Monthly US Tax Bulletin

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Lloyd Pinto
Partner and US Tax Leader
Grant Thornton Bharat

Welcome to the December edition of Grant Thornton Bharat's US Tax Bulletin, a monthly guide to keep you informed of key developments across the federal, state, and local tax landscape. In an environment marked by regulatory shifts, economic uncertainty, and increasing complexity, staying informed is crucial for making strategic and compliant decisions. This newsletter is designed to deliver timely, relevant, and actionable insights to help you navigate the evolving tax landscape with confidence.

This edition features curated updates on recent legislative changes, IRS enforcement priorities, and emerging trends. Whether you are navigating corporate tax reform, assessing cross-border implications, or managing compliance challenges, we aim to support your efforts with clarity and precision.

The most notable federal tax updates this month are that businesses with foreign branches or Qualified Business Units (QBUs) are required to adopt the Internal Revenue Service (IRS) finalised Foreign Exchange Exposure Pool (FEEP) method for recognising foreign currency translation gains and losses, replacing the traditional 'earnings and capital' approach, effective from 2025. The IRS has proposed regulations under the Foreign Investment in Real Property Tax Act (FIRPTA) that eliminate the shareholder "look-through" requirement for domestic C corporations when determining domestic control of Qualified Investment Entities (QIEs), streamlining compliance and broadening tax relief for foreign investors. The IRS has proposed rules to source borrow fees in securities lending based on the recipient's residence. The FinCEN has postponed the implementation of its new real estate reporting rule to March 2026, providing additional time for compliance preparation. The IRS launched a two-year Post Appeals Mediation pilot programme for faster dispute resolution.

Several states have introduced notable tax changes this month. Massachusetts has revised its corporate tax regulations to state that certain internet-based activities are not protected under Public Law 86-272, which may create income tax nexus for businesses operating online. Rhode Island has announced that it will decouple from federal provisions under the One Big Beautiful Bill Act, which expands the deductions for interest expense, research and development, depreciation, qualified sound recording equipment, and changes to qualified opportunity zone designations. This will maintain its own rules for state taxable income and allow limited amortisation relief over future years. Iowa will tax the Net Controlled Foreign Corporation Tested Income (NCTI) starting in 2026 and adopt the new Foreign-Derived Deduction Eligible Income (FDDEI) deduction, replacing the Foreign- Derived Intangible Income (FDII) deduction under rolling conformity approach. Minnesota has issued updated guidance stating that digital products, webinars, and non-fungible tokens linked to taxable goods, unless they meet specific exemption criteria, are subject to sales and use tax, while accredited online courses remain exempt. New Mexico will mandate all employers to e-file quarterly withholding returns and annual statements beginning January 2026.

We recognise that tax considerations are integral to broader business strategy. As such, we remain committed to helping you align your tax planning with your organisational objectives, ensuring you are well-positioned to respond to both immediate developments and long-term regulatory shifts.

We trust this edition provides a valuable perspective on the evolving tax and compliance landscape. As we continue to monitor developments at the federal and state levels, our goal is to keep you informed with insights that are both timely and actionable.

Happy reading!

A.
Key developments under US federal laws

IRS finalised regulations for Section 987 – Branch transactions effective for 2025

The Treasury and IRS have finalised regulations under Section 987, effective for tax years beginning after 31 December 2024. These rules govern foreign currency translation gains and losses for the QBUs operating in a currency different from their owner's functional currency. For 2025 and beyond, taxpayers must transition from the historic "earnings and capital" method to the **Foreign Exchange Exposure Pool (FEEP)** method, with options to elect a current rate approach or annual recognition of unrecognised gains and losses. Additional provisions include a small business election, de minimis rules for suspended losses, and transition relief for pre-2025 amounts. In addition, the regulations clarify rules related to functional currency, remittances, and the application of exchange rates, providing much-needed guidance for taxpayers with the QBUs operating in non-US currencies. Entities with foreign branches or QBUs should review their structures and prepare for compliance with these regulations. Proper planning can help mitigate the risks associated with foreign currency fluctuations and ensure accurate tax reporting.

[2024 Final regulations for IRC Section 987]

Treasury and IRS propose changes to domestically controlled Qualified Investment Entity (QIE) rules under the Foreign Investment in Real Property Tax Act (FIRPTA)

Under the FIRPTA, foreign investors disposing of US real property interests are generally subject to US tax. However, stock in a domestically controlled QIE, such as a regulated Real Estate Investment Trust (REIT) or a certain Regulated Investment Company (RIC), can be excluded from the FIRPTA rules, making the definition of "domestically controlled" critical for cross-border investment planning.

On 21 October 2025, the US Department of the Treasury and IRS issued proposed regulations (REG-109742-25) that significantly change how QIEs determine domestic control under IRC §897(h)(2). The 2024 final regulations required a "look-through" approach for domestic C corporations owning QIE shares, examining the residency of their shareholders.

The new proposal removes this requirement, treating domestic C corporations as "non-look-through persons," regardless of foreign ownership. These foreign investors will be treated as U.S. persons for the domestic control test, making it easier for QIEs to qualify as domestically controlled. This change makes it easier for QIEs to qualify as domestically controlled, which is significant because foreign investors selling stock in such entities are exempt from the U.S. tax on gains. In contrast, gains remain taxable if the entity is not domestically controlled. This change will simplify testing for domestic control and reduce compliance burdens for QIEs.

The proposed rules maintain the existing treatment for qualified foreign pension funds, international organisations, and domestic partnerships. Publicly traded QIEs may continue to presume that shareholders with less than 5% ownership are U.S. persons unless actual knowledge indicates otherwise. Effective for transactions on or after 20 October 2025, taxpayers may rely on these rules upon publication in the Federal Register, retroactive to 25 April 2024.

[REG-109742-25]

IRS issue proposed rules on borrow fees in securities lending and repo deals

The IRS announced (Notice 2025-63) plans to issue proposed regulations on sourcing borrow fees, negative rebates paid in securities lending and sale-repurchase transactions. Under the rules, borrow fees will be sourced based on the recipient's residence, consistent with Section 988(a)(3)(B).

A "borrow fee" is defined as a payment under an industry standard agreement for making securities available in the ordinary course of business or investment activities. The regulations will apply prospectively, with optional early adoption once finalised. Taxpayers may rely on the notice until the regulations are finalised.

[IRS Notice 2025-63, Source of Certain Borrow Fees]

New FinCEN rule for real estate reporting deferred to March 2026

The FinCEN Residential Real Estate Rule, issued under the Bank Secrecy Act, aims to curb money laundering and illicit financial activity in real estate transactions. The rule requires certain parties involved in real estate closings and settlements referred to as "reporting persons" to report non-financed transfers of residential property to legal entities and trusts. These transactions are considered high-risk for money laundering and other illicit financial activities because they often occur outside the oversight of traditional financial institutions.

The rule was initially scheduled to take effect on 1 December 2025. However, the FinCEN has issued an exemptive relief order, delaying the effective date to 1 March 2026. This extension aims to provide the industry with additional time to prepare for compliance, while supporting regulatory readiness and efforts to safeguard the financial system from illicit activity.

This reporting does not apply to the transfers associated with an easement, death, divorce, or bankruptcy, or that are otherwise supervised by a court in the United States, as well as certain no consideration transfers to trusts, transfers to a qualified intermediary for purposes of 1031 Like-Kind Exchange, and any transfer where no reporting person exists.

[FinCEN, Anti-Money Laundering Regulations for Residential Real Estate Transfers, 89 FR 70258, FinCEN, Exemptive Relief Order, 30 September,2025]

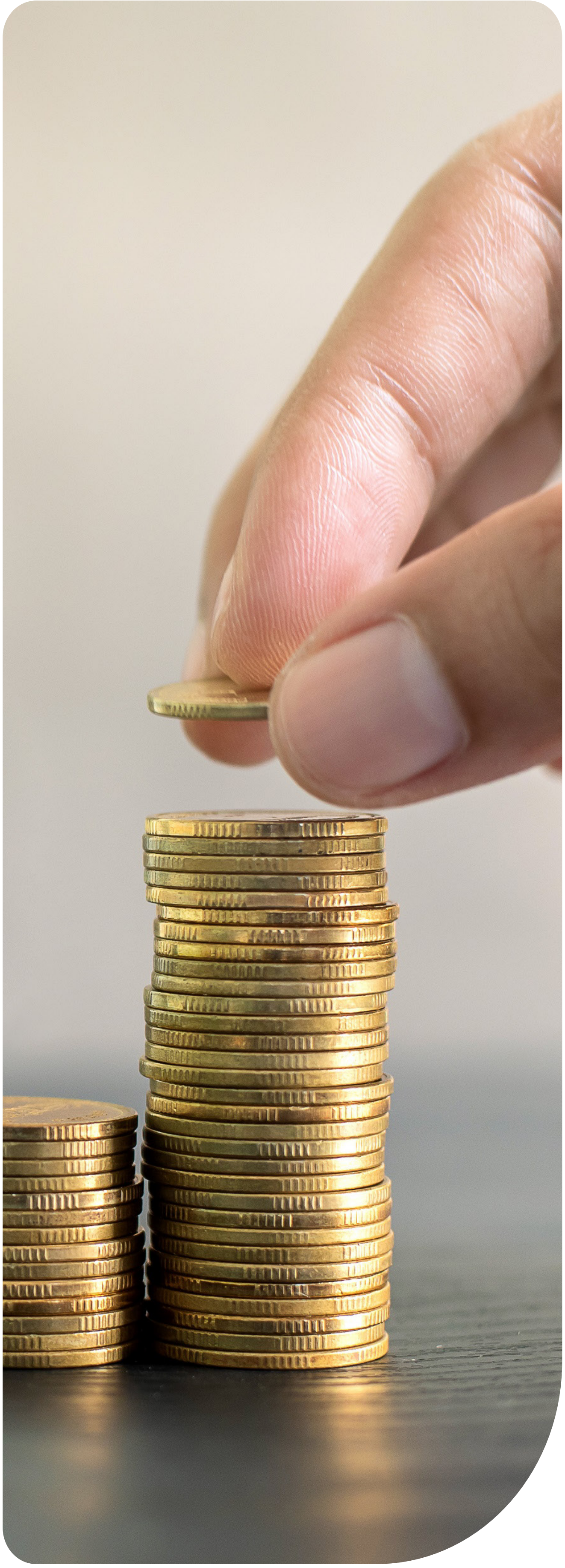
IRS independent office of appeals commences post-appeals mediation pilot programme

The IRS Independent Office of Appeals has introduced a two-year pilot program to make Post Appeals Mediation (PAM) more attractive to taxpayers. This initiative is part of Appeals' ongoing commitment to offering Alternative Dispute Resolution (ADR) options that are cost-effective, taxpayer friendly, and resource-efficient.

After an unsuccessful appeals proceeding, the taxpayer may request PAM. If the request is accepted, the parties meet in an accelerated mediation session, typically lasting one day, to make a final attempt to reach a mutually acceptable resolution. These sessions are facilitated by an appeal mediator with no connections to the underlying cases. Taxpayers may invite a co-mediator at their own expense. This structural change is designed to enable a resolution without initiating a new appeal.

Appeals continues to enhance the use of its five ADR programmes: Fast Track Settlement, Fast Track Mediation Collection, PAM, the Rapid Appeals Process, and Early Referral to serve taxpayers better and contribute to the quick and efficient resolution of tax controversies.

[IRS News releases IR-2025-100]



B.

Key developments under US state laws

Massachusetts narrows P.L. 86-272 protections by amending rules for web-based activities.

Public Law 86-272 is a federal law that generally protects out-of-state sellers of tangible personal property from state income tax if their only in-state activity is soliciting orders for such property. Historically, this meant businesses without a physical presence in a state could avoid income tax there. However, states have recently reinterpreted this law, considering modern e-commerce and online business practices, following guidance from the Multistate Tax Commission (MTC).

Under Public Law 86-272, a corporation is protected from Massachusetts' income-based corporate excise tax if its only activity in the state is the solicitation of orders for tangible personal property. To qualify for this exemption all such orders must be sent outside Massachusetts for approval or rejection and must be fulfilled by shipment or delivery from a location outside the state.

On 10 October 2025, the Massachusetts Department of Revenue promulgated an amendment to Section (4)(e) of regulation 830 CMR 63.39.1, clarifying that certain internet-based activities conducted by vendors may not be protected under P.L. 86-272. Activities conducted by a vendor through a website accessible in Massachusetts may involve actions that go beyond mere solicitation. For instance, placing internet cookies on customers' devices to collect data used for adjusting inventory, planning production, developing new products, or determining items to offer for sale is not considered ancillary to solicitation. It may establish an income tax nexus in Massachusetts.

[830 CMR 63.39.1 Corporate Nexus Mass.gov]

Rhode Island decouples from key federal tax changes

The Rhode Island Division of Taxation, through **Advisory 2025-20**, has confirmed that the state will **not conform** to several business-related provisions introduced under the federal **One Big Beautiful Bill Act (OBBBA),** which was enacted on 4 July 2025.

Under the OBBBA, federal law expanded deductions for key business expenses, including.

