $5 million credit limitation is applied to the aggregate amount of "tax," as defined in Cal. Rev. and Tax. Code Section 23036, of all combined group members.

As with the temporary credit limitation, the permanent limitation applies to most business tax credits, with a short list of exceptions including the low-income housing tax credit and the pass-through entity tax credit. The excepted credits (not subject to the credit limitation) are to be applied after any business credits subject to the limitation are applied.

The permanent limitation will be computed without taking into account the amount of any refundable credits pursuant to the election described above. Taxpayers will continue to be able to take advantage of the refundable credits as outlined above, but new refundable credit elections will not be allowed beginning with the 2030 tax year.

S.B. 122 provides that the amount of any credit otherwise allowable for the tax year that is not allowed due to application of the credit limitation will remain a credit carryover amount. However, the legislation does not appear to provide an extension of the allowable carryover period for limited credits (unlike the temporary credit limitation).

Multiple states adjust conformity to federal P.L. 119-21, OBBBA

Arizona updates IRC conformity, requires Section 168(n) modification beginning in 2026

Enacted Arizona legislation (H.B. 4168) updates references to the IRC for tax years beginning from and after December 31, 2024 through December 31, 2025 to include provisions in P.L. 119-21 (the OBBBA) that are retroactively effective during the 2022-2025 tax years.

Further, the legislation updates IRC conformity for tax years beginning from and after December 31, 2025 to the IRC as amended and in effect on January 1, 2026, including provisions that became effective during 2025 and with the specific adoption of all retroactive effective dates. However, for tax years beginning from and after December 31, 2025, an addition is required for the amount of the special depreciation allowance for qualified production property under Section 168(n).

The legislation also updates the existing subtraction for dividend income from foreign corporations, which treats "global intangible low-taxed income" (GILTI) as defined in Section 951A as deductible dividend income. Effective for tax years beginning from and after December 31, 2024, the reference to GILTI is deleted and the statute instead references "income as described in Section 951A."

Florida decouples from Section 168(k), 168(n), 174A, and 163(j) OBBBA changes

Florida legislation (H.B. 7031) enacted on June 11 updates references to the IRC as amended and in effect on January 1, 2026 (updated from January 1, 2025), effective "retroactively to January 1, 2026." Also effective as of January 1, 2026:

- Sections 168(k), 174(a), and 163(j) are included as amended and in effect on January 1, 2025, and
- Sections 168(n) and 174A are not included.

The legislation amends the definition of “taxable income” to mean income as defined in IRC Section 63 and properly reportable for federal income tax purposes “except as provided” above.

The practical effect of these changes is that the starting point for computing Florida taxable income:

- Follows pre-OBBBA law for the 2025 tax year and
- Follows OBBBA beginning in 2026 except for specified decoupling from Sections 168(n) and 174A and application of Sections 168(k), 174(a), and 163(j) as in effect pre-OBBBA. Note that Florida has a subtraction modification for its existing application of pre-OBBBA Section 168(k).

The legislation authorizes the Florida Department of Revenue to adopt rules to implement the legislation, including emergency rules effective for six months after adoption and that may be renewed during the pendency of permanent rulemaking.

Massachusetts requires Sections 174A, 168(n), and 163(j) modifications

Massachusetts’ supplemental budget (H. 5470) 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. However, the legislation will allow each of these deductions for future years because of a decision by the Massachusetts Supreme Judicial Court barring placement of the “25-18 Initiative Petition” on the November ballot.

Click here for PwC’s Insight on this legislation.

Rhode Island legislation amends conformity for Sections 174A and 163(j)

Legislation (H.B. 7127 Sub. A as amended) enacted on June 12 requires modifications in computing net income related to Sections 174A and 163(j). The 2026 legislation did not address 2025 and prior tax years.

Under 2025 H.B. 5076, enacted June 29, 2025, Rhode Island amended the definition of “net income” to add to such income, “for the taxable year beginning on or before January 1, 2025, the amount of any income, deduction or allowance that would be subject to federal income tax but for the Congressional enactment of the One Big Beautiful Bill Act ("OBBBA") or any other similar Congressional enactment." On December 15, 2025, the Rhode Island Department of Revenue, Division of Taxation (the Division) issued an emergency regulation (280-RICR-20-25-16) stating that "for the taxable year beginning on or before January 1, 2025" includes fiscal tax years beginning in 2025 and all tax years prior to 2025. This emergency regulation was adopted as a permanent regulation (280-RICR-20-25-17) on March 27, 2026.

