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Key Tax Law Changes for Fund Managers Under the One Big Beautiful Bill Act

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The "One Big Beautiful Bill Act" (OBBBA), signed into law on July 4, 2025, brings important changes for investment funds. The OBBBA also omits several anticipated provisions that would have adversely impacted investment funds. This alert highlights nine of the most relevant tax-related provisions and omissions and their practical effect on private equity and venture capital fund managers.

1. Carried interest

Key takeaway: The final legislation **does not change** the tax treatment of carried interest. Congress had considered proposals to further limit the applicability of long-term capital gains rates to carried interest, but these were not ultimately included in the OBBBA.

Implications and considerations

- The current regime remains in place, which generally taxes allocations of capital gains in respect of carried interest at favorable long-term capital gains rates (subject to a three-year holding period).

2. Pass-through entity taxes (PTET) and SALT deductions

Key change: For taxable years beginning after December 31, 2024, the state and local tax (SALT) deduction cap is temporarily increased from $10,000 to $40,000 (with phaseouts for high-income taxpayers[1]) through 2029. Importantly, the OBBBA **does not limit or repeal the PTET workaround** (which is a change from the proposal passed in the House), allowing pass-through entities to continue to deduct state taxes at the entity level.

Implications and considerations

- Management company entities of investment firms that are structured as partnerships or S corporations can continue to benefit from PTET regimes in states that offer them.
- Fund managers should review state conformity and election requirements to maximize effective SALT deductions for pass-through owners

3. Qualified small business stock (QSBS)

Key change: The OBBBA significantly **expands** the benefits of and eligibility for QSBS under Internal Revenue Code Section 1202 for stock acquired after July 4, 2025:

- **Partial gain exclusion** is now available for QSBS held at least three years (50% exclusion) or four years (75% exclusion), with the full 100% exclusion retained for qualifying investments held for five years.
- The **gain exclusion cap** increases from $10 million to $15 million, indexed for inflation.
- The **aggregate gross assets threshold** for a company to qualify as a "small business" increases from $50 million to $75 million, also indexed for inflation.
- Refer to our July 11 client alert on the OBBBA's QSBS benefits for more information.

Implications and considerations

- These changes make QSBS an even more attractive and accessible planning tool for investment funds (particularly venture capital funds) investing in qualifying portfolio companies.
- Fund managers should consider investment transactions, structures and holding periods to maximize QSBS benefits for both

the fund and its qualifying investors.

4. Interest deductibility

Key change: For taxable years beginning after December 31, 2024, the OBBBA permanently **restores the more generous EBITDA-based limitation** for business interest expense under Section 163(j), allowing deductions of up to 30% of adjusted taxable income plus business interest income – calculated in a manner similar to earnings before interest, taxes, depreciation and amortization (EBITDA) rather than earnings before interest and taxes (EBIT) and determined without regard to subpart F and global intangible low-taxed income (GILTI) inclusions (and the associated gross-ups). However, the Section 163(j) limitation now applies before the interest capitalization rules are applied, so that interest expense that is capitalized into the basis of assets is subject to the Section 163(j) limitation and included for purposes of applying the 30% cap.

Implications and considerations

- Subject to the interest capitalization changes referenced above, portfolio companies with significant leverage will benefit from increased interest deductibility, improving after-tax cash flow and potentially enhancing returns.
- Capitalizing domestic blocker corporations (often set up for foreign and tax-exempt investors) with debt and equity could result in less corporate income tax drag.

5. Section 899 'revenge tax'

Key takeaway: Proposed Section 899 from the House version of the bill (discussed in this June 30 client alert), which would have increased tax rates on residents of "discriminatory foreign countries," was **not included** in the OBBBA.

6. Endowment tax

Key change: For taxable years beginning after December 31, 2025, the excise tax on net investment income of large private college and university endowments is expanded to a **tiered rate structure** (1.4%, 4% and 8%) from the current uniform 1.4% rate, based on endowment size per student,[2] but the threshold for application increases from 500 to 3,000 tuition-paying students.

Implications and considerations

- The higher student threshold will reduce the number of institutions subject to the tax, but those affected (especially for institutions with larger endowments) may see increased tax liabilities.
- It remains to be seen how the increased excise tax rates will impact investment decisions by affected university endowments.

7. Cuts to tax benefits for green-energy projects

Key change: The OBBBA **accelerates the phase-out and termination** of many clean energy tax credits enacted under the Inflation Reduction Act, including the investment tax credit (ITC), production tax credit (PTC) and others. New restrictions are imposed on projects involving "prohibited foreign entities."

Implications and considerations

- Investment funds investing in renewable energy should reassess project timelines, as eligibility for credits now depends on construction and placed-in-service dates.
- Increased compliance and diligence are required to avoid foreign entity restrictions.
- Fund managers should model the impact of reduced or eliminated credits on project returns and consider alternative structures or exit strategies.

8. Miscellaneous itemized deductions for US individuals

Key change: The OBBBA **permanently disallows** miscellaneous itemized deductions, continuing the disallowance introduced in the 2017 Tax Cuts and Jobs Act (TCJA) that was set to expire in 2026.

Implications and considerations

- Consistent with current law, fund manager principals and investors that are high net worth individuals and members of family offices are unable to deduct certain expenses incurred by investment funds, such as management fees, investment advisory fees, and certain legal and accounting costs.

9. Downward attribution rules for controlled foreign corporations (CFCs)

Key change: For taxable years of foreign corporations beginning after December 31, 2025, the OBBBA **eliminates downward attribution** for purposes of determining CFC status, reversing the expansion introduced by the TCJA. However, the downward attribution rules still apply in certain “de-control” transactions. For more information regarding CFCs and the OBBBA’s other international tax provisions, please refer to our July 21 client alert.

Implications and considerations

- Fewer foreign corporations will be classified as CFCs solely due to US ownership of lower-tier foreign entities, meaning that a single US subsidiary in a foreign parented group will not cause all the foreign sister subsidiaries to be CFCs.
- This change may reduce US tax and reporting obligations for funds with complex international structures.
- Fund managers should review existing structures to determine if any entities will lose CFC status and adjust compliance processes accordingly.

For further analysis or to discuss the implications for your specific fund structure, please contact a member of your Cooley team.

[1] A taxpayer’s cap on SALT deductions is subject to a phaseout under which it is reduced by 30% of the amount of such taxpayer’s modified adjusted gross income above a threshold amount (but the cap cannot be reduced below a minimum of $10,000). The threshold amount is $500,000 for taxable years beginning in 2025, with annual increases by 1% per year through 2029. In other words, the cap is reduced to $10,000 for those with income above $600,000 (with annual 1% increases to this income threshold).

[2] The endowment size per student is calculated by dividing the aggregate fair market value of the institution’s assets (excluding those used directly in carrying out the institution’s exempt purpose) by the number of tuition-paying students. Under the OBBBA’s three-tier rate structure, the excise tax rate is 1.4% for endowment sizes per student between $500,000 and $750,000, 4% for amounts between $750,001 and $2 million, and 8% for amounts exceeding $2 million.

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