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A REVIEW AND ASSESSMENT OF THE MAIN BUSINESS TAX PROVISIONS OF THE 2025 RECONCILIATION ACT

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EXECUTIVE SUMMARY

The 2025 reconciliation bill—known as the *One Big Beautiful Bill Act (OBBBA)*—extends and reinstates several business tax provisions originally enacted under the 2017 *Tax Cuts and Jobs Act (TCJA)*. While the TCJA permanently lowered the corporate income tax rate from 35 to 21 percent, other core provisions expired as early as 2022, with additional phaseouts running through 2027.

This brief reviews OBBBA's major domestic business tax provisions, their fiscal cost, and their likely economic effects—particularly through their influence on the cost of capital and business investment. The key provisions include:

Bonus depreciation allows immediate deduction of the full cost of qualifying equipment, boosting the present value of tax deductions, lowering the cost of capital, and improving cash flow. Empirical evidence shows bonus depreciation increases investment, particularly amongst small and financially constrained firms. Bonus depreciation had started to phase out in 2023 and was scheduled to fully expire in 2027. The reconciliation bill permanently reinstates 100 percent bonus depreciation in 2025 and after, which the Joint Committee on Taxation (JCT) estimates to cost about $363 billion over 10 years.

Expensing of some structures allows immediate deduction of the cost of building structures used for domestic manufacturing, chemical and agricultural production, and some refining operations like fuel processing. This is a new provision in the reconciliation bill and was not part of the TCJA. Expensing of structures is valuable compared with regular depreciation, which requires the cost to be recovered evenly over 39 years. It has never been allowed in the US and is not common in most countries. It applies if construction begins between January 20, 2025, and December 31, 2029, and the property is placed in service before January 1, 2031. JCT estimates this will cost $141 billion over 10 years.

R&D expensing allows immediate deduction of R&D outlays rather than capitalization and amortization over five years. There is a strong economic case for subsidizing R&D because of positive social spillovers. The TCJA required R&D expenditures to be capitalized beginning in 2022. The reconciliation bill reinstates expensing in 2025, which will cost $141 billion over 10 years. The new law allows small businesses to retroactively expense R&D expenditures incurred between 2022 and 2024.[1]

Interest deduction limitations disallow deductions for net interest above a certain fraction of income. The TCJA set an initial limit at 30 percent of earnings before interest, taxes, depreciation, and amortization (EBITDA), and then tightened it starting in 2022 to 30 percent of earnings before interest and taxes (EBIT). The reconciliation bill reinstates the 30 percent EBITDA limit, which will align the US with most OECD countries. This will cost $61 billion over 10 years.

The qualified business income (QBI) deduction allows eligible pass-through businesses to deduct up to 20 percent of qualified income, lowering their effective tax rate. Unlike the benefits of the other four provisions above, the benefits of the QBI deduction do not depend on the level of investment and there is little evidence of its impact on growth. The benefits are concentrated among high-income owners and certain industries. The reconciliation bill permanently extends the 20 percent deduction, which will cost $737 billion over 10 years.

Although the House initially passed a version of the bill that temporarily extended bonus depreciation and R&D expensing, Congress ultimately chose to make these provisions permanent. While a permanent extension carries a higher budgetary cost, it has a larger long-term impact on investment and economic growth.

Impact on Investment and Growth

The Tax Policy Center (TPC) estimates that permanently reinstating 100 percent bonus depreciation, R&D expensing, and the 30 percent EBITDA limit on interest deductions would raise GDP in 2035 by 0.3 percent, increase the capital stock by 0.9 percent, and lift investment by 1.5 percent relative to prior law. By contrast, temporary expensing of certain structures has little long-run effect on GDP or investment. Overall, TPC projects that the reconciliation bill will increase GDP in 2035 by 0.5 percent, the capital stock by 0.4 percent, and investment by 1 percent. The smaller impact of the full package—relative to the business provisions alone—reflects the offsetting effect of higher federal debt and deficits, which crowd out private investment.[2]

Although bonus depreciation, R&D expensing, and the loosening of the interest deduction limit make up a fraction ($560 billion) of cost of the reconciliation bill, they drive most of its growth impact and have a significant effect on investment.[3] In contrast, the Qualified Business Income (QBI) deduction contributes little to growth and is less directly linked to new investment. On a GDP-per-dollar basis, its impact is weaker than other business provisions, yet its fiscal cost is more than 30 percent higher over the next decade and more than double over 25 years. Moreover, because permanent bonus depreciation already lowers the cost of capital for pass-throughs, the QBI deduction adds little benefit at the margin.

To help illuminate the trade-offs involved, this brief reviews findings from the Tax Policy Center's Investment and Capital Model (ICM), which calculates how taxation affects the user cost of capital and the effective marginal tax rates (EMTR) on marginal investments, key measures in understanding how tax policy distorts investment decisions at the margin. This analysis considers the overall impact of the reconciliation bill on effective marginal tax rates and compares it with recent changes and the original impact of the TCJA and of the above provisions for both C corporations and pass-through entities, accounting for both debt and equity financing. Our key observations are as follows:

- **OBBBA's impact.** The reconciliation bill significantly brings down the cost of capital and effective marginal tax rate of new investments for both corporations and pass-throughs, with an average reduction in EMTR of 6 and 8 percentage points in 2025, respectively. Equity-financed investments see a decline of roughly 5 percentage points for corporations, compared with over 9 percentage points for

debt-financed investment, due to the relaxing of interest deduction limit. The average corporate EMTR for manufacturing structures sees a large reduction of about 20 percentage points.

- **TCJA's impact.** The TCJA had also significantly reduced the cost of capital of investments financed with equity for both corporations and pass-throughs—by about 11 percentage points for C corporations and 7 percentage points for pass-throughs—primarily through lower statutory rates and expanded bonus depreciation. Since 2022, EMTRs had risen because of the phaseout of bonus depreciation and the requirement to capitalize R&D expenditures
- **Equity vs. debt financing.** The TCJA narrowed the tax wedge between equity and debt financing. Equity-financed investments saw substantial EMTR reductions and debt-financed investments experienced an increase in EMTRs because of the reduced value of interest deductions from lower tax rates and the new limitation. Tax differentials between equity and debt remain narrow under the reconciliation bill, although debt-financed investments would have a small advantage.
- **Corporations vs. pass-throughs.** Pass-throughs had a tax advantage prior to 2018. The TCJA greatly reduced that advantage, and as of 2025, C-corporations and pass-throughs faced similar EMTRs, on average. The reconciliation bill retains a small advantage for pass-throughs that finance with equity, and a small advantage for corporations that finance with debt. The average EMTR is now roughly the same under the new law for corporations and pass-through businesses.

In summary, there is a solid economic justification for allowing the expensing of investments in tangible assets and research and development. Those provisions target marginal investments, reducing the cost of capital, and potentially boosting investment. Sectors with higher shares of equipment (e.g., utilities, transportation) benefit most; sectors dominated by structures (e.g., real estate) benefit less. Full expensing was a large factor in reducing the average effective marginal tax rates after 2017, and its phaseout had led to a slow but steady increase in EMTRs since 2022.

In addition, a significant portion of the budgetary cost of allowing for expensing is temporary and comes from shifting future deductions into the present, which limits the long-term costs of these policies. Because those provisions impact the timing of deductions, the cost of a temporary extension is much smaller than a permanent extension, but with little long-term impact on growth.

The QBI deduction is costly, and there is little evidence that it had a positive impact on growth and investment. When the law allows for 100 percent bonus depreciation, the QBI deduction has a smaller impact on the effective marginal tax rate for pass-throughs, mainly by lowering the effective marginal taxation of structures.