According to the Division, required adjustments under H.B. 5076 for the 2025 and prior years include:

- ***Section 174A***. For tax year 2025, Rhode Island is decoupled from OBBBA's allowance to accelerate expensing of qualified research and experimental (R&E) expenditures at the federal level. If a corporation does not amortize on its federal filing, the taxpayer must amortize the expenditures on the Rhode Island return. For all tax years, taxpayers will be required to maintain an amortization schedule for Rhode Island tax purposes. Any amount that is not allowed within the tax year may be carried forward for a total of five years. Future amortization deductions may not exceed 20% of the initial addback each subsequent year a deduction is taken as allowed by law.
- ***Section 163(j)***. If the federal corporate return is originally filed or amended and includes an additional deduction for business interest expense than what was allowed prior to the enactment of OBBBA, then the corporation must add back the additional business interest expense on the RI Schedule HR1 - Entity form.

H.B. 7127 reenacts the above provision from 2025 H.B. 5076 "for the taxable year beginning on or before January 1, 2025." Further, the legislation requires the following additions to net income:

- ***Section 174A.*** For any tax year beginning on or after January 1, 2026, the amount of the deduction taken for domestic R&E expenditures under Section 174A less the amount of the deduction that would have been allowed under pre-OBBBA Section 174.
- ***Section 163(j).*** For any tax year beginning on or after January 1, 2027, the amount of any deduction allowable for depreciation, amortization, or depletion pursuant to Section 163(j)(8)(A)(v) (the amount of additional interest deduction allowed due to the OBBBA's changes to the calculation of the interest expense limitation).

While the H.B. 7127 provides for an addition modification to net income related to IRC Section 163(j), H.B. 7127 does not specifically provide for a subtraction modification for any disallowed amount relating to this modification.

H.B. 7127 also allows a deduction for any tax year beginning on or after January 1, 2026 for “the amount as determined by the tax administrator required to be added back in a prior year that would have been allowed” under Section 174A but would not have been allowed as a deduction under pre-OBBBA Section 174. The legislation provides that “at no time may the cumulative modification amount for each amortized expenditure exceed 100% of said expenditure’s expense amount.”

Texas Comptroller finalizes margin tax COGS rule amendments to align with IRC conformity interpretation

The Texas Comptroller has adopted amendments to Regulation Section 3.588, concerning margin tax cost of goods sold (COGS), without changes to the proposed text as published in the April 3, 2026, issue of the Texas Register. [34 TAC 3.588, Texas Register, Volume 51 TexReg 3843, 6/12/2026]

The amended rule provides that, beginning with the 2026 franchise tax report, a taxable entity must use the then-current federal tax law, instead of the 2007 Internal Revenue Code (IRC), when determining includible depreciation from the federal tax return on which the report is based, including amounts for which the taxable entity elected to expense certain depreciable business assets. The 2007 IRC only applies where the statute and rule specifically reference the IRC.

For example, beginning with the 2026 franchise tax report, a taxable entity may include in its COGS the bonus depreciation claimed on its federal return, to the extent associated with and necessary for the production of the goods. Further, on the 2026 franchise tax report only, a taxable entity with qualifying assets also may include a one-time net depreciation adjustment for each qualifying asset in its COGS calculation. Qualifying assets are those placed in service prior to the accounting year start date on the 2026 report, if the assets have not been disposed of prior to this date and are associated with and necessary for the production of the goods. The depreciation adjustment for a qualifying asset for a given year is the difference in the depreciation claimed on the federal tax return and the depreciation claimed for Texas franchise tax COGS. For each tax year the qualifying asset was in service (through the accounting year end date on the 2025 report), the taxable entity may calculate the depreciation adjustment.

A taxable entity should add the depreciation adjustment for each year to arrive at the net depreciation adjustment for that qualifying asset and include this amount in the entity's COGS on its 2026 franchise tax report.

Vermont requires modifications for Sections 168(k) and (n), 174A, and 250

Legislation (H.B. 933) enacted on June 18 updates IRC conformity to the IRC as amended through December 31, 2025 (updated from December 31, 2024), effective for tax years beginning on or after January 1, 2025.

