

## **I. MAINE TAX CONFORMITY AND FEDERAL PUBLIC LAW NO. 119-21<sup>1</sup>: OVERVIEW**

### **A. Overview of Federal/Maine Conformity Considerations**

Historically, Maine has chosen to “conform” to provisions of the federal Internal Revenue Code. This usually is done in a routine bill, adopted every legislative session, by updating certain definitions in Title 36 of the Maine Statutes to conform to the current federal definitions of those same terms. As of the date of this report, Maine conforms with federal tax law effective December 31, 2024.<sup>2</sup>

Conforming in this manner offers substantial advantages to taxpayers and the State. For taxpayers, filing their Maine income tax returns is relatively simple; once they have prepared their federal returns, they can simply take the relevant figures from particular lines of their federal returns and enter them on their Maine returns, adjusting as necessary to reflect differences between federal and Maine law. For the State, conforming with these federal definitions greatly simplifies tax administration; for instance, there is no need for Maine Revenue Services and the Maine courts to consult a separate body of law for guidance on who qualifies as a “dependent” because, thanks to conformity, Maine looks to the statutory, caselaw, and regulatory authority developed at the federal level.

It is important to note that there is a sense in which the word “conformity” is misleading. Maine traditionally adopts certain provisions of federal law, but the two are by no means identical. For instance, there are deductions available at the federal level not available for Maine tax purposes, just as there are Maine deductions not available for federal income tax purposes.

Maine achieves individual income tax conformity by adopting the federal definition of “adjusted gross income” (in this report, “FAGI;” verbally, each letter sound is pronounced separately) and certain other critical federal tax terms. FAGI is determined by taking gross income—which is all income, from whatever source, including, but not limited to, wages, business income, investment income, and retirement distributions—and subtracting certain federal deductions provided by the federal Internal Revenue Code (the “Code”), such as, for example, contributions to certain retirement accounts, student loan interest paid, a portion of self-employment tax paid, and certain types of combat pay. Generally, the allowable deductions are listed on federal Form 1040, Schedule 1, Part II. These

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<sup>1</sup> ACT To provide for reconciliation pursuant to title II of H. Con. Res. 14, also known as the “The One Big Beautiful Bill Act.”

<sup>2</sup> P.L.2025, c. 432.

deductions are often referred to as “above the line” deductions. Thus, all other deductions are called “below the line” deductions.

For federal law purposes, there are essentially two ways to approach below the line deductions. Approximately 90% of taxpayers take the standard deduction, a flat amount that is the same for all similarly situated taxpayers. The remainder opt to itemize their deductions.

Maine’s treatment of itemized deductions differs from the federal treatment in two important ways. First, Maine caps the allowable itemized deduction for any given individual at \$35,250 plus certain medical expenses. Secondly, Maine law specifically disallows certain federal below the line deductions, including state sales and income taxes, certain expenses associated with Maine-taxable financial institution income, and expenses incurred in the production of income which is exempt from Maine tax.

To further complicate matters, federal law recognizes two categories of “below the line” deductions: most are itemized deductions, which are calculated on Schedule A of the federal 1040.<sup>3</sup> There are also some federal deductions, like the deduction for “qualified business income,” which appear below the line but are given their own line on the federal 1040, rather than being grouped in with other itemized deductions on Schedule A.

Since Maine law traditionally conforms by taking FAGI as the starting point for calculating Maine tax due, any changes in federal law that create or modify “above the line” deductions would be automatically incorporated into Maine’s tax base, should the Legislature adopt a standard conformity bill.<sup>4</sup> There would be no need for separate consideration by the State (although of course Maine could decouple from federal law any time by adopting only limited conformity), and no complication for taxpayers. Any changes in federal law that create or modify Schedule A “below the line” deductions would be treated in a similar manner because the State also offers itemized deductions based on the

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<sup>3</sup> Familiar Schedule A itemized deductions include certain medical and dental expenses, state and local taxes, certain home mortgage interest and related expenses, and charitable gifts, among many others; Maine law allows individual taxpayers to use federal itemized deductions as the starting point for calculating their Maine itemized deductions, with certain specific exemptions and subject to other limitations discussed below; *see generally* 36 M.R.S. 5125.