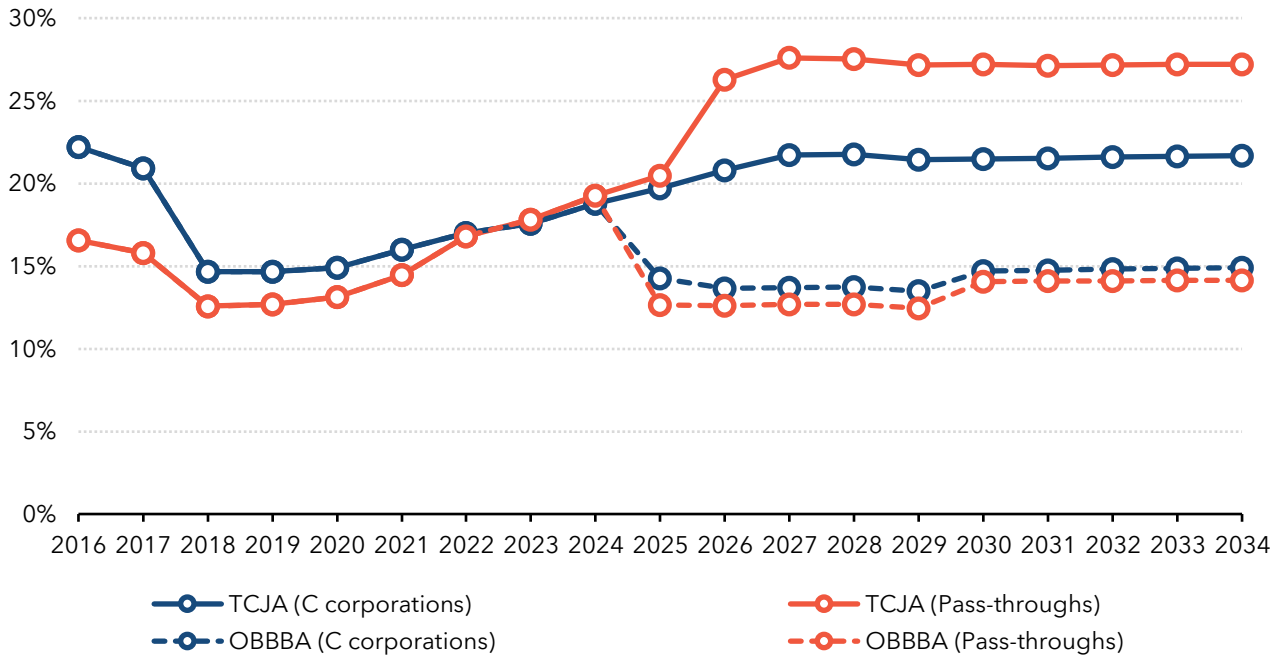
A REVIEW AND ASSESSMENT OF THE OBBBA'S MAIN BUSINESS TAX PROVISIONS

The Investment and Capital Model (ICM) at the Tax Policy Center calculates the cost of capital and effective marginal tax rates (EMTRs) for C corporations and pass-through businesses (see figure 1). It does so at both the investor and firm levels, accounting for investments financed through debt or equity.[4] EMTRs measure the tax burden on new marginal investments that just break even after taxes.[5] As such, they are a critical metric for understanding how taxes affect investment decisions across firms.

The ICM estimates the marginal cost of capital and tax burden from the perspective of investors, incorporating individual-level taxation of dividends, capital gains, and interest. These individual-level tax estimates are derived from the Tax Policy Center's microsimulation model.

FIGURE 1

Average Economy-Wide Effective Marginal Tax Rate



Source: Authors calculations from the investment and capital model.
Notes: OBBBA = One Big Beautiful Bill Act. The figure plots the weighted average effective marginal tax rates at the shareholder level for C corporations and pass-throughs between 2016 and 2034. We use the distribution of assets reported by the Bureau of Economic Analysis (equipment, structures, and intangibles) in each year until 2023 to determine the weights. We follow CBO's parameters (https://github.com/US-CBO/captax) for inflation, real interest rate, expected rate of return, the share of investment financed with debt, and the share of profits distributed to shareholders as dividends or buybacks. We used our estimates of the average share of allowed interests by sector between 2018 and 2021, and since 2022 to estimate average EMTRs. The average marginal tax rate applied to pass-throughs comes from the microsimulation model at the Tax Policy Center. Our estimates include the impact of the R&E tax credit and the FDII deduction (for C corporations) on EMTRs.

In this brief, we present weighted average EMTRs based on the distribution of assets in the economy in 2023, as reported by the Bureau of Economic Analysis.[6] In addition to accounting for corporate and individual tax rates and cost recovery provisions, the ICM accounts for the effects of the research and experimentation tax credit, foreign-derived intangible income deductions, and limitations on interest deductions.

The One Big Beautiful Bill Act reduces EMTRs for C corporations and pass-through businesses by approximately 6 and 8 percentage points in 2025, respectfully. Most of the decrease can be attributed to 100 percent bonus depreciation, as well as the expensing of R&D and some structures. As shown in Figure 1, this brings EMTRs back roughly to their 2018 level, before the requirement to capitalize R&D and the phase-out of bonus depreciation drove increases in the rates.

In comparison, the Tax Cuts and Jobs Act (TCJA) reduced EMTRs for C corporations and pass-through businesses by approximately 8 and 4 percentage points, respectively.

Equity-Financed vs. Debt-Financed Investments

To better understand the impact of the reconciliation bill provisions, Figure 2 illustrates EMTRs separately for equity-financed and debt-financed investments:

- **Equity-financed investments.** The reconciliation bill reduces the average equity-financed EMTR for C corporations by over 5 percentage points, and by 7 percentage points for pass-throughs in 2025. Since pass-through businesses have a higher entity-level average tax rate, they benefit more from the reintroduction of expensing.[7]

  In comparison, the TCJA reduced the average equity-financed EMTR for C corporations by over 11 percentage points in 2018, largely because EMTRs were significantly higher in 2017, with only 50 percent bonus depreciation and a statutory rate of 35 percent. The TCJA cut the average equity-financed EMTR for pass-through by 7 percentage points in 2018.

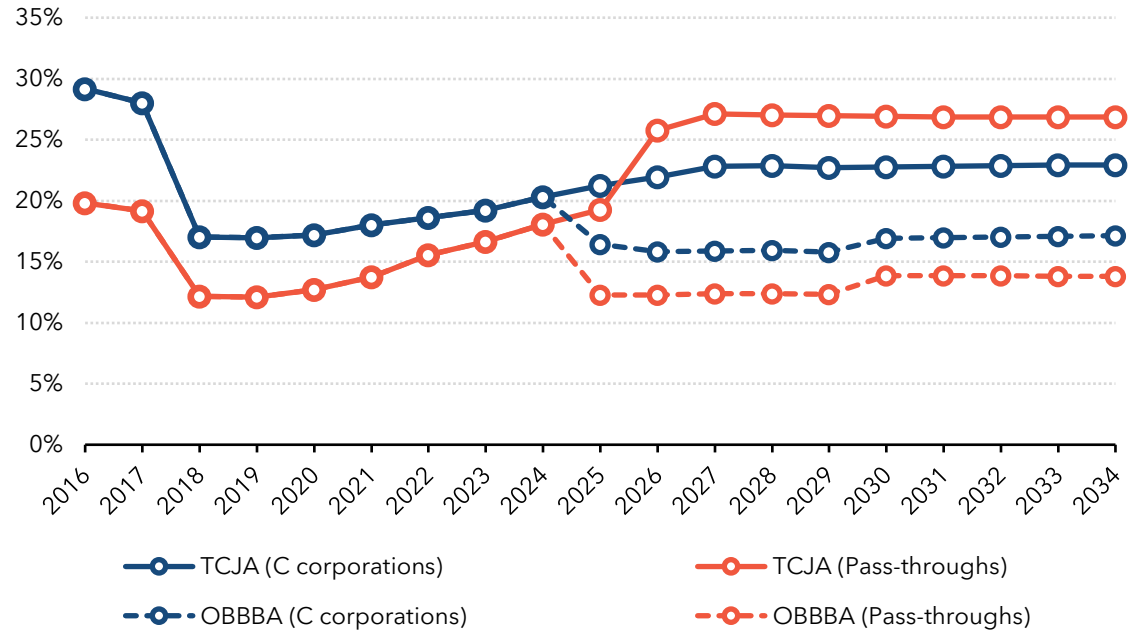
- **Debt-financed investments:** The reconciliation bill lowers the average debt-financed EMTR for C corporations by 10 percentage points, and by almost 12 percentage points for pass-throughs in 2025. In addition to expensing, the relaxing of interest limit lowers the effective marginal rates. The impact is larger for pass-throughs because the higher entity-level average tax rate increases the value of interest deductions.[8]

  In contrast, the TCJA increased the EMTR on debt-financed investments. The average corporate EMTR rose from below -20 percent in 2017 to nearly 10 percent in 2018. This shift was driven by two primary factors: the reduction in marginal tax rates for both C corporations and pass-through entities decreased the value of interest deductions, and the introduction of interest limitations.

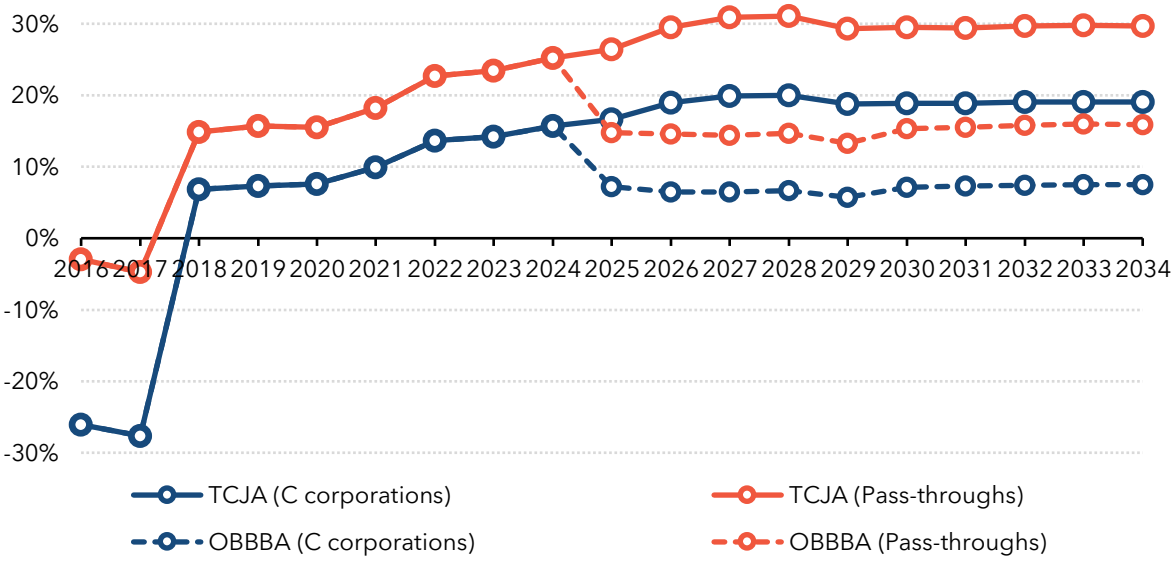
FIGURE 2

Average Economy-Wide Effective Marginal Tax Rate

Equity-financed assets



Debt-financed assets



Source: Authors calculations from the investment and capital model.
Notes: OBBBA = One Big Beautiful Bill Act. The figure plots the weighted average effective marginal tax rates at the shareholder level for C corporations and pass-throughs between 2016 and 2034. We use the distribution of assets reported by the Bureau of Economic Analysis in each year until 2023 to determine the weights. We follow CBO's parameters (https://github.com/US-CBO/captax) for inflation, real interest rate, expected rate of return, the share of investment financed with debt, and the share of profits distributed to shareholders as dividends or buybacks. We used our estimates of the average share of allowed interests by sector between 2018 and 2021, and since 2022 to estimate average EMTRs. The average marginal tax rate applied to pass-throughs comes from the microsimulation model at the Tax Policy Center. Our estimates include the impact of the R&E tax credit and the FDII deduction (for C corporations) on EMTRs.