However, also effective for tax years beginning on or after January 1, 2025, the legislation strikes existing provisions that specify that "Vermont net income" means taxable income under the IRC "without regard to... § 168(k)" and instead provides that Vermont net income is to be increased by:

- The "bonus depreciation deduction" taken on the taxpayer's federal income tax return under Section 168(k) or (n).
- The deduction taken on the taxpayer's federal income tax return under Section 174A and OBBBA Section 70302(f)(2) (the "catch-up" deduction for 2022-2024 domestic R&E expenditures), except for certain taxpayers that meet the gross receipts test (small business test) under Section 448(c) for the tax year.
- An amount equal to the amount of income deducted under Section 250 to the extent deducted from net income.
  - Vermont previously provided deductions from net income under Section 250 both for purposes of the GILTI deduction and the FDII deduction.
  - As noted in the Department of Taxes' updated conformity guidance, this impacts Vermont's foreign dividend based, which is set forth in Vt. Reg. Section 1.5862(d)-8(b). This also impacts Vermont apportionment. The Department advises that "all GILTI included in the taxpayer's Vermont net income will now be eligible for factor relief under Vt. Reg. Section 1.5862(d)-8(b). Vermont's denominator for the purposes of apportionment factor relief will now include all gross receipts relating to GILTI. This is a change from previous years, when the denominator included net GILTI factors (after the IRC § 250 deduction)."

The legislation provides corresponding deductions for:

- the depreciation deduction that would be allowed if the taxpayer had made the election under Section 168(k)(7) or (n)(6) to not claim bonus depreciation on that property; and

- the deduction that would be allowed under pre-OBBBA Section 174. As noted in the Department's updated conformity guidance, taxpayers making the amortization election at the federal level under Section 174A(c)(1) for expenses incurred in tax years beginning on or after January 1, 2025 will not need to report modifications "because the net Vermont R&E adjustment is zero."

The legislation also amends the existing R&D tax credit from 27% to 75% of the amount of the federal tax credit allowed for eligible R&D expenditures under IRC Section 41(a) that are made within Vermont, effective for tax years beginning on and after January 1, 2027.

See Vermont conformity guidance here.

Net operating losses

Illinois retains $500,000 NOL carryover limitation, introduces "greater of" income percentage limitation

Legislation (S.B. 3019) enacted on June 16 introduced a percentage limitation to the corporate net operating loss carryover allowance, so that the limitation will be the greater of $500,000 (the existing limit) or a percentage of net income.

Under preexisting law, no NOL carryover deduction is allowed exceeding $500,000 for any tax year ending on or after December 31, 2024 and prior to December 31, 2027. As amended, the statute imposes a carryover limitation of *the greater of* $500,000 or the following percentages of net income (without regard to the NOL carryover deduction):

- 15%, for tax years ending on or after December 31, 2027, and before December 31, 2028;
- 30% for tax years ending on or after December 31, 2028, and before December 31, 2029;
- 50% for tax years ending on or after December 31, 2029, and before December 31, 2030;
- 65% for tax years ending on or after December 31, 2030, and before December 31, 2031; and
- 80% for tax years ending on or after December 31, 2031.

As under preexisting law, for purposes of applying the carryforward period, the years for which the carryover is limited above will not be counted.

New Jersey adopts temporary $1 million NOL cap

New Jersey legislation (A. 5322) enacted on June 30 provides that the amount of any prior net operating loss deduction (PNOL) and any post-unitary NOL deduction claimed by a taxpayer (except for a public utility) cannot exceed in the aggregate $1 million for privilege periods ending on or after July 31, 2026, but before July 31, 2030. For taxpayers with a privilege period of less than 12 months, the limitation will be prorated by the number of months covered during the privilege period. For privilege periods ending on or after July 31, 2030, but before July 31, 2032, taxpayers may deduct PNOLs/NOLs that were disallowed due to the $1 million cap, but only up to 75% of the taxpayer's allocated entire net income.

Taxpayers may carry over the balance amount of the disallowed PNOL/NOL deduction that remains unused due to the above limitations for an additional six privilege periods beyond their normal expiration date immediately following the privilege period during which the PNOL/NOL deduction would have otherwise expired. New Jersey generally has a 20-year carryforward period for PNOLs/NOLs.

No interest or penalty will be assessed against a taxpayer for an underpayment of an installment payment of estimated tax resulting from the above limitations, provided that the installment payment is due and payable after December 31, 2025 but before January 1, 2027.

Unitary combined reporting

Colorado enacts worldwide combined reporting regime with water's-edge election, repeals 80/20 company treatment

On June 3 Colorado enacted legislation (H.B. 1289) 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.

Click here to view PwC's Insight on this development.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact:

Caleb Gauen
Principal, State Income Tax Leader
+1 703-635-0063
caleb.gauen@pwc.com