<sup>4</sup> Some states practice “rolling” conformity, which operates by having a provision in state law to the effect that any changes to relevant federal definitions will automatically be incorporated into that state’s law without any legislation or other formalities needed. For various customary and constitutional reasons, Maine’s approach is “static” conformity, by which the Legislature needs to adopt legislation each session conforming to the federal Code as of a date certain. Currently, Maine conforms as of December 31, 2024. For simplicity, except where explicitly stated otherwise, this memorandum assumes that Maine will continue its historical practice of adopting static dates for conformity, and when we discuss a change that would occur “automatically,” we merely mean a change that would, upon adoption of a new static conformity date, occur by virtue of the math, without any special language or adjustments to Maine tax law or the Maine tax forms.

federal deductions (although the cap on Maine itemized deductions means the economic consequences to Maine of conforming to federal below the line deductions will be limited). The changes in federal law that create non-itemized below the line deductions need to be carefully reviewed, but it is likely they would not automatically apply against Maine taxable income unless the Legislature specifically adopts them.<sup>5</sup>

## **B. Overview of P.L. 119-21 Structure and Considerations.**

P.L. 119-21, frequently referred to as the “One Big Beautiful Bill Act” (or, for purposes of this summary, “the Act,”) is the most significant overhaul of the Internal Revenue Code since 2017’s Tax Cuts and Jobs Act (the “TCJA”). It contains a wide variety of amendments to the Code, most of which do not raise particular conformity or other state law concerns and therefore are beyond the scope of this report.

The bulk of the provisions of the Act relate to making permanent provisions of the TCJA that were scheduled to expire. Although many of these changes are significant and many will have important budgetary impacts in Maine relative to the baseline assumption that they would sunset at the end of 2026, none of them raise immediate conformity concerns.

The Act also focuses on terminating or modifying various federal credits, such as the credit for used energy-efficient vehicles and the credit for energy-efficient property. Most of these provisions are prospective, but a few apply retroactively. However, changes to federal credit programs generally have no impact on Maine tax liability and therefore do not raise conformity challenges and are not discussed in detail in this report.

The Act also creates a number of new deductions and modifies several existing ones; many of those changes are retroactive to 2025, and they are each examined in detail in this preliminary report. In addition, the Act makes several miscellaneous changes that will modify taxes on businesses and business owners in various ways. The provisions which will be likely or certain to create conformity challenges for tax year 2025 are discussed below.

## **C. Conformity and Retroactivity**

Most of the provisions of the Act apply to tax years beginning on or after January 1, 2026. The Maine Legislature will have ample time to examine and decide whether and to what extent to conform to those provisions when it reconvenes in 2026. However, there are

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<sup>5</sup> The upcoming administrative treatment by the IRS of several of the new federal deductions is currently unclear and may impact taxpayers and the State. For instance, the Maine tax forms will need to coordinate with the form design decisions made by the IRS in the placement and description of certain deductions as below- or above-the-line adjustments.

a number of provisions of the Act which apply to the 2025 tax year (or earlier). Given the current legislative schedule, Maine's ability to conform to those items for tax year 2025 and begin the filing season on schedule, will be limited.<sup>6</sup> This preliminary report focuses on the retroactive provisions of the Act. Detailed analysis of the non-retroactive provisions will follow.

If Maine does not adopt retroactive conformity in 2025, Maine taxpayers will be confronted by a distinction between their 2025 FAGI as reflected on their federal returns and the FAGI used on their Maine returns. Reconciling these differences will require careful attention to the design of Form 1040ME and related forms, a project that is already underway. Therefore, decisions to address meaningful retroactive conformity will need to be made as soon as feasible.

The IRS typically begins the individual income tax filing season in mid-to-late January for the previous year.<sup>7</sup> In order to secure the start of the 2025 tax season in a timely manner, Maine should provide final versions of the 2025 Form 1040ME and associated schedules and worksheets to MRS software contractors as soon as possible. These finalized forms are also relied upon by external vendors to accurately develop tax return tax filing software for the public. The completion of final forms will require guidance on whether Maine will conform to all, a portion, or none of the provisions of the Act. The IRS has not yet released a draft of the redesigned 2025 Form 1040; it may not be possible to get clarity on federal treatment until it does, although Maine Revenue Services is carefully monitoring federal announcements regarding form design and has developed related contingencies. In any case, for purposes of this report, it is important to note that Maine forms will need to be updated to reflect federal changes, whether or not Maine chooses to conform to the provisions of the Act for 2025, but that it is premature to get into detail on where precisely the conformity or nonconformity will be reflected on Form 1040ME.

## **II. Detailed Analysis: Retroactive Individual Income Tax Provisions**

### **A. Increased Standard Deduction**

Prior to the Act, the federal standard deduction for 2025 was scheduled to be \$15,000 for single taxpayers and married taxpayers filing separately, \$22,500 for taxpayers

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<sup>6</sup> The options and manner for temporarily conforming to some of those items pursuant to recently-enacted P.L.2025, C. 336 ("An Act to Address the Effect of Changes to Federal Income Tax Laws on Maine Income Tax Laws") are currently under review.