Impact By Asset Category

The reconciliation bill produces the largest reduction in EMTR for manufacturing structures, which benefit from the new provision allowing partial expensing of certain structures. The estimated decline is about 20 percentage points for corporations and nearly 30 percentage points for passthroughs (see table 1). Bonus depreciation and R&D expensing also substantially reduce average EMTRs for equipment and R&D spending. The reduction is larger for debt-financed assets than for equity-financed assets, reflecting the relaxation of the interest deduction limit (see Appendix table 1).

TABLE 1

Impact of OBBBA on Average EMTR by Asset Category

Mixed-financed assets, 2025

Asset category	Corporations	Passthroughs
Equipment	-8.4%	-12.2%
Structures (manufacturing)	-20.2%	-29.3%
Structures (other)	-2.4%	-3.2%
Intangibles (non-R&D)	-0.5%	-0.8%
R&D (with R&D credit)	-15.7%	-27.5%

Source: Authors calculations from the investment and capital model.
Notes: OBBBA = One Big Beautiful Bill Act. The table displays the impact of the OBBBA on the weighted average effective marginal tax rates at the shareholder level for C corporations and pass-throughs by category of asset. We use the distribution of assets reported by the Bureau of Economic Analysis in 2023 to determine the weights. We follow CBO's parameters (https://github.com/US-CBO/captax) for inflation, real interest rate, expected rate of return, the share of investment financed with debt, and the share of profits distributed to shareholders as dividends or buybacks. We used estimates of the average share of allowed interests by sector between 2018 and 2021, and since 2022 to estimate average EMTRs. The average marginal tax rate applied to pass-throughs comes from the microsimulation model at the Tax Policy Center. Our estimates include the impact of the R&E tax credit and the FDII deduction (for C corporations) on EMTRs. Structures (manufacturing) looks at the impact of the OBBBA on structures that benefit from the new expensing provision.

Impact on Investment and Economic Growth

On their own, these business tax provisions generally promote growth by lowering the cost of investment and expanding the capital stock. Evidence shows that bonus depreciation increases investment (see next section), and expensing of R&D costs encourages additional research spending. The effects of loosening interest deduction limits are less clear, though it may stimulate investment for firms constrained by the cap and reliant on debt financing. By contrast, the impact of the QBI deduction on investment is uncertain. Pass-through businesses already benefit from the same expensing and interest deduction rules as C corporations.

The Tax Policy Center (TPC) estimates that permanently reinstating 100 percent bonus depreciation, R&D expensing, and the 30 percent EBITDA limit on interest deductions would have raised GDP by 0.3 percent, the capital stock by 0.9 percent, and investment by 1.5 percent in 2035 relative to pre-OBBBA law. By comparison, the reconciliation bill—which includes these provisions along with others—is projected to increase GDP by 0.5 percent, the capital stock by 0.4 percent, and investment by 1 percent. The smaller long-run impact on capital

and investment reflects the offsetting effect of higher federal debt and deficits, which crowd out private investment.

TABLE 2

Revenue Impact of Business Tax Provisions in the OBBBA

Provision (cost is in billion USD)	Effective date	Permanent	10-year cost (2025-34)	Additional 15-year cost (2035-49)
100 percent bonus depreciation	20-Jan-25	Yes	363	302
Expensing of some manufacturing structures	20-Jan-25	No (expires Dec. 2030)	141	-
R&D expensing	1-Jan-25	Yes	141	53
Interest deductions - 163(j) - limited to 30 percent of EBITDA	1-Jan-25	Yes	61	127
QBI deduction (20 percent)	1-Jan-26	Yes	737	1940

Sources: Original 10-year estimates for 100 percent bonus depreciation, R&D expensing, previous interest deductions limitations, and QBI deduction come from the Joint Committee on Taxation (JCT). See JCX-35-25 (https://www.jct.gov/publications/2025/jcx-35-25/). Estimates are for fiscal years. The Tax Policy Center has its own revenue estimate models which use the Joint Committee on Taxation's estimates as benchmarks.
Notes: We use current law in calculating the cost of each policy. Bonus depreciation applies to equipment and follows the same definition for eligible assets as under current law. For years after 2035, we assume R&D expenditures and investment grow at the same rate as nominal GDP. The expensing of some manufacturing structures is eligible for investment in structures after January 20th, but only if they are not placed into service before July 4th, 2025 (date of enactment of the reconciliation bill). R&D expensing is eligible for expenditures that occurred after December 31st, 2024. However, businesses that meet a gross receipt test (under $31 million a year) can expense their remaining capitalized R&D expenditures that occurred between 2022 and 2024.

Table 2 summarizes the 10-year revenue cost of each provision from the Joint Committee on Taxation (JCT) between 2025 and 2034 and presents our estimates of the revenue cost for an additional 15 years (between 2035 and 2049). Bonus depreciation, expensing of structures, and R&D expensing are costly in early years (see appendix figure 1 for yearly revenue impact of a permanent extension until 2035), but largely because the policies shift future deductions to the present. Loosening interest-deduction limitations costs much less ($61 billion over 10 years) compared with extending the QBI deduction, which amounts to over $737 billion in the next 10 years, and almost $2 trillion for an additional 15 years

Next, we assess how bonus depreciation, expensing of structures, R&D expensing, interest deduction limits, and the QBI deduction affect the average tax burden on new investments and their broader economic impact.

Bonus Depreciation and Expensing

Capital assets lose value and productive capacity over time because of depreciation. Although some assets, such as structures, can last for decades, others—like equipment and software—require regular updates or replacement. The tax code originally allowed businesses to deduct capital investments (cost recovery) over

time in line with their actual economic depreciation. This contrasts with regular business expenses, which can typically be fully deducted in the year they occur.

The current cost recovery system for most assets—the Modified Accelerated Cost Recovery System (MACRS)—was introduced in 1986. MACRS aimed to better align tax depreciation schedules with economic depreciation while still permitting accelerated depreciation.

In 2001, Congress introduced bonus depreciation, allowing companies to immediately deduct 30 percent of their investments in equipment—assets traditionally depreciated over 20 years or less—while following the regular depreciation schedule for the remaining costs. In the following 15 years, bonus depreciation was increased and extended multiple times. TCJA increased bonus depreciation from 50 to 100 percent (full expensing) for qualifying assets purchased between 2018 and 2022. Starting in 2023, bonus depreciation began phasing out by 20 percentage points annually. The reconciliation bill permanently established 100 percent bonus depreciation, for assets purchased on or after January 20, 2025. Notably, bonus depreciation does not apply to structures or buildings.[9]

Accelerated depreciation provides significant value to businesses because inflation erodes the value of deductions taken in future years. A dollar today is worth more than a dollar tomorrow; thus, deductions taken upfront have a higher present value than those deferred. Bonus depreciation also reduces tax liability during the year an asset is purchased, freeing up cash flow—a benefit particularly valuable for firms with positive income but limited liquidity.

However, only firms with sufficient taxable income can fully benefit from expensing. Additionally, companies that invest heavily in longer-lived assets derive disproportionate advantages from this policy. See the following examples below:

- The difference in present value between expensing and MACRS is 0.1 for assets depreciated over five years (i.e., the present value of depreciation allowances equals 90 percent of the asset's cost).[10] This means a company that buys $100 worth of computers gains about $10 in present value of tax deductions with expensing.
- For assets depreciated over 15 years, this difference increases to 0.32, reflecting greater benefits for longer-lived assets.

The reconciliation bill also introduced full expensing for structures used in manufacturing, chemical production, agriculture, and certain refining operations like fuel processing. The non-production areas of new structures, like parking or office space will not be eligible for expensing. This marked a significant departure from past policy: Congress had never previously permitted the full expensing of structures, largely due to the large associated budgetary cost.

Expensing structures can be very valuable for businesses. Under current depreciation rules, the present value of deductions for a structure depreciated over 39 years is approximately 0.35. In contrast, full expensing allows a company investing $1 million in a new structure to immediately deduct the full amount, yielding around $650,000 more in present-value tax deductions.

IMPACT OF BONUS DEPRECIATION AND EXPENSING ON EFFECTIVE MARGINAL TAX RATES

Full expensing (100 percent bonus depreciation) significantly reduces the EMTR on new investments, and sectors that use proportionally more equipment stand to benefit the most from reinstating this policy.

