What's on the table—and chopping block—for tax reform in 2025

Expired
Expiring
Asks

Congress is about to consider a major tax overhaul, especially as many tax provisions benefiting small businesses implemented under the Tax Cuts and Jobs Act (TCJA) expire. This is an opportunity for policymakers to renew expired or expiring tax provisions and enact new tax provisions that support startups. (This document is not legal advice or tax assistance.)

Allow startups to make their funds go further:

Immediate full expensing for R&D costs. Prior to 2022, companies were able to immediately expense R&D costs. Companies must now capitalize and amortize these expenses over five years for domestic expenditures and 15 years for foreign expenditures. Just two developed countries do not permit immediate expensing for R&D costs. Immediate expensing for R&D expenditures helps companies, including startups, afford to undertake R&D by reducing their cash tax burden.

Full expensing of capital equipment costs. Expensing of new equipment for businesses is being incrementally phased out, allowing businesses to expense 80% of new equipment costs in 2023 to full phase out in 2027. Enhanced bonus depreciation helps enable new purchases of capital equipment by allowing businesses to more quickly recover the cost of those purchases.

R&D tax credits. These credits are designed to encourage companies to invest in research and development and can be suited to support innovative startups. Congress should improve the R&D tax credit for startups, including by expanding the existing credit to further offset tax liability and by expanding the list of qualifying activities.

Tax deduction for startup expenses. Currently, for business owners who have spent less than $50,000 setting up a business, they can deduct up to $5,000 in startup costs and $5,000 in organizational costs in their first year. Vice President Harris has expressed interest in raising the tax deduction for startup expenses to $50,000. She has also proposed allowing businesses to wait to claim the deduction until they have begun to turn a profit.

Incentivize investment in startups:

Opportunity Zones. Taxpayers investing in Opportunity Zones incur certain benefits including the ability to temporarily defer capital gains when those gains are placed in qualifying Opportunity Funds and a permanent exclusion on capital gains when investments in qualifying Opportunity Funds are held for a minimum of 10 years. Federal tax benefits relating to Opportunity Zones expire at the end of 2026. Some startups benefit from being located in Opportunity Zones because of the investment directed to these areas and, at times, lower operational costs.

Angel investor tax credit. Several states across the U.S. provide tax credits for angel investment in qualified startups, though a framework does not exist at the federal level. Implementing a federal angel tax credit could incentivize startup investment, including in diverse founders, who are more likely to receive angel capital vs. venture capital. For example, the state of New Jersey has implemented a tax credit equal to 20% of a qualified investment in an eligible business, which can escalate to a 25% credit for investment in a certified minority or women's business enterprise or in a business located in an Opportunity Zone or New Markets Tax Credit Census tract.

Preserve the capital gains rate. Favorable tax treatment for long term investment incentivizes investment in the innovation ecosystem. To continue to promote investment in our nation's startups, policymakers should not raise the current capital gains rate.

Preserve carried interest treatment. Carried interest is the share of investment profits paid to fund/investment managers (representing most of their compensation) and is treated as a return on investment and is therefore taxed at the capital gains tax rate, as opposed to the income tax rate. This favorable treatment serves as an incentive for fund managers, and is especially important for emerging fund managers, who are more likely to be diverse and to invest in diverse founders, and are often managing smaller funds. Carried interest helps to enable these managers to continue to invest in new and early-stage founders, making the preservation of the current carried interest tax treatment important.

Enable people to pursue entrepreneurship:

Reinstate expanded Child Tax Credit. Under TCJA, the child tax credit was increased to up to $2,000 per child. By the end of 2025, the credit drops to a maximum credit of $1,000 per child. During the pandemic, the CTC was temporarily expanded as part of the American Rescue Plan, benefitting millions of children and families. To enable more parents—especially mothers—to pursue entrepreneurship policymakers should pursue a permanently expanded CTC.

Credit for other dependents. TCJA established a new $500 nonrefundable credit—expiring at the end of 2025—for those dependents ineligible for the CTC. Applicable dependents include children 17 and 18 years old who live at home, adult children between the ages of 19-24 that are enrolled in an education program full time, and elderly dependent parents.

Lower overall tax burden:

Interest deductions. Beginning in 2017, business interest deductions were limited to 30% of earnings before interest, taxes, depreciation, and amortization (EBITDA). But as of 2022, business interest deductions are limited to 30% of earnings before interest and taxes (EBIT). This is uncommon as most countries use an EBITDA-based limit. Using an EBIT-based limit increases the cost of debt by restricting the deduction and increasing the tax burden on U.S. companies, which raises effective tax rates especially for low profit margin companies.