<sup>7</sup> For example, the IRS "opened" the 2024 tax season for individual income tax returns covering tax year 2023 on January 29, 2024. MRS typically begins the filing season for Maine individual income tax returns on or near the same day as the IRS.

filing as head of household, and \$30,000 for married taxpayers filing jointly. The Act slightly increases those amounts, effective for tax year 2025, to \$15,750, \$23,625, and \$31,500, respectively.

Maine law currently provides that for tax year 2025<sup>8</sup>, the standard deduction shall be equal to the federal standard deduction, subject to phase-out for certain high-income taxpayers. Since Maine currently conforms to the Code as of December 31, 2024, under existing law, Maine would conform to the pre-Act standard deduction amounts, rather than the amounts as modified. If Maine opts to conform to the Act changes for 2025, the amount of the standard deduction would be increased slightly. No revisions to forms would be necessary, and overall revenues would be reduced by approximately \$31 million.<sup>9</sup> If Maine does not opt to conform to this provision for 2025, the 1040-ME will need to be drafted to provide taxpayers the appropriate figure to insert, rather than simply cross-referencing the appropriate line of the taxpayer's federal 1040.

## **B. Temporary Senior Deduction**

The Act creates a new deduction of up to \$6,000 per qualifying individual, for tax years 2025 through 2028. Qualifying individuals are taxpayers aged 65 and older who provide a valid Social Security Number on their returns. The deduction is reduced by an amount equal to 6% of the taxpayer's modified gross income in excess of \$75,000 (\$150,000 for married taxpayers filing jointly) but can never be less than zero.<sup>10</sup>

There has been some debate about whether this deduction would appear above or below the line, however it is included in the Code section relating to personal exemption deductions, which are typically below the line. The legal classification of this deduction and potential inclusion in Maine tax law should Maine's conformity date be updated is currently under review. Final IRS treatment of the deduction for federal income tax form purposes has not been established. Absent an update of the conformity date Maine would not conform to this deduction.<sup>11</sup> However, if Maine were to conform, any change in the expected federal treatment mentioned above could cause delays in developing Maine

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<sup>8</sup> P.L.2023, c. 412 amended the standard deduction to maintain consistent levels after the TCJA's increased standard deduction expired at the end of 2025. The Maine standard deduction for tax years 2026 and later may need to be updated to account for the changes made by the Act, either adopting the increased federal standard deduction or maintaining the current benefit level enacted by P.L.2023, c. 412.

<sup>9</sup> All revenue estimates in this memo are preliminary and likely to change as further information becomes available.

<sup>10</sup> Maine has enacted provisions in recent years addressing similar concerns by exempting pension income up to the maximum annual social security benefit amount (subject to certain phaseouts). In addition, Maine has a longstanding exemption for all social security benefits.

<sup>11</sup> Whether Governor direction pursuant to P.L.2025, C. 336 could allow temporary conformity to items lacking a direct conformity linkage is still under review.

income tax forms (MRS has developed certain contingencies); the estimated revenue loss for the 2025 tax year would be approximately \$31 million.

### **C. No Tax on Tips**

The Act provides a temporary federal deduction for tips received by employees in certain industries. The deduction is capped at \$25,000 per year per taxpayer, though it phases out by \$100 for every \$1,000 of modified adjusted gross income above \$150,000 (or \$300,000, for married taxpayers filing jointly). Tips are only deductible if they are received voluntarily in connection with employment in an industry where the IRS deems tipping customary, are properly reported to the IRS, and meet other eligibility requirements. The federal deduction will be available for tax years 2025 through 2028.

The legal classification of this deduction and potential inclusion in Maine tax law should Maine's conformity date be updated is currently under review. In addition, the IRS treatment of the deduction for federal income tax form purposes has not been established, complicating the development of Maine state income tax forms that must utilize the federal forms. Absent an update of the conformity date Maine would not conform to this deduction.<sup>12</sup> However, if Maine were to conform to this provision for 2025, the revenue loss would be approximately \$9 million.

### **D. No Tax on Overtime**

The Act also includes a temporary federal deduction for certain overtime pay. The deduction is capped at \$12,500 per year (\$25,000 for joint filers), and phases out by \$100 for every \$1,000 of modified adjusted gross income above \$150,000 (\$300,000 for joint filers). Structurally, the provision is very similar to the deduction for tip income: the deduction is available for tax years 2025 through 2028, and is available to taxpayers regardless of whether they take the itemized deduction.