Figure 3 illustrates the impact of 100 percent bonus depreciation and expensing of some structures in 2026 on EMTRs across sectors:

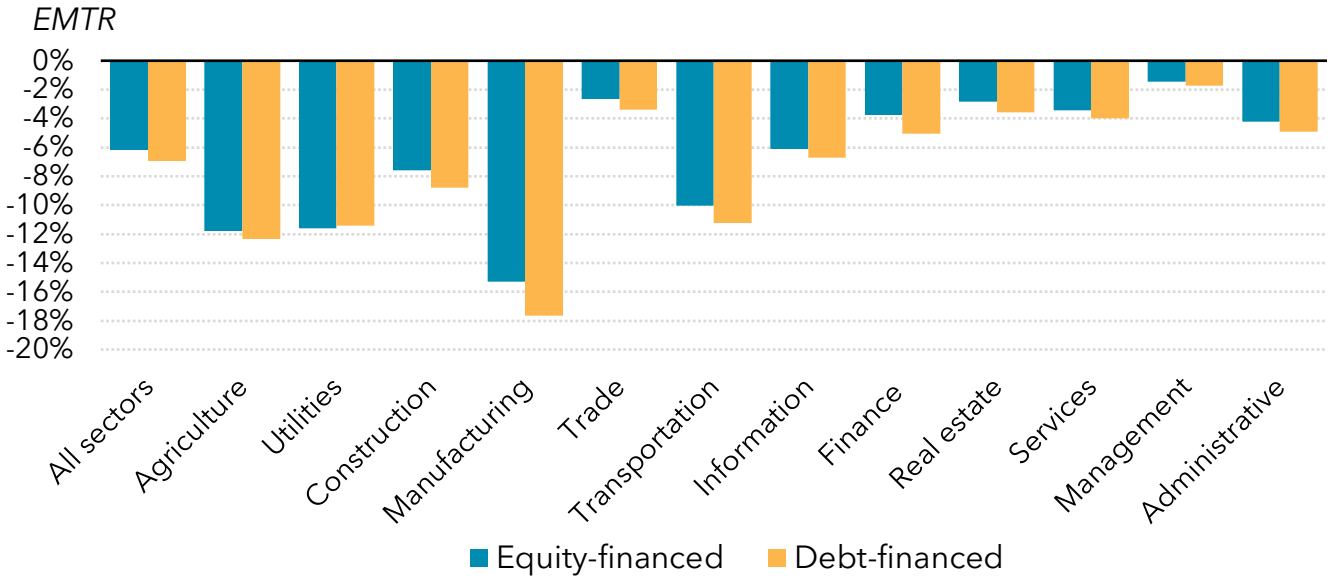
- The average decline in EMTRs across all assets (excluding R&D spending) in 2026 will be 6.2 percentage points for equity-financed investments and 6.9 percentage points when debt-financed.
- Sectors such as utilities or transportation will see the larger declines from bonus depreciation because of their higher reliance on equipment relative to structures. Conversely, sectors like wholesale and retail trade or finance will see smaller declines because of their relatively higher use of structures.
- Manufacturing experiences the largest decline due to expensing of qualifying structures. For example, a C corporation would face an average EMTR of 27 percent for structures under regular depreciation, but these provisions reduce the rate to only 6 percent.[11]

The variation in EMTR reductions is primarily driven by differences in asset composition across sectors (Appendix figure 2 provides a similar analysis restricted to assets eligible for bonus depreciation). Figure 3 assumes full take-up of bonus depreciation and expensing of structures, illustrating its potential impact on firms that qualify for it. But historically, firms have taken up bonus depreciation at rates well below 100 percent.[12] Thus, the average reduction in EMTRs will be smaller, since many new investments eligible for bonus depreciation are still likely to be depreciated under regular MACRS schedules.

FIGURE 3

Impact of Bonus Depreciation and Expensing by Industry

Calendar year 2026



Source: Authors calculations from the investment and capital model.
Notes: This graph shows the impact of bonus depreciation on average EMTR using the distribution of assets in 2023 from the Bureau of Economic Analysis and excluding R&D expenditures. The first two bars indicate the average impact of introducing 100 percent bonus depreciation in 2026 for equity-financed investments (blue bar) and debt-financed investments (yellow bar). Light blue bars indicate the average decrease in EMTRs for equity-financed investments by sector, while the yellow bars indicate the average decrease in EMTRs for debt-financed investments. All estimates are based on current law excluding bonus depreciation.

DOES BONUS DEPRECIATION BOOST INVESTMENT?

Expensing brings down the user cost of capital, and there is a large and rich literature evaluating how investment responds to changes in the user cost of capital and the average effective marginal tax rate. For example, the Congressional Budget Office estimates that investment goes up by 0.7 percent when the user cost of capital decreases by 1 percent—within the 0.5 to 1 percent rage reported by many studies.[13]

Zwick and Mahon (2017) analyzed the impact of bonus depreciation between 2001 and 2012 using firm-level tax data. They found that the introduction of 30 percent bonus depreciation in 2001 increased investment in eligible assets by 10.4 percent compared with ineligible assets. When bonus depreciation was raised to 50 percent in 2008, investment in eligible assets rose by 16.9 percent. Their estimates suggest an investment increase of 1.5 to 2 percent in response to a 1 percent decline in the user cost of capital.

A common concern with temporary policies like bonus depreciation is that firms might accelerate future planned investments to take advantage of the policy before it expires. However, Zwick and Mahon tested for this behavior and found limited evidence of such "pull-forward" effects.[14] Their findings align with prior research that shows a positive aggregate impact of bonus depreciation on investment.[15]

The study also revealed that small firms responded almost twice as strongly as larger firms, particularly when the policy provided immediate cash flow benefits. On the other hand, firms with net operating losses or insufficient taxable income to fully utilize bonus depreciation derived little benefit from the policy.

Evaluating the impact of the 100 percent bonus depreciation introduced under the TCJA is more complex because of the many contemporaneous tax policy changes that also influenced investment incentives. However, Chodorow-Reich and coauthors (2024) found that the increase to 100 percent bonus depreciation significantly boosted investment, particularly among small, profitable, and financially constrained firms.[16] They concluded that bonus depreciation delivers a better "bang for the buck" than cutting corporate tax rates when it comes to incentivizing new investment.[17]

HOW MUCH WILL BONUS DEPRECIATION AND EXPENSING COST?

The short-term cost of implementing full expensing (100 percent bonus depreciation) is substantial—often multiples of the long-term cost—due to transition effects.[18] Expensing effectively accelerates deductions, shifting them from the future to the present. During the transition period, businesses can deduct both the remaining cost recovery of older assets and the full expensing of new investments. Over time, however, the long-term static cost declines significantly, primarily reflecting the difference in present value between regular depreciation schedules and full expensing.[19]

JCT estimates that making100 percent bonus depreciation permanent in 2025 and after will cost approximately $363 billion between 2025 and 2034. We estimate an additional cost of $302 billion between 2035 and 2049, indicating lower nominal and real costs in the long run. JCT estimates that the temporary expensing of structures will cost about $141 billion over 10 years.

Interest Deductions and Limitations

From 1918 to 2017, companies were allowed to fully deduct their interest expenses from taxable income. However, section 163(j) of the TCJA introduced new limitations on the amount of interest expenses that firms could deduct each year.[20]

Between 2017 and 2021, corporations could deduct interest expenses up to 30 percent of their earnings before interest, taxes, depreciation, and amortization (EBITDA). Starting in 2022, this limitation became stricter, allowing deductions only up to 30 percent of earnings before interest and taxes (EBIT). Since this change, many have advocated for a return to using EBITDA instead of EBIT as the basis for determining the interest deduction limit. The 2025 reconciliation bill reinstates the previous limitations based on 30 percent of EBITDA for years 2025 and after.

Allowing the deduction of interest expenses helps avoid double taxation, as interest is taxed both at the corporate level (as part of a firm's profits) and at the individual level (when received by creditors as income). However, there are compelling arguments against unrestricted interest deductions.

First, interest deductions create a bias toward debt financing. Corporations can deduct interest payments but not shareholder payments such as dividends or stock buybacks. Additionally, firms deduct the nominal cost of debt rather than the real cost (adjusted for inflation), further encouraging debt financing. Prior to 2017, this led to a significant tax advantage for debt over equity, as illustrated in Figure 2—potentially resulting in excessive leverage, increased financial risk, and inefficient capital allocation.

Disallowing interest deductions would bring the tax system closer to a cash-flow base, which many economists view as more efficient and neutral. With expensing, the firm-level EMTR is simply zero for investments financed with equity but negative for investments financed with debt when interest costs are deductible. Because OBBBA introduced several expensing provisions—an essential feature of a destination-based cash-flow tax—there is a strong case for further limiting, or even eliminating, interest deductions. [21]

In our current tax system, however, the previous 30 percent EBIT limitation can create disparities among firms depending on the types of assets they invest in. If Congress aims to tighten interest deductions further, it should consider reducing the 30 percent threshold that sets the deduction limit instead.

HOW DO INTEREST LIMITATIONS AFFECT INVESTMENT INCENTIVES?

The impact of interest expense limitations on investment incentives depends on what firms use as their marginal source of financing:

- If most firms finance marginal investments with debt, the debt-financed EMTR is most relevant for assessing tax policy impacts.
- If firms primarily finance marginal investments with equity (including retained earnings), the equity-financed EMTR is more relevant.

