2025 – 26 INDIVIDUAL INCOME TAX UPDATE

Blaise C. Bender MS, MPA, JD, CPA

SECTION I: TAX RATES, REPORTING AND FILING STATUS

I. Tax Rates

A. Tax Rates for 2025 (Rev. Proc. 2024 – 40; IR 2024 – 273)

Married Individuals Filing Joint Returns and Surviving Spouses

Taxable Income	Tax Liability
Not over $23,850.	10% of taxable income.
Over $23,850 but not over $96,950.	$2,385 plus 12% of the excess over $23,850.
Over $96,950 but not over $206,700.	$11,157 plus 22% of the excess over $96,950.
Over $206,700 but not over $394,600.	$35,302 plus 24% of the excess over $206,700.
Over $394.600 but not over $501,050.	$80,398 plus 32% of the excess over $394,600.
Over $501,050 but not over $751,600.	$111,462 plus 35% of the excess over $501,050.
Over $751,600.	$202,154.50 plus 37% of the excess over $751,600.

A. Tax Rates for 2025 (Rev. Proc. 2024 – 40; IR 2024 – 273): Con't

Heads of Households

Taxable income	Tax Liability
Not over $17,000.	10% of taxable income.
Over $17,000 but not over $64,850.	$1,700 plus 12% of the excess over $17,000.
Over $4,850 but not over $103,350.	$7,442 plus 22% of the excess over $64,850.
Over $103,350 but not over $197,300.	$15,912 plus 24% of the excess over $103,350.
Over $197,300 but not over $250,500.	$38,460 plus 32% of the excess over $197,300.
Over $250,500 but not over $626,350.	$55,484 plus 35% of the excess over $250,500.
Over $626,350.	$187,031.50 plus 37% of the excess over $626,350.

A. Tax Rates for 2025 (Rev. Proc. 2024 – 40; IR 2024 – 273): Con't

Unmarried Individuals (other than Surviving Spouses and Heads of Households)

Taxable income	Tax Liability
Not over $11,925.	10% of taxable income.
Over $11,925 but not over $48,475.	$1,192.50 plus 12% of the excess over $11,925.
Over $48,475 but not over $103,350.	$5,578.50 plus 22% of the excess over $48,475.
Over $103,350 but not over $197,300.	$17,651 plus 24% of the excess over $103,350.
Over $197,300 but not over $250,525.	$40,199 plus 32% of the excess over $197,300.
Over $250,525 but not over $626,350	$57,231 plus 35% of the excess over $250,525.
Over $626,350.	$188,769.75plus 37% of the excess over $626,350.

A. Tax Rates for 2025 (Rev. Proc. 2024 – 40; IR 2024 – 273): Con't

Married Filing Separately

Taxable income	Tax Liability
Not over $11,925.	10% of taxable income.
Over $11,925 but not over $48,475.	$1,192.50 plus 12% of the excess over $11,925.
Over $48,475 but not over $103,350.	$5,578.50 plus 22% of the excess over $48,475.
Over $103,350 but not over $197,300.	$17,651 plus 24% of the excess over $103,350.
Over $197,300 but not over $250,525.	$40,199 plus 32% of the excess over $197,300.
Over $250,525 but not over $375,800	$57,231 plus 35% of the excess over $250,525.
Over $375,800.	$101,077.25 plus 37% of the excess over $335,800.

A. Tax Rates for 2025 (Rev. Proc. 2024 – 40; IR 2024 – 273): Con't

Estates and Trusts

Taxable income	Tax Liability
Not over $3150.	10% of taxable income.
Over $3,150 but not over $11,450.	$315 plus 24% of the excess over $3,150.
Over $11,450 but not over $15,650.	$2,307, plus 35% of the excess over $11,450
Over $15,650.	$3,777, plus 37% of the excess over $15,650.