The legal classification of this deduction and potential inclusion in Maine tax law should Maine's conformity date be updated is currently under review. In addition, the IRS treatment of the deduction for federal income tax form purposes has not been established, complicating the development of Maine state income tax forms that must utilize the federal forms. Absent an update of the conformity date Maine would not conform to this deduction.<sup>13</sup> However, if Maine does conform to this provision for 2025, the change would have a revenue loss of approximately \$28 million.

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<sup>12</sup> Whether Governor direction pursuant to P.L.2025, C. 336 could allow temporary conformity to items lacking a direct conformity linkage is still under review.

<sup>13</sup> Whether Governor direction pursuant to P.L.2025, C. 336 could allow temporary conformity to items lacking a direct conformity linkage is still under review.

## **E. Temporary Deduction for Car Loan Interest**

Generally speaking, individuals cannot deduct ‘personal interest,’ meaning interest incurred in connection with a loan to purchase property for personal use. The Act creates a temporary federal exception to that rule: for tax years 2025 through 2028, individuals can deduct up to \$10,000 of car loan interest per year, subject to a phase-out for taxpayers with more than \$100,000 of modified adjusted gross income (\$200,000 for joint filers). The debt must be incurred after December 31, 2024, for the purchase of a new personal use vehicle with a gross vehicle weight rating of under 14,000 pounds, for which final assembly was completed within the United States, and which meets certain other requirements.

The legal classification of this deduction and potential inclusion in Maine tax law should Maine’s conformity date be updated is currently under review. In addition, the IRS treatment of the deduction for federal income tax form purposes has not been established, complicating the development of Maine state income tax forms that must utilize the federal forms. Absent an update of the conformity date Maine would not conform to this deduction.<sup>14</sup> Should Maine affirmatively choose to conform for 2025, the revenue loss to the state is approximately \$9 million.

## **F. Increased State and Local Tax Deduction**

The TCJA capped the individual federal deduction for state and local taxes at \$10,000. That cap was scheduled to sunset on December 31, 2025. The Act made the limitation permanent and temporarily increases the cap from \$10,000 to \$40,000 for tax years 2025 through 2029.<sup>15</sup>

The deduction for state and local taxes has always been a below the line deduction and therefore is available only to taxpayers who itemize their federal deductions (although quadrupling the amount of the potential state and local tax deduction will likely increase the proportion of Mainers who choose to itemize deductions). Further, Maine has traditionally not permitted a deduction for state and local sales and income taxes, though it does allow an income tax deduction for the amount of local property tax paid.

Because Maine does not allow a deduction for state and local income taxes and does not currently conform to the \$10,000 federal cap with respect to property taxes there is not a compelling need for immediate action to retroactively address the federal increase.

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<sup>14</sup> Whether Governor direction pursuant to P.L.2025, C. 336 could allow temporary conformity to items lacking a direct conformity linkage is still under review.

<sup>15</sup> The cap is increased by 1% per year during that period; it is also subject to phaseout for taxpayers with federal Modified Adjusted Gross Income greater than \$250,000 (or \$500,000, for taxpayers filing jointly) in 2025 (the phaseout threshold is also increased by 1% per year for each year during the period).

Many states have responded to the cap on federal state and local tax deductions by creating a new, entity-level tax (often called a “Pass-Through Entity Tax” or “PTET”) coupled with a credit for individual members of the entity, which effectively allows owners of certain sorts of “pass-through entities” to cause the entity, rather than its owners, to pay state tax on the income it generates, and then gives the owners a credit for the amount of tax paid on their behalf by the pass-through entity. Maine has not adopted such a statute, although the Legislature has considered it. Under current IRS guidance, there is no limit to the amount of state tax that may be deducted for federal purposes if the tax is paid at the entity level; thus, a PTET regime allows a tax benefit to certain high-income taxpayers, without costing the state any net tax revenues. Although the increased cap on state and local taxes will reduce the demand on Maine to establish a similar PTET regime, it would still be of benefit to a significant number of taxpayers, and therefore LD 191, introduced in the 132<sup>nd</sup> Legislature, which would enact such a tax and was carried over in the Taxation Committee, is expected to receive significant interest. However, it would be extremely difficult, if not impossible, for Maine to implement a retroactive PTET regime at this point in the year.

#### **G. Qualified Disaster Losses and Qualified Farmland Sales**

The Act also contains a number of changes to the federal treatment of disasters. Most of these changes apply to tax years 2026 and forward, but one very minor change applies to a portion of 2025, as well: under prior law, taxpayers qualified for certain specific filing benefits if they were victims of “qualified disaster losses;” a disaster loss was a qualified disaster loss only if, among other things, it related to a disaster that occurred on or before January 11, 2025. The Act extends that date, so that disaster losses will still qualify as long as the disaster occurs before July 5, 2025. Maine conforms to the treatment of qualified disaster losses; retroactively conforming to this provision (likely through action pursuant P.L. 2025 C. 336 discussed in more detail below, rather than formal act of the Legislature) would simplify the relationship between federal and state law, at little or no cost to Maine, since it would only affect the handful of Maine taxpayers who were victims of natural disasters in other states during the period in question.

Another provision with a similarly modest effect relates to sales of “qualified farmland property.” The Act creates a new rule allowing sellers of “qualified farmland property” to elect to pay capital gains taxes resulting from the sale over four equal annual installments, rather than all at once in the year of the sale. “Qualified Farmland Property” is U.S. property used as a farm or leased to a farmer, which has been used substantially for farming purposes for the ten years prior to sale, and is subject to prohibitions on non-farm use for at least ten years following the sale. The new provision applies to sales and exchanges in tax years beginning after the date of enactment. It is not immediately clear



how many farmland sales are likely to qualify under this provision or how many farmers will elect to take it, but the costs to conformity for the last six months of 2025 are likely to be negligible and should Maine elect retroactive conformity here, it likely would avoid some difficulties at minimal cost in foregone revenues. The reduced administrative burden, however, would likely justify using the administrative provisions of P.L. 2025 C. 336 to order such a change.<sup>16</sup>

The Office of Tax Policy (OTP) recommends adopting retroactive conformity to both of those provisions through the P.L. 2025 C. 336 process.<sup>17</sup>

### **III. Detailed Analysis: Retroactive Business Income Tax Provisions**

#### **A. Section 179 Expensing Limits**

Section 179 of the federal Code allows immediate expensing of certain business property. Prior to the enactment of the Act, there was an annual statutory limit--\$1,250,000 for property purchased in 2025—on the amount eligible for section 179 expensing. Further, the limit was phased down once property placed in service during the year exceeds a certain threshold--\$3,130,000, for 2025 property—so that the more property that is placed in service, the less is eligible for immediate expensing under section 179.

The Act changed the statutory limit to \$2,500,000 and the phasedown threshold to \$4,000,000 for property acquired after December 31, 2024; both amounts will be adjusted for inflation going forward.

Maine conforms with federal law for purposes of section 179 expensing, but that conformity extends to the Code as it stood on December 31, 2024, and therefore will not automatically incorporate the increased limit and phasedown thresholds. Unless Maine chooses to conform to the Act changes for 2025, taxpayers will be eligible to expense more property under Section 179 for federal purposes than they will for Maine purposes, and will

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<sup>16</sup> A handful of other provisions would have negligible revenue effects but would create complications were Maine not to conform. In particular, the Act would allow certain educational credentialing expenses to be treated as qualified higher education expenses for purposes of 529 account distributions, would treat spaceports like airports for purposes of the tax-exempt bond facility rules, would allow the exclusion of a portion of the interest income on loans secured by agricultural and rural real property, and would allow immediate deduction of up to \$150,000 of expenses related to qualified sound recording productions.

<sup>17</sup> Briefly, upon a finding that “the Legislature has not had the opportunity before the bureau begins processing returns for the most recently completed tax year to conform or adjust Maine laws in response to federal...changes affecting the tax year,” the Governor may order the Assessor to adjust the administration of taxes for the affected year; such changes must be consistent with the intent of the Legislature, as reflected in enacted laws, and must be made after consideration of the budgetary implications of the changes and the extent to which doing so reduces complexity of tax filing and administration.

need to track the difference going forward. This decoupling would be logistically quite difficult, particularly if Maine chooses to conform to the Act's change for tax years 2026 and forward, but not for 2025.

Retroactively complying with the Act's 2025 increased expensing limits would have an estimated cost of just under \$2 million. Given the significant complexity failing to retroactively conform would create, and the relatively modest cost of conformity to this item, OTP recommends conforming to this provision retroactively, even if Maine chooses not to retroactively conform to any other provisions of the Act.

## **B. 100% Bonus Depreciation**

The 2017 TCJA allowed purchasers of qualifying equipment to elect to take additional, "bonus" depreciation in the year of purchase.<sup>18</sup> The amount of the bonus was 100% for the first few years following the TCJA, but reduced gradually by 20 percentage points per year, and was scheduled to be 40% for 2025. However, the Act permanently set bonus depreciation at 100% for eligible property purchased after January 19, 2025.

Generally speaking, capital purchases of business equipment are subject to depreciation over the expected useful lifetime of the asset. A mill's purchase of a pulper, for instance, might be depreciated over ten years, meaning the tax benefits associated with the purchase would not all be recognized in the year of purchase, but would phase in gradually. Businesses would therefore need to carefully track the acquisition date and remaining depreciable value of their property, to ensure that an appropriate amount of the cost was depreciated every year, and also to ensure that should the equipment ever be sold the purchase price would be "recaptured" to the extent it exceeded the purchaser's remaining, undepreciated basis in the property. This is a fairly straightforward accounting exercise, but it does require considerable bookkeeping care and attention, and imposes some cost on businesses. With 100% bonus depreciation, however, the entire cost of qualified equipment is deducted in the year of purchase, and the only remaining bookkeeping challenge is keeping track of sales or other disposition of equipment for purposes of possible depreciation recapture.

Maine does not now, and has only rarely, conformed to federal bonus depreciation. Maine taxpayers making qualifying purchases therefore are required to track their depreciation annually for Maine purposes using the standard federal depreciation system, even in years when there was no reason to do so for federal purposes. This imposes

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<sup>18</sup> There is substantial overlap between property eligible for bonus depreciation and property eligible for expensing under Section 179; a taxpayer may take one or the other, but not both, with respect to property eligible under both sections.

additional administrative costs on taxpayers, although the inconvenience and expense made sense given that the bonus depreciation regime was scheduled to fully phase out (and was in fact in the process of phasing out) prior to the enactment of the Act. Now that businesses have fewer reasons<sup>19</sup> to track depreciation of qualifying expenses for federal tax purposes, the inconvenience and cost associated with doing so for Maine tax purposes will become increasingly onerous, and consideration will need to be given to whether it makes sense for Maine to continue to have a depreciation system governed by a largely obsolete set of federal rules. On the other hand, the upfront costs of conforming with the federal system would be large: retroactive conformity for 2025 would be expected to reduce revenues by approximately \$103 million.

### **C. 100% Depreciation Election for Real Property Used for Producing Tangible Personal Property.**

The Act creates a new elective 100% depreciation deduction for “qualified production property” placed in service after July 4, 2025. “Qualified Production Property” is nonresidential real property used as an integral part of certain production activities, which generally include manufacturing, production (for agricultural and chemical producers) or refining of qualified products meeting other specified criteria. The statute goes into considerable detail on each of those terms and conditions. Once again, however, unless Maine affirmatively chooses to conform to federal law for 2025, Maine taxpayers who elect 100% federal depreciation under this provision will have to separately account for depreciation on the property for Maine tax purposes, which will entail modest administrative hassles and accounting costs, as well as modest changes to the instructions to the relevant tax forms. Unlike Section 179, this is an item Maine does not have a history of conforming to, and it in some ways is duplicative of the Dirigo credit. Therefore, OTP does not see a pressing need for conformity at this time. Should Maine choose to conform for 2025, the cost would be just under \$6 million.

### **D. Immediate Expensing of Research and Experimental Expenses**

The Act creates a new Code section 174A, which allows taxpayers to immediately deduct domestic research and experimental (R&D) expenditures, including software development costs, paid or incurred in 2025 and later years. Alternatively, taxpayers can elect to capitalize and amortize domestic R&D expenditures over a period of 60 months. Under federal law, a U.S. company’s foreign research and experimental expenditures would still be amortized over 15 years, as provided under current law. The Act also contains

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<sup>19</sup> There are some circumstances where a taxpayer might choose not to elect bonus depreciation on eligible property, typically involving companies with substantial net operating loss carryforwards or similar special circumstances.

catch-up provisions, allowing certain small businesses to amend their returns for 2022 through 2024 to retroactively apply this rule for expenses incurred during those tax years and businesses may elect to deduct the unamortized balance of previously capitalized domestic R&E expenses in the first year beginning after December 31, 2024, or over a two-year period starting after December 31, 2025.

This change restores the R&D expense treatment that existed under both federal and Maine tax law pre-TCJA. Immediate R&D expensing has strong economic and tax policy justifications and has had significant and lasting bipartisan support. The TCJA removal of immediate R&D expensing was one of the bill's revenue raisers, and may never have been intended to take effect. When it did go into effect, it raised revenue at both the federal and State level, causing a significant increase in Maine State Corporate Income Tax revenue.

As with the other expensing provisions of the Act discussed above, having separate amortization systems for Maine and federal tax purposes would create additional complexity for both taxpayers and the State. In the long run, the simplest approach is to conform to the ongoing federal treatment of R&D expenses. However, doing so would come at a high upfront cost. It should be noted the long run cost to the State is similar regardless of whether the State allows immediate expensing or instead requires the deduction to be taken over time.

The multiyear nature of the current deduction, retroactivity, and catch-up provisions increases the complexity of the change for both taxpayers and the State and increases the potential (short term) revenue loss of conforming to the new federal law. The cost of the retroactive changes must be balanced against the complexity of remaining decoupled from federal law.

Conforming retroactively for tax years 2022 through 2024 by allowing certain small businesses to amend their returns would require the reopening of affected tax returns for those years but would reduce complexity for taxpayers and the State by aligning federal and State tax returns on both a present and on an ongoing basis, removing the need for multi-year State adjustments to the deduction. Conforming to this change would have a more moderate revenue loss of approximately \$5 million.

Conforming to the entire federal change, including immediate expensing for 2025 expenses, as well as the retroactive amendments and the catch-up deduction of the unamortized balance of previously capitalized domestic R&D expenses would be the

simplest approach, however, it would come at a much higher cost of approximately \$136 million.<sup>20</sup>

Conforming retroactively for 2025 R&D expenditures alone is another option, it would lack the simplicity benefits of conforming to the retroactive amended returns or the catch-up provisions, but would bring the State into conformity for expenditures made in 2025. The cost would still be substantial—an estimated \$59 million.

#### **E. Termination of Accelerated Cost Recovery for Energy Property**

Under pre-Act law, production of certain types of clean energy property, such as solar panels, wind turbines, fuel cells and similar goods, was eligible for accelerated depreciation over a five-year period. The Act removes this eligibility for property for which construction begins in 2025 or later, meaning they will be depreciated over longer periods, with the term depending on the type of property produced. Unless Maine chooses retroactive conformity, this means taxpayers producing qualifying property will have the right (but not the obligation) to elect different treatment of such property under federal and Maine law. In this case, Maine law will provide more favorable treatment in 2025; presumably taxpayers in affected industries would have no incentive to prefer conformity on this point, but in any case, systems will have to be implemented in Maine to account for the discrepancy. Conforming to this provision would result in a negligible revenue gain. The Office of Tax Policy recommends retroactive conformity on this minor point.

#### **F. Business Interest Deduction Adjustment**

Under federal law, businesses are allowed to deduct interest they pay, subject to certain limits. However, in order to prevent abuse of this rule, federal tax law caps the amount of the interest deduction to 30% of “adjusted taxable income,” plus certain other specified amounts for most business taxpayers. The Act expands the definition of “adjusted taxable income,” by defining it as an amount prior to deductions for depreciation,

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<sup>20</sup> Constitutional concerns may make it impossible to avoid at least partial nonconformity between state and federal law on this point. Under federal constitutional principles, states are not allowed to discriminate against foreign commerce, including non-U.S. commerce. No such restriction applies at the federal level. It is not entirely clear how the courts would apply those principles in this case, but an argument could be raised that a system by which Maine taxpayers are allowed immediately expensing of U.S.-based R&D expenditures, but 15-year amortization of equivalent foreign R&D expenditures, would violate the federal constitution. If that argument were accepted by the courts, it would be impossible for Maine to conform fully with this provision of the law; it would either have to allow immediate expensing of all R&D expenditures, regardless of location, or maintain the current system by which it does not distinguish between the two. This issue is not unique to Maine, and at this point it is unclear how it will be resolved by the various states and courts.

amortization and depletion.<sup>21</sup> By increasing the amount of income that qualifies as “adjusted taxable income,” the Act essentially increases the cap on deductible interest.

Maine conforms with the federal method of calculating the interest deduction, so failure to retroactively conform to this provision would create another noncontinuity between federal and Maine law. Maine’s forms for 2025 would need to be adjusted to reflect the differences, and taxpayers would have to separately track Maine versus federal interest deductions. Retroactively conforming to the provisions of the Act would simplify matters considerably; on the other hand, the cost to the State would be approximately \$7 million.

#### **IV: CONCLUSION**

When substantial changes are made to the federal tax code, states that conform to it must decide quickly how to respond. The Act makes significant changes to portions of federal law that directly impact how Maine administers its tax laws. In addition to the usual concerns about how to conform with federal law going forward for future tax years, which will be addressed in a future update to this report, swift decisions need to be made about how to conform for tax year 2025.