20% deduction for pass-through business income. Pass-through businesses (most of U.S. small businesses, including sole proprietorships, LLCs, partnerships, S corporations) are taxed according to individual income tax rates. TCJA implemented a 20% deduction for pass-through business income (subject to income limits), which, when coupled with the lower individual tax rates also implemented by TCJA, significantly lowers the top marginal rate for many startups and small businesses. This deduction is set to phase out at the end of 2025. Making the 20% pass-through deduction permanent would ensure pass-throughs are not at a tax disadvantage compared to C corps, giving startups and other small businesses lower tax rates so they can reinvest in their companies, increase employee wages, and expand their businesses.

Marginal tax rates. TCJA lowered the individual tax rates from 10%, 15%, 25%, 28%, 33%, 35%, and 39.6% to 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The current rates will revert to pre-TCJA levels starting in 2026. The lower rates are particularly helpful for startups organized as pass-throughs, lowering their tax liability.

Standard deduction. TCJA increased the standard deduction to $12,000 for single filers, $24,000 for joint filers, and $18,000 for heads of households. These levels will revert to pre-TCJA levels for 2026 ($6,500, $13,000, and $9,550 respectively).

Alternative minimum tax (AMT) exemption. The AMT is a tax that applies to high earners, under which a taxpayer calculates their tax liability via ordinary income tax as well as under the AMT. The tax owed is the higher amount. TCJA raised the individual AMT exemptions, raised the income limit at which the exemption begins to phase out, and adjusts these amounts for inflation through 2025. At expiration, the AMT exemption and phase out will revert to the levels set prior to TCJA. The higher AMT exemption levels are helpful for small businesses, many of which are unsure if they must apply the AMT and therefore have to plan for that contingency.

Modernize net operating loss treatment. The Tax Cuts and Jobs Act restricted the use of Net Operating Losses (NOLs)–prohibiting corporations from carrying them back to offset prior year taxes and stipulating that carryforwards can offset no more than 80% of their taxable income in any one year going forward; any remaining NOLs can still be carried forward indefinitely. Pass-throughs are subject to a cap on NOLs. These limitations are more challenging for startups because many startups generate significant losses in the early years, and these limitations will force startups to pay taxes as soon as they begin generating profits–even if they have accumulated significant net operating losses. This limits companies' abilities to reinvest in their businesses in the most crucial growth stages. Policymakers should restore the pre-TCJA treatment of NOLs. The pass-through provisions will expire in 2028.

Lowered corporate tax rate. TCJA lowered the corporate tax rate from 35% to 21%. While this provision is not expiring, some policymakers, including Vice President Harris, have signaled interest in setting the corporate tax rate at 28%. A low corporate tax rate is not only beneficial to businesses, but also to consumers, who will likely shoulder the cost of an increased rate. Because corporations are taxed twice, at the business level and again at the shareholder level, a higher tax rate disincentives investment in businesses, including startups.

Incentivize employees to join early-stage companies:

Employer credit for paid family and medical leave. TCJA implemented a nonrefundable tax credit for employers with written paid family and medical leave policies that include at least 2 weeks of paid leave paid at 50% or more of an employee's wages. Eligible employers can claim a credit to offset between 12.5% and 25% of wages paid to an employee while on leave, depending on the wage rate paid to employees on leave. This credit may enable some startups to attract employees with more robust benefits packages.

Preserve and expand QSBS. Section 1202 of the Internal Revenue Code, or the Qualified Small Business Stock exclusion, exempts eligible startup founders, investors and employees from paying federal taxes on up to 100% of capital gains when selling their equity—on the greater of $10 million or 10 times their cost basis—provided certain conditions are met. Section 1202 incentivizes founders to take on the risk of starting a company, pushes needed talent to join companies as early employees, and drives investors to take on the risk of supporting early-stage companies. Policymakers should preserve and expand QSBS.

Maintain taxation of non-qualified deferred compensation plans upon exercise. Stock-based compensation is critical for talent recruitment and employment by our nation's startups, allowing early stage companies to compete with established businesses for talent. Policymakers have previously (unsuccessfully) proposed to require tax assessment and payment on stock options and other stock-based incentive compensation when that stock vests as opposed to when it is exercised, a financial blow many employee stockholders are unable to contend with. Instead, policymakers should maintain that employees pay tax on income they actually receive, as opposed to hypothetical gains—which would render stock-based compensation unworkable for startups and their employees.