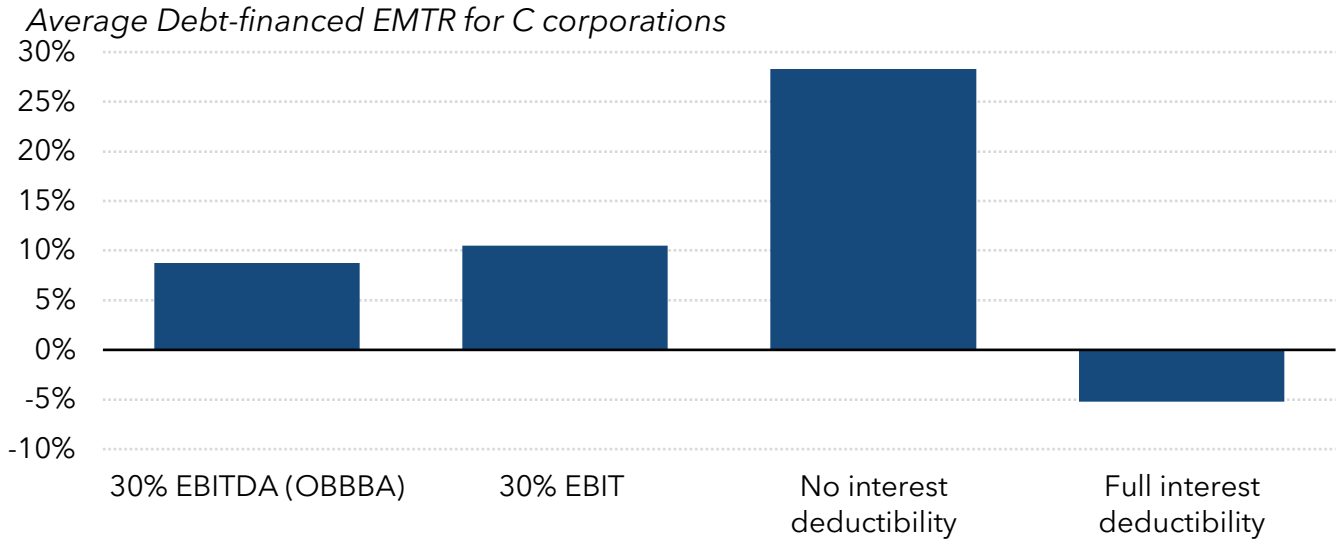
Leading corporate finance theories suggest that equity tends to be the marginal source of financing for most firms under most circumstances. To estimate the average EMTR represented in Figure 1, we leverage data from Congressional Budget Office's cost of capital model which provides the share of investments financed with debt (the reported average share of marginal investments financed with debt is about 27 percent for C corporations and 30 percent for the non-corporate sector).[22]

We estimate that the average debt-financed EMTR for corporations would have been 12 percent in 2026 under the previous limit (assuming all other provisions of 2025 reconciliation bill). Adjusting the interest deduction limit from EBIT back to EBITDA will reduce this EMTR to 8.8 percent, a decline of 2.2 percentage points. Allowing businesses to deduct all their interest expenses would lower the average debt-financed EMTR further to -3.5 percent, while no interest deductibility would increase it to 30 percent.

FIGURE 4

Interest Limitations and Effective Marginal Taxation of New Investments

Calendar year 2026



Source: Author's calculations from the investment and capital model.
Notes: EBIT = Earnings Before Interest and Taxes; EBITDA = Earnings Before Interest, Taxes, Depreciation, and Amortization; EMTR = effective marginal tax rate; OBBBA = One Big Beautiful Bill Act. We present average debt-financed EMTR for investments in 2026 under OBBBA but various alternatives on interest limits. The 30 percent EBITDA and 30 percent EBIT for C corporations report the average EMTRs assuming a varying fraction of interests are disallowed because of the limitations. No interest deductibility reports the actual EMTR for investments financed with debt for which none of the interests can be deducted-this would apply to investments when a firm is above the limit. Full interest deductibility reports the EMTR for investments financed with debt for which all interests can be deducted—this would apply to corporations that have interest below the limit.

EMPIRICAL EVIDENCE ON INTEREST DEDUCTION LIMITATIONS

Given that full deductibility of interest expenses was in place in the US for nearly a century before 2017, there is limited empirical research on how restricting these deductions affects investment and firm behavior. However, recent research provides some insights.

De Mooij and Liu (2021) compare multinational companies in 34 countries with different interest deduction limitations and find that tighter limits are associated with lower investment. Carrizosa, Gaertner, and Lynch (2023) find that the most affected firms decreased leverage substantially, by an estimated 7.6 percent of assets. Richmond, Goodman, and Isen (2025) used firm-level tax data to study the impact of TCJA's new restrictions on interest deductions. They found no economically significant effect on investment or leverage but observed that firms issued more equity in response to the limitations.[23] Their findings align with prior literature suggesting that most firms do not use debt as their marginal source of financing.

These results imply that further restrictions on interest deductions could generate additional revenue with minimal economic disruption. However, caution is warranted when interpreting these findings. The study's outcomes were driven by a subset of firms with high levels of interest expense, and the analysis was conducted

during a period of historically low interest rates (2013–19), which may not reflect current economic conditions.[24]

HOW MUCH WILL THE NEW INTEREST LIMITATIONS COST?

JCT estimated that reverting the interest deduction limit from 30 percent of EBIT back to 30 percent of EBITDA will cost approximately $61 billion between 2025 and 2034. We estimate the provision will cost an additional $127 billion over the next 15 years.

The Treatment of R&D Expenditures

From 1954 and 2021, businesses could fully deduct all eligible research and experimentation (R&E) expenses in the year they were incurred.[25] However, starting in 2022, businesses were required to capitalize and amortize R&D expenditures over several years.[26] Qualifying R&D expenditures could still benefit from the R&E tax credit, which remains the largest tax incentive for research and development.[27] It is important to note that while all expenditures qualifying for the R&E credit must also qualify as R&D expenditures, not all R&D expenditures are eligible for the credit. The reconciliation bill restores the full deductibility of R&D expenditures that occurred on or after January 1, 2025, for large firms, and retroactively back to 2022 for businesses that meet the gross receipts requirement.

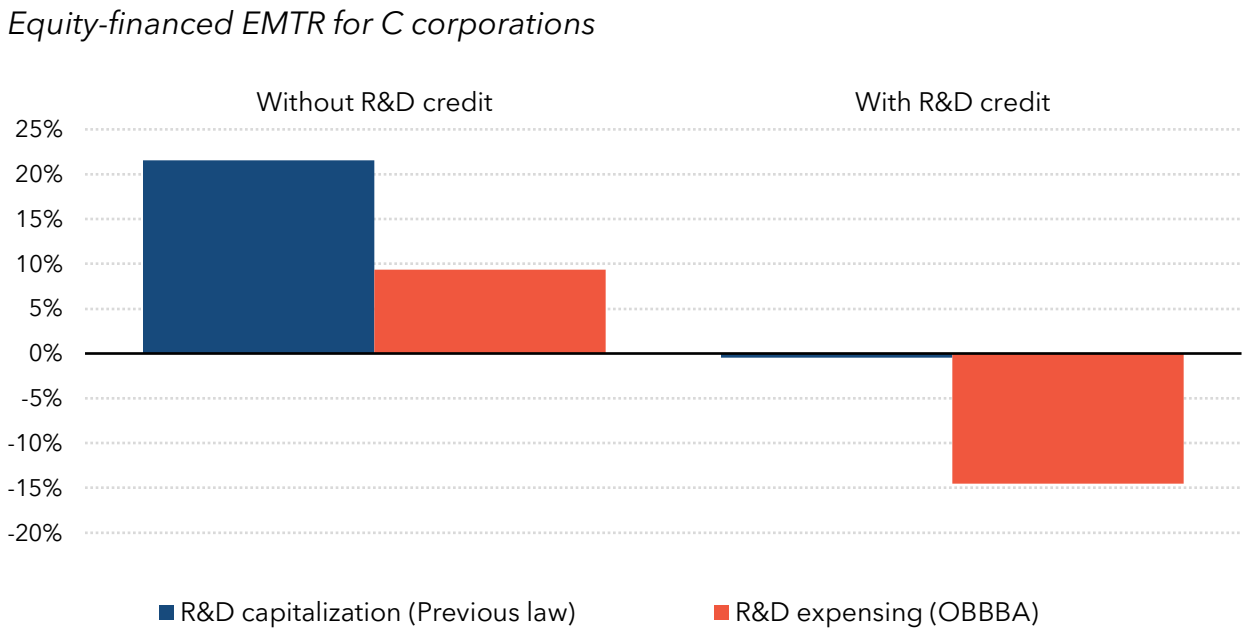
R&D investments are often riskier than other types of investments and are typically financed with equity. Under the current capitalization and amortization regime, we calculate the following:

- The reconciliation bill lowers the corporate equity-financed EMTR on R&D expenditures by about 15 percentage points. In 2025, R&D expenditures eligible for the R&E tax credit would have an EMTR of roughly 0 percent (see figure 5). In contrast, the EMTR with expensing is -14.5 percent.
- Other R&D spending (not eligible for the credit) would have faced a significantly higher EMTR of 21.5 percent with capitalization. With expensing, the EMTR will decrease to 9.4 percent.

FIGURE 5

R&D Expensing and Effective Marginal Taxation of New Investments

For C corporations, calendar year 2025



Source: Authors calculations from the investment and capital model.
Notes: EMTR = effective marginal tax rate; R&D = research and development. The blue bars display the equity-financed EMTR for R&D expenditures in 2025 under the previous regime of capitalization and amortization. The red bars show the same EMTRs when R&D can be expensed right away as under the reconciliation bill. See Brosy and Matheson (2024) for additional information on how TPC's model incorporates the R&D credit. The credit is adjusted for Internal Revenue Code section §280(c), which either adjusts deductions or the value of the credit as double-dipping between expensing and the credit is not allowed. Basis adjustment was eliminated after 2021, but OBBBA reintroduced it along R&D expensing.

DID FIRMS RESPOND TO THE R&D CAPITALIZATION REQUIREMENT?

It is still too early to fully assess how firms responded to the capitalization requirement for R&D expenditures. However, early findings by Cowx, Lester, and Nessa (2024) suggest that research-intensive domestic corporations reduced their R&D spending by approximately $12 billion in their sample of firms, equivalent to an 11 percent decline.

This measured decline may have been temporary because of expectations that expensing would be quickly reinstated. Alternatively, it is possible that the capitalization requirement disproportionately impacted lower-value or low-spillover R&D projects.

AN ECONOMIC CASE FOR SUBSIDIZING R&D

Economic research shows that R&D is a key driver of innovation and growth. Because innovations benefit society broadly, not just the firm conducting the research, the social returns to R&D often exceed private returns (see Lucking, Bloom, and Van Reenen 2018). As a result, markets tend to underinvest in projects with high social spillovers but relatively low private returns.

Tax subsidies like expensing and credits boost private R&D investment, helping bring it closer to the socially optimal level. The R&E tax credit is effective at encouraging new R&D spending (see Rao 2016), but it comes at a high cost. R&D expensing, by contrast, is less costly over the long run, while still strengthening investment incentives and improving cash flow.

HOW MUCH WILL R&D EXPENSING COST?

Permanently reinstating full expensing for R&D expenditures will cost approximately $141 billion until 2034. Although this figure appears large, much of the cost stems from the transition to expensing again, which shifts future deductions into earlier years. In fact, more than two thirds of the total revenue cost will occur in the first three years following reinstatement. In the long run, the revenue impact is small and essentially captures the present value cost of expensing relative capitalizing and amortizing.

The Qualified Business Income Deduction

The Qualified Business Income (QBI) deduction, created under the Tax Cuts and Jobs Act (TCJA), allows certain self-employed individuals and pass-through businesses to deduct up to 20 percent of their qualified business income from federal taxable income. Eligibility phases out above certain income levels, with additional limits based on wages paid and business investment. High-income "specified service trades or businesses" (SSTBs)—such as law, consulting, and health—face restrictions, while non-SSTBs, including retail, manufacturing, and real estate, generally qualify. The reconciliation bill permanently extended the deduction, which was scheduled to expire in 2026.

For eligible businesses, the QBI deduction effectively lowers their tax rate, but unlike other provisions, it is not tied to new investment. Pass-through businesses have long enjoyed tax advantages over corporations: between 1980 and 2016, their share of business income rose from 25 to 67 percent (Gale and Haldeman 2021), and their share of employment grew from 15 to 49 percent between 1982 and 2015 (Dyrda and Pugsley 2024). The 2017 corporate rate cut would have shifted the advantage to C corporations, but the QBI deduction preserved a small edge for pass-throughs. That edge, however, would disappear if the top individual rate rises to 39.6 percent, eliminating the pass-through advantage and slightly tipping the scales toward corporations for equity-financed investments. Evidence to date suggests the QBI deduction has had little effect on investment, employment, or wages (Goodman, Lim, Sacerdote, and Whitten, 2025; Risch, 2024).

HOW MUCH WILL THE QBI DEDUCTION COST?

The QBI deduction is costly: about $737 billion over the next 10 years (2025–34), and roughly $1.9 trillion for the 15 years after that (2035–49). Unlike the other provisions, the QBI deduction reduces taxes on income generated by past and future investment but only has a small impact at the margin, where bonus depreciation and R&D expensing have a much larger effect on the marginal cost of capital and minimizing the tax wedge between pass-throughs and C corporations (see Appendix figure 3 for the impact of reconciliation bill but without the extension of the 20 percent QBI deduction).

CONCLUSION

The OBBBA substantially reduces effective marginal tax rates (EMTRs) on new investments—whether financed with debt or equity and for both pass-through businesses and corporations. Bonus depreciation (full expensing) and R&D expensing are central to this reduction.

Together, these provisions lower average EMTRs to—or even below—their 2018 levels, restoring stronger investment incentives across sectors. With the addition of full expensing for structures, the manufacturing sector in particular faces a broad and significant decline in EMTRs and the cost of capital. Empirical studies suggest that a 1 percent reduction in the cost of capital increases investment by 0.5 to 1 percent, with more recent evidence pointing to even larger effects. 28 Among broad-based policies, expensing consistently delivers one of the highest returns on growth and investment relative to its cost—outperforming rate cuts—while remaining administratively simple for both businesses and government.

Reinstating the interest deduction limit at 30 percent of EBITDA aligns the U.S. with most developed economies and reduces disparities across firms—particularly those with similar pre-depreciation income but different investment profiles. Nonetheless, a debt bias remains. Under full expensing, interest deductions can drive effective marginal tax rates (EMTRs) below zero, effectively creating a federal subsidy. To address this bias, Congress could either disallow interest deductions entirely or lower the 30 percent threshold while retaining EBITDA as the income measure.

Overall, there is strong theoretical and empirical evidence that reinstating 100 percent bonus depreciation and R&D expensing will boost investment and long-run growth. Allowing expensing for structures—though temporary and novel—could stimulate short-term investment, while the reinstated interest deduction limit aligns U.S. rules with those of peer economies, even if its direct effects on investment are less clear. Both C corporations and pass-throughs stand to benefit from these policies.

The fiscal cost of these four provisions is substantial in the short run but declines over time, with an estimated 10-year cost of roughly $710 billion. By contrast, extending the QBI deduction is expected to cost nearly $750 billion over the same period, despite offering little evidence of any meaningful effect on investment or long-run growth.

TABLE A.1

Impact of OBBBA on Average EMTR by Asset Category

Mixed-financed assets, 2025

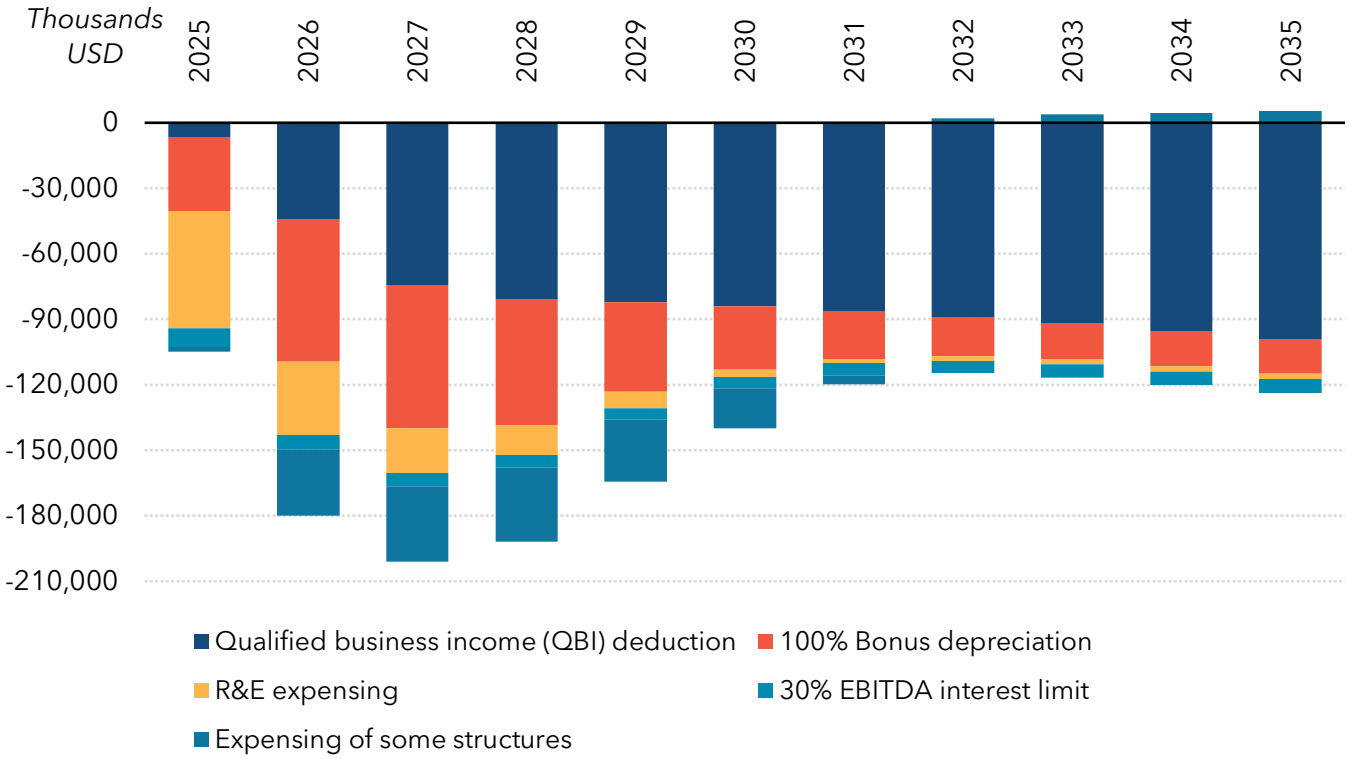
Asset category	Equity-finance		Debt-finance	
	Corporations	Passthroughs	Corporations	Passthroughs
Equipment	-7.5%	-11.2%	-13.7%	-17.3%
Structures (manufacturing)	-19.8%	-27.7%	-29.8%	-35.6%
Structures (other)	-1.9%	-2.6%	-4.9%	-5.9%
Intangibles (non-R&D)	0.0%	0.0%	-3.3%	-4.0%
R&D (with R&D credit)	-13.9%	-24.5%	-29.2%	-47.8%

Source: Authors calculations from the investment and capital model.

Notes: OBBBA = One Big Beautiful Bill Act. The table displays the impact of the OBBBA on the weighted average effective marginal tax rates at the shareholder level for C corporations and pass-throughs by category of asset. We use the distribution of assets reported by the Bureau of Economic Analysis in 2023 to determine the weights. We follow CBO's parameters (https://github.com/US-CBO/captax) for inflation, real interest rate, expected rate of return, the share of investment financed with debt, and the share of profits distributed to shareholders as dividends or buybacks. We used estimates of the average share of allowed interests by sector between 2018 and 2021, and since 2022 to estimate average EMTRs. The average marginal tax rate applied to pass-throughs comes from the microsimulation model at the Tax Policy Center. Our estimates include the impact of the R&E tax credit and the FDII deduction (for C corporations) on EMTRs. Structures (manufacturing) looks at the impact of the OBBBA on structures that benefit from the new expensing provision.

FIGURE A.1

Revenue Impact of Permanently Extending Business Provisions of the Tax Cuts and Jobs Act

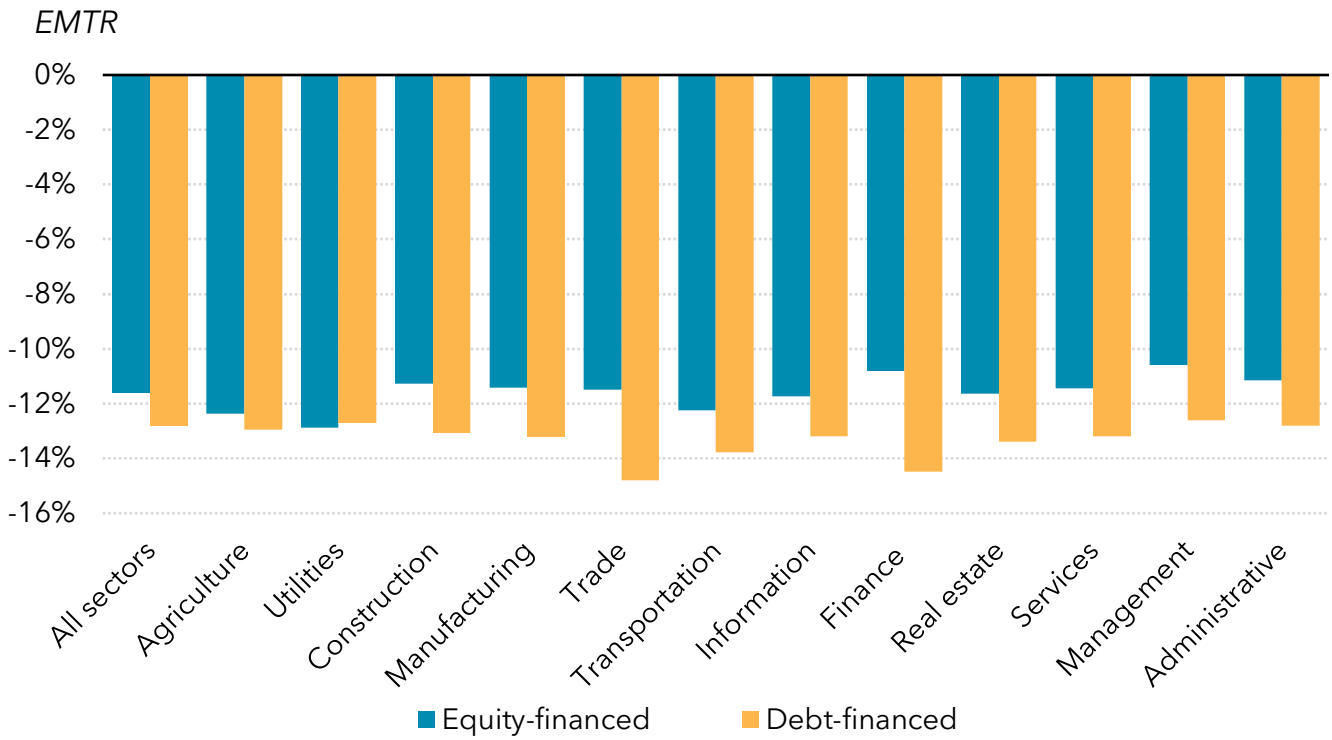


Sources Joint Committee on Taxation official estimates for 2025-2034. JCT score JCX-35-25, July 1, 2025. See https://www.jct.gov/publications/2025/jcx-35-25/). The estimates for fiscal year 2035 are from the author.

FIGURE A.2

Impact of Bonus Depreciation by Industry

Calendar year 2026



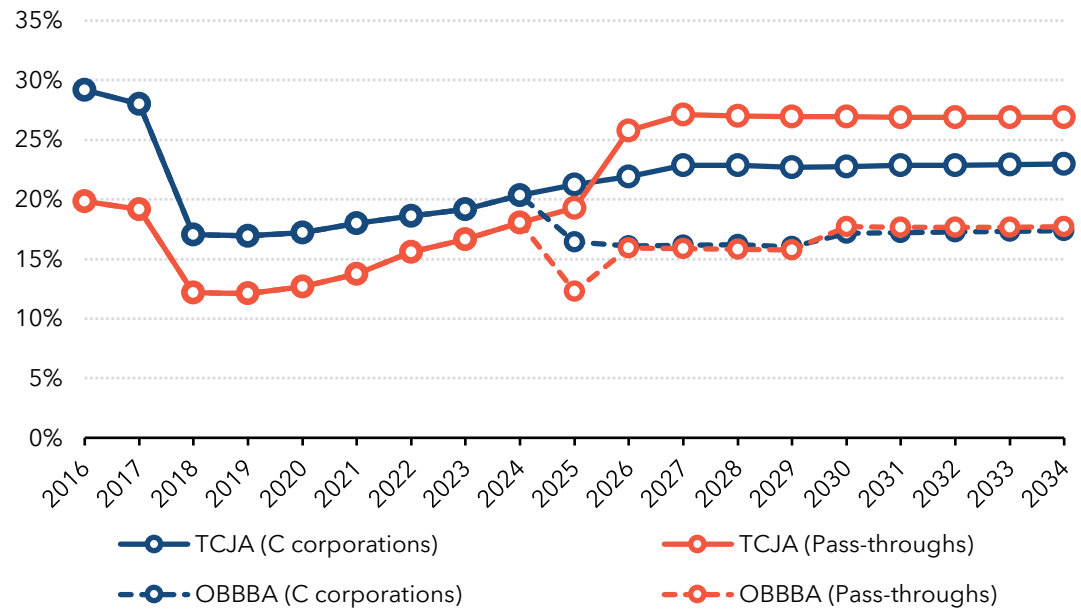
Source: Authors calculations from the investment and capital model.

Notes: EMTR = effective marginal tax rate. This graph shows the impact of bonus depreciation on average EMTR using the distribution of assets in 2023 from the Bureau of Economic Analysis, excluding assets that are not eligible for bonus depreciation. The first two bars indicate the average impact of introducing 100 percent bonus depreciation in 2026 relative to 0 percent for equity-financed investments (blue bar) and debt-financed investments (red bar). Light blue bars indicate the average decrease in EMTRs for equity-financed investments by sector, while yellow bars indicate the average decrease in EMTRs for debt-financed investments. All estimates are based on current law excluding bonus depreciation.

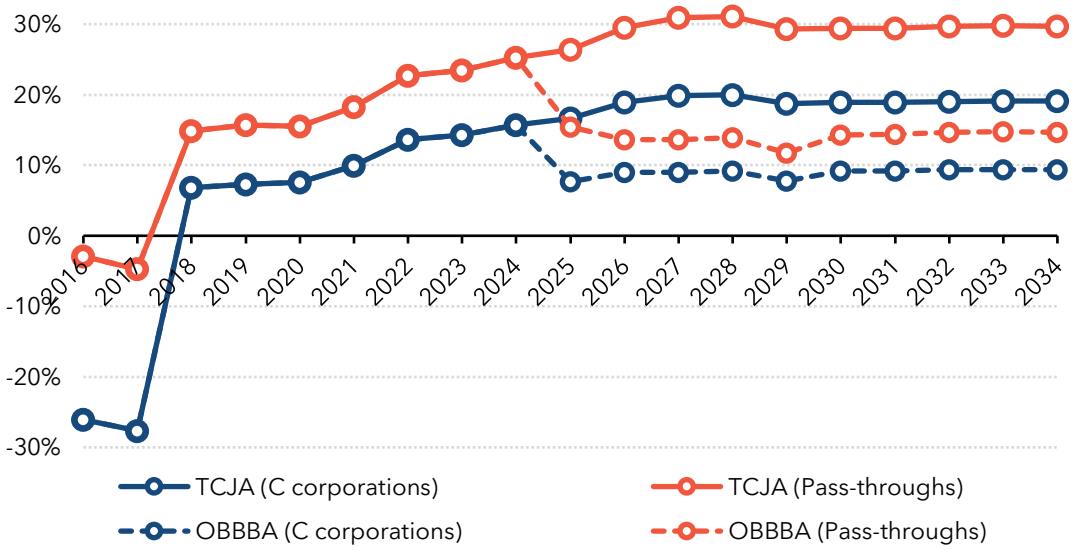
FIGURE A.3

Average Economy-Wide Effective Marginal Tax Rate (EMTR), Only Business Tax Provisions Implemented (no QBI Deduction)

Equity-financed assets



Debt-financed assets



Source: Authors calculations from the investment and capital model.
Notes: OBBBA = One Big Beautiful Bill Act. The figure plots the weighted average effective marginal tax rates at the shareholder level for C corporations and pass-throughs between 2016 and 2034. We assume only bonus depreciation, expensing of structures, R&D expensing, and previous interest limits are implemented (no QBI deduction or any other changes). We use distribution of assets reported by the Bureau of Economic Analysis in each year until 2023 to determine the weights. We follow CBO's parameters (https://github.com/US-CBO/captax) for inflation, real interest rate, expected rate of return, the share of investment financed with debt, and the share of profits distributed to shareholders as dividends or buybacks. We used estimates on the average share of allowed interests by sector between 2018 and 2021, and since 2022 to estimate average EMTRs. The average marginal tax rate applied to pass-throughs comes from the microsimulation model at the Tax Policy Center based on current law. Our estimates include the impact of the R&E tax credit and the FDII deduction (for C corporations) on EMTRs.

NOTES

1 Businesses with average annual gross receipt under $31 million can expense the remaining R&D expenditures that were capitalized and amortized between 2022 and 2024.

2 See Benjamin R. Page, "The 2025 Budget Reconciliation Act Will Increase Debt While Modestly Boosting the Economy" *TaxVox* (blog), July 23, 2025, https://taxpolicycenter.org/taxvox/2025-budget-reconciliation-act-will-increase-debt-while-modestly-boosting-economy.

3 Our EMTRs do not measure the impact of crowding out directly, because we assume a constant rate of return and interest rate, to focus on the direct impact of tax policy. However, EMTRs would capture the impact of rising interest rates and required return on equity from the increase in the federal debt and deficit.

4 In costs of capital models, economists can estimate the cost of capital equivalent to the minimum rate of return required for a marginal investment to break even. Firms will invest in productive capital with decreasing returns until the marginal return is equal to the marginal cost of investing. The tax system affects the cost of capital and fundamentally distorts investment decisions compared with a world with no taxes. Tax incentives such as investment tax credits lower the marginal cost of capital and incentivize more investment, while the treatment of depreciation or simply the tax rate can increase the cost of capital, lowering investment. The effective marginal tax rate (EMTR) is a measure of the wedge in the cost of capital created by taxes. We can define it simply as $EMTR = \frac{\rho - r}{\rho}$, where ρ is the pretax marginal cost of capital for an investment that breaks even, and r is the after-tax marginal rate of return for an investor.

5 More details on the ICM can be found at https://www.taxpolicycenter.org/resources/documentation-tax-policy-centers-business-tax-model. We also describe the model and the parameters used in more detail in the appendix.

6 We use the most recent data released by the Bureau of Economic Analysis on the distribution of assets and investments by type of assets and industries. A detailed explanation of TPC's microsimulation individual tax model can be found at https://www.taxpolicycenter.org/resources/brief-description-tax-model.

7 The reduction in the corporate income tax rate can affect investment incentives through several channels. However, when there is full expensing of new investments, the firm-level EMTR is zero (with equity finance) and the tax rate is irrelevant at the margin for eligible assets.

8 Between 2018 and 2021, changes in individual-level taxation of interest income contributed to variations in EMTRs. In 2022, tighter interest-deduction limitations further raised average EMTRs.

9 The One Big Beautiful Bill Act also increases the deduction and phase-out limit of section 179, which allows small businesses to fully expense their investments. Section 179 allows more assets to be expensed compared to bonus.

10 Assuming a 6.5 percent discount rate.

11 Although the EMTRs for pass-throughs are not shown in figure 3, they see a comparable decline. See Thomas Brosy, "House Budget Bill Would Lower Taxes for Some US Manufacturers," *TaxVox* (blog), June 6, 2025, https://taxpolicycenter.org/taxvox/house-budget-bill-would-lower-taxes-some-us-manufacturers.

12 See Brosy, Goodman, and Matheson (2024) for a discussion on take-up. Another key question for policymakers is whether the spur in capital investment affected labor markets. Garrett, Ohrn, and Suárez Serrato (2020) exploit the interaction of cross-industry variation in the benefits of bonus depreciation between 2001 and 2012 and industrial composition at the county-level. They estimate strong employment responses but no effect on earnings per worker, concluding that their findings "suggest federal corporate tax policy has large effects on local labor markets." Leveraging matched employer-worker microdata from manufacturing establishments, Curtis and coauthors (2022) find strong complementary between capital inputs and labor. Bonus depreciation lowered production costs and led to an increase in employment but had no impact on wages, assuaging concerns that plants would replace workers with machines.

13 See Congressional Budget Office, "CBO's Model for Estimating the Effects on New Investment of Deductions to Recover the Cost of Capital," December 2024, https://www.cbo.gov/system/files/2024-12/60985-Effects-of-Capital-Cost-Recovery.pdf.

[14] A major concern with temporary policy is how much the observed outcomes reflect higher long-term investment and shifting planned future investment to take advantage of the policy.

[15] Previously, House and Shapiro (2008) had found a similar response during the first episode of bonus depreciation using aggregate investment data, and Edgerton (2012) found strong responses by public firms analyzing financial statement data.

[16] Hartley, Hassett, and Rauh (2025) use variation on the change in cost of capital to estimate the impact of full bonus depreciation introduced by the TCJA. Assetts with greater reductions in user cost of capital had higher investment rates. They report that 1 percentage point decrease in the user cost of capital is associated with a 1.68 to 3.05 increase in the rate of investment.

[17] Recent research has also shown some of the unintended consequences of bonus depreciation. Ohrn finds that for publicly traded firms, bonus depreciation led to an increase in executive compensation. He shows that for a one dollar increase in value from the tax break, compensation for top executives went up by 17 to 25 cents, a significant fraction of the value for the firms, and argues that this response is driven by executive rent extraction. See Ohrn (2023).

[18] A simple example can illustrate these mechanics. There is $100 of investment each year, and the regular tax depreciation schedule is $20 each year. In the year when expensing is implemented, firms will deduct $100 (the current year investment) and another $60 ($20 for the past three years) in leftover cost recovery from previous investment. In the following year, firms will deduct $180 ($100 of new investment and $20 of depreciation for the past four years). In the fifth year following the implementation, total depreciation will be $100 again.

[19] The impact of bonus depreciation on tax burden is more complicated to assess. From the perspective of a business owner, the value of bonus depreciation is the difference in present value between expensing part or all their investment and depreciating the asset over time. Hence, only a fraction of the revenue cost is borne by taxpayers. Changes in depreciation rules also fall largely on normal returns, such that labor bears a much larger share of the burden compared with a change in the corporate tax rate. TPC assumes that labor income bears 50 percent of the burden on normal returns.

[20] Internationally, most OECD countries and other large economies have thin capitalization rules, often dating back to the 1990s and early 2000s, but sometimes earlier. Canada introduced limits to the deductions of interest expenses in 1972, France in 1979, and the United Kingdom in 1988 (Blouin, Huizinga, Laeven, and Nicodème 2013). In Europe, most countries disallow interest deductions above 30 percent of EBITDA.

[21] See Toder (2017) "What is the Difference between the Current Corporate Income Tax and a Destination-Based Cash Flow Tax?", Tax Policy Center.

[22] See CBO January 2025 parameters at: https://github.com/US-CBO/captax/blob/main/captax/data/inputs/environment_parameters/debt_shares.csv; and: https://github.com/US-CBO/captax/blob/main/captax/data/inputs/environment_parameters/environment_parameters.csv

[23] Jordan Richmond, Lucas Goodman, and Adam Isen, "Tax Policy, Investment, and Firm Financing: Evidence from the US Interest Limitation," unpublished manuscript, 2025.

[24] Firms that were not constrained then may have a different marginal source of financing and react differently. Nonlinear responses are also likely with fixed leverage adjustment costs, and there is a need for more evidence on the impact of the 2022 tightening in a higher interest rate environment to better understand the policy.

[25] For details on how TPC incorporates the R&D tax credit into the cost of capital model, see Brosy and Matheson (2024).

[26] The law does not allow "double-dipping," which means that companies can either get a lower tax credit or add the value of the tax credit back to their taxable income.

[27] Importantly, a vast majority of R&D expenditures are wages. Even though companies could theoretically reclassify wages for workers in R&D as regular wages and deduct them from taxable income immediately, these expenses would not be eligible for the R&E credit, which is more valuable for a given investment than the ability to immediately expense. Likely, a vast majority of R&D expenditures were capitalized and amortized starting in 2022.

[28] See "The Case for Temporary 100 Percent Expensing: Encouraging Business to Expand Now by Lowering the Cost of Investment. ". U.S. Department of the Treasury's Office of Tax Policy Report. 2010. https://home.treasury.gov/system/files/131/Report-Temporary-100percent-Expensing-2010.pdf

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