Fundamentally, the choice is between not conforming, and potentially increasing the nonconformity between Maine and federal law and creating the need for substantial changes in Maine’s 2025 tax forms, or conforming quickly, at the expense of considerable tax revenue and the procedural hurdles associated with short-term legislative action or reliance on the procedures set forth in P.L. 2025 C. 336. Either way, a decision is needed within the next few weeks.

At a more granular level there are a handful of provisions applicable to 2025 where retroactive conformity would have a very modest revenue impact but would ease the administrative burdens created by nonconformity with federal law. This modest retroactive conformity could be implemented using the process spelled out in P.L. 2025 C. 336 to apply retroactively for the upcoming filing season the provisions under the new federal Act regarding qualified disasters, sales of qualifying farmland, Section 179 expensing, termination of accelerated cost recovery for energy property, and if financially feasible the Business Interest adjustment.

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<sup>21</sup> Technically, this is a reversion to the definition of “adjusted taxable income” applicable prior to 2022 when the limit became more restrictive (potentially to address “Byrd Rule” revenue requirements when the TCJA was enacted).

It is the recommendation of the Office of Tax Policy that the Governor consider retroactive compliance with these particular provisions through the P.L. 2025 C. 336 process. OTP does not see a pressing case for broader retroactive compliance at this time. A chart setting forth our recommendations in a condensed form is below.

**Tax Year 2025 Conformity Items: Estimated Revenue Impact (Millions) and Recommendation for 2025 Tax Forms**

Provision	2025 Direction Recommendation	Tax Year 2025 Revenue Change**	Fiscal Year *			
			2026	2027	2028	2029
Qualified Disaster Loss	Conform	Negligible Loss			Negligible Loss	
Qualified Farm Property	Conform	Negligible Loss	-\$0.27	-\$0.94	-\$0.84	-\$0.46
Sec. 179 Expensing	Conform	-\$2.0	-\$2.0	-\$1.8	-\$1.5	-\$1.3
Business Interest Deduction	Conform	-\$6.8	-\$5.9	-\$4.9	-\$4.2	-\$3.9
R&D Expenses						
Allow small business amended returns only	Conform	-\$4.7	-\$3.6	-\$1.1	-\$0.0	-\$0.0
Miscellaneous***	Conform	Negligible			Negligible	
<b>Total Cost</b>		<b>-\$13.5</b>	<b>-\$11.77</b>	<b>-\$8.74</b>	<b>-\$6.54</b>	<b>-\$5.66</b>
R&D Expenses	Do not adopt					
TY 2025+ expenses only		-\$58.5	-\$52.1	-\$49.7	-\$38.7	-\$27.6
Full conformity		-\$136.0	-\$111.1	-\$30.9	-\$20.5	-\$11.9
Accelerated depreciation for qualified production property	Do not adopt	-\$6.2	-\$7.7	-\$22.9	-\$25.8	-\$24.2
Increase in standard deduction****	Do not adopt	-\$30.8	-\$42.2	-\$33.8	-\$32.1	-\$31.8
Bonus Depreciation	Do not adopt	-\$102.8	-\$92.6	-\$75.0	-\$45.3	-\$33.3
Senior Exemption	Do not adopt	-\$31.3	-\$42.2	-\$32.4	-\$30.6	-\$18.3
Car Loan Interest	Do not adopt	-\$9.0	-\$9.4	-\$11.6	-\$14.8	-\$10.1
No Tax on Tips	Do not adopt	-\$9.2	-\$13.1	-\$9.8	-\$10.1	-\$6.2
No Tax on Overtime	Do not adopt	-\$27.8	-\$39.4	-\$29.4	-\$30.6	-\$18.8

\* The fiscal year estimated revenue change corresponds to the scenario where 2025 Maine tax forms assume conformity and the Legislature conforms to provision in the upcoming session. The initial timing of the revenue loss will be different if the 2025 forms do not assume conformity but the Legislature eventually conforms to the provision.

\*\*The tax year 2025 revenue loss will primarily be spread over fiscal years 2026 and 2027.

\*\*\*Certain postsecondary credentialing expenses treated as qualified higher education expenses for purposes of 529 accounts (distributions made after DOE); Spaceports are treated like airports under exempt facility bond rules (obligations issued after DOE); Treatment of certain qualified sound recording productions (commencing in tax years ending after DOE); Exclusion of interest on loans secured by rural or agricultural real property (tax years ending after DOE); ACRS/Energy Efficient property.

\*\*\*\*Under current law, Maine decouples from the federal standard deduction starting in 2026. Therefore, updating the conformity date alone would only affect tax year 2025.