B. Tax Rates Under the One Big Beautiful Bill Act (OBBBA)

1. For tax years beginning after December 31, 2025, the section makes the base tax year for measuring the prior year chained CPI, 2016 (instead of 2017) for the 10% and 12% individual tax brackets, and the 10% trust and estate tax bracket. The base year remains 2017 for the 22%, 24%, 32%, 35%, and 37% individual tax rate brackets, and the 24%, 35% and 37% trust and estate tax brackets. (See Act Sec. 70101(b) amends IRC Section 1(j)(3)(B)(i))

a. Economists believe that the adjustment to the 2016 CPI will result in those taxpayers in the 10% and 12% brackets likely will receive $200 on average tax savings in the 10% bracket and approximately $1500 in the 12% bracket. (See The Tax Foundation)

B. Tax Rates Under the One Big Beautiful Bill Act (OBBBA): Con't

2. 2026 Tax Rates per Revenue Procedure 2025 – 32

Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income Is:	The Tax Is:
Not over $24,800	10% of the taxable income
Over $24,800 but not over $100,800	$2,480 plus 12% of the excess over $24,800
Over $100,800 but not over $211,400	$11,600 plus 22% of the excess over $100,800
Over $211,400 but not over $403,550	$35,932 plus 24% of the excess over $211,400
Over $403,550 but not over $512,450	$82,048 plus 32% of the excess over $403,550
Over $512,450 but not over $768,700	$116,896 plus 35% of the excess over $512,450
Over $768,700	$206,583.50 plus 37% of the excess over $768,700

B. Tax Rates Under the One Big Beautiful Bill Act (OBBBA): Con't

Heads of Households

If Taxable Income Is:	The Tax Is:
Not over $17,700	10% of the taxable income
Over $17,700 but not over $67,450	$1,770 plus 12% of the excess over $17,700
Over $67,450 but not over $105,700	$7,740 plus 22% of the excess over $67,450
Over $105,700 but not over $201,750	$16,155 plus 24% of the excess over $105,700
Over $201,750 but not over $256,200	$39,207 plus 32% of the excess over $201,750
Over $256,200 but not over $640,600	$56,631 plus 35% of the excess over $256,200
Over $640,600	$191,171 plus 37% of the excess over $640,600

B. Tax Rates Under the One Big Beautiful Bill Act (OBBBA): Con't

Unmarried Individuals (other than Surviving Spouses and Heads of Households)

If Taxable Income Is:	The Tax Is:
Not over $12,400	10% of the taxable income
Over $12,400 but not over $50,400	$1,240 plus 12% of the excess over $12,400
Over $50,400 but not over $105,700	$5,800 plus 22% of the excess over $50,400
Over $105,700 but not over $201,775	$17,966 plus 24% of the excess over $105,700
Over $201,775 but not over $256,225	$41,024 plus 32% of the excess over $201,775
Over $256,225 but not over $640,600	$58,448 plus 35% of the excess over $256,225
Over $640,600	$192,979.25 plus 37% of the excess over $640,600

B. Tax Rates Under the One Big Beautiful Bill Act (OBBBA): Con't

Married Individuals Filing Separate Returns

If Taxable Income Is:	The Tax Is:
Not over $12,400	10% of the taxable income
Over $12,400 but not over $50,400	$1,240 plus 12% of the excess over $12,400
Over $50,400 but not over $105,700	$5,800 plus 22% of the excess over $50,400
Over $105,700 but not over $201,775	$17,996 plus 24% of the excess over $105,700
Over $201,775 but not over $256,225	$41,024 plus 32% of the excess over $201,775
Over $256,225 but not over $384,350	$58,448 plus 35% of the excess over $256,225
Over $384,350	$103,291.75 plus 37% of the excess over $384,350

B. Tax Rates Under the One Big Beautiful Bill Act (OBBBA): Con't

Estates and Trusts

If Taxable Income Is:	The Tax Is:
Not over $3,300	10% of the taxable income
Over $3,300 but not over $11,700	$330 plus 24% of the excess over $3,300
Over $11,700 but not over $16,000	$2,346 plus 35% of the excess over $11,700
Over $16,000	$3,851 plus 37% of the excess over $16,000

C. Withholding Tables and W – 2

1. The IRS announced as part of its implementation of OBBBA that there will be no changes to certain information returns or withholding tables for 2025 related to the Act. Specifically, Form W – 2., Forms 1099 and 941 will remain the same for 2025. This is also the case for federal withholding tables. Guidance for 2026 will be forthcoming.