- Changes to business interest expense rules,
- Accelerated research and development expensing,
- Increased depreciation caps for business assets,
- Deductions for qualified sound recording equipment.
- Changes to qualified opportunity zone designations.

Rhode Island (RI) has opted to decouple from these provisions. As a result, deductions allowed at the federal level will not be recognised under state law. Businesses claiming these deductions at the federal level must add them back when determining Rhode Island's taxable income.

The RI Schedule HR1-Entity specific schedule was used to report adjustments (addbacks) for items that are deductible at the federal level but **not allowed under Rhode Island law**. This schedule must accompany the RI-1120C (Rhode Island corporate income tax return), which reports all the above addbacks at the state level.

The guidance also addresses the treatment of IRC §174A amortisation. Taxpayers who report an addback for amortisation in 2025 will be permitted to claim a decreasing modification in subsequent years, limited to 20% annually.

[Rhode Island Advisory 2025-20 (2 October 2025)]

Effective from 2026, Iowa Corporate Tax to reflect federal overhaul by implementing Net CFC Tested Income (NCTI) and Foreign-Derived Deduction Eligible Income(FDDEI)

Since 2020, Iowa has excluded the global intangible low-taxed income (GILTI), taxable at the federal level, from its corporate income tax base. Beginning 1 January 2026, the GILTI will be eliminated under federal law and replaced by a new category of income called the Net Controlled Foreign Corporation Tested Income (NCTI). Iowa law does not provide an exemption for the NCTI, resulting in this income being subject to the Iowa corporate income tax from 2026 onward to the same extent it is included in federal taxable income.

Iowa has also conformed to the federal Foreign-Derived Intangible Income (FDII) deduction since 2020. Under the enacted OBBBA on 4 July 2025, the FDII has been repealed and replaced with the Foreign-Derived Deduction Eligible Income (FDDEI) deduction. Because Iowa follows rolling conformity, the FDDEI deduction will automatically apply for Iowa tax purposes.

[IDR Releases Updated Guidance: GILTI / NCTI and FDII / FDDEI]

Minnesota Department of Revenue issues updated guidance on taxation of digital products, NFTs, and webinars

The Minnesota Department of Revenue has released a new industry guide detailing the application of state sales and use tax to digital products. This guide, which replaces the Sales Tax Fact Sheet No. 177, provides a comprehensive guidance on the tax treatment of digital products, non-fungible tokens (NFTs), webinars, and virtual currency.

- **Digital products** delivered electronically, such as music, movies, audiobooks, e-greeting cards, online games, and digital codes, are taxable. Pre-written software remains taxable regardless of the delivery method.
- **Non-Fungible Tokens (NFTs)** are taxable when tied to a taxable product or service.
- **Virtual currency sales** are not taxed, but redemption for taxable goods or services is subject to tax.
- **Webinars** are generally taxable unless they meet specific exemption criteria.
- **Accredited online courses** remain exempt.

Bundled transactions combining taxable and non-taxable items are fully taxable unless the taxable portion is 10% or less of the total price. The sales of digital products are sourced to the purchaser's address, and local taxes may apply.

[Digital Products, Minn. Dept. Rev, 09/26/2025, released October 2025.]

New Mexico requires all employers to e-file quarterly withholding returns starting 2026

The New Mexico Taxation and Revenue Department has updated the filing requirements for employers, which will take effect in 2026. Previously, only employers with 25 or more employees were required to file and pay their quarterly withholding returns electronically. Starting from 1 January 2026, all employers are required to file and pay their quarterly withholding returns electronically. In addition, the quarterly wage withholding and workers' compensation fee returns will be due on the 25th of each month, following the close of each calendar quarter. Employers must also electronically file their annual statement of withholding, which is due to the department on or before 31 January. The department accepts credit cards, ACH debit, and ACH credit as electronic methods of payment for tax remittances.

[New Mexico Taxation and Revenue E-filing mandates dated 9 October 2025.]

For any queries or more information on these monthly insights, please contact:

Lloyd Pinto

Partner and US Tax Leader
Grant Thornton Bharat
E: Lloyd.pinto@in.gt.com

Chitranshi Gupta

Director, US Tax,
Grant Thornton Bharat
E: Chitranshi.gupta@in.gt.com

Contributed by

Dhruti Biswas

Manager, US Tax,
Grant Thornton Bharat
E: dhruti.biswas@in.gt.com

Editorial review

Akshay Kapoor

Design

Ashwani Kumar

For media enquiries, write to

media@in.gt.com

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