II. Personal Exemptions

A. Overview

1. Under IRC Section 151, taxpayers were historically allowed to claim a personal exemption deduction for themselves, their spouse, and qualifying dependents. For tax years prior to 2018, this deduction reduced taxable income by a set amount per eligible individual.

2. The TCJA suspended the personal exemption deduction for tax years 2018 through 2025. During this period, the deduction amount was set to zero for most taxpayers, but the underlying statutory language remained in place, allowing for the deduction to return after 2025 unless further legislative action was taken.

B. Permanent Elimination Under OBBBA

1. Under OBBBA Section 70103 of the Act amends Section 151(d)(5) to permanently eliminate the personal exemption deduction for most taxpayers. However, this section also introduces a new, temporary deduction specifically for seniors. The deduction regarding seniors will be discussed in a separate section.

2. These changes apply to tax years beginning after December 31, 2024 (See Act Section 70103 amends Section 151(d)(5)).

III. Filing Status Issues

A. Married Filing Joint Status and Married Filing Separate Status

1. General Rule. The determination of whether an individual is married shall be made at the close of the taxable year. The exception would be if the spouse died during the taxable year. In that event such determination shall be made at the date of death and an individual legally separated from their spouse under a decree of divorce or separate maintenance shall not be considered married.

A. Married Filing Joint Status and Married Filing Separate Status: Con't

2. Married Individuals Living Apart. If an individual who is married and who files a separate return maintains as his or her home a household which constitutes for more than one half of the taxable year the principal place of abode of a child (qualifying child) and such individual furnishes over half the cost of maintaining the household during the taxable year and during the last six months of said year the other spouse is not a member of the household such shall be considered as not married.

Example

Elbasha v. Comm., TC Memo 2022 – 1. Married couple with wife living abroad and who is a nonresident alien does not entitle taxpayer to claim single filing status. The determination of whether an individual is married is made at the close of the tax year unless the spouse died during the year. A person is considered not married at the close the taxable year if they either are separated under a decree of divorce or separate maintenance agreement or furnishes over half of the cost of maintaining a household that does not include the spouse but does include a qualifying child.

A. Married Filing Joint Status and Married Filing Separate Status: Con't

3. Revised! – Name Changes. If a couple marries during the tax year, the IRS requires any name change to be reported to the Social Security Administration. The name on the tax return must match what is on file with the Social Security Administration. If the name does not match, it could delay a refund. Taxpayers are instructed to go to the Social Security Website and look for Changed Name with Social Security. Name changes can also be processed by calling 800- 772 – 1213 or visit a local office. (See IRS Website)

B. Head of Household

1. Rule. A U.S. citizen or resident alien who is unmarried or considered unmarried at the end of the tax year and who maintains as his or home a household that is the principal place of residence for certain qualifying individuals for more than one-half the year may file as a Head of Household (See Section 2(b)(1)).

2. **Qualifications.** To qualify as a Head of Household:

B. Head of Household: Con't

a. A U.S. citizen or resident alien must be married or considered unmarried on the last day of the tax year.

b. The taxpayer files a separate tax return;

c. Taxpayer pays more than one-half the cost of maintaining his or her household for the tax year. It is NOT sufficient that the taxpayer merely pays the expenses of the household to qualify for Head of Household status;

B. Head of Household: Con't

d. The taxpayer's spouse is not a member of the household during the last six months of the tax year; and

e. The household is, for more than six months of the year, the principal home of the taxpayer's child for whom the taxpayer can claim a dependency exemption or could claim such an exemption except for the special rules for divorced parents. (i.e.; either qualifying children or qualifying relatives).

B. Head of Household: Con't

3. Tie–Breaking Rules For Qualifying Child -Section 152(c)(4). If an individual can be claimed as a qualifying child) by two or more taxpayers for a tax year beginning in the same calendar year, the tie-breaking rules.

a. If two or more taxpayers may claim an individual as a qualifying child for a tax year beginning in the same calendar year, the individual will be treated as the qualifying child of the taxpayer who is:

- a parent of the individual, or
- if the parent of the individual does not apply, the taxpayer with the highest adjusted gross income (AGI) for that tax year. (See Section 152 (c) (4) (A)

B. Head of Household: Con't

b. If more than one taxpayer who can claim an individual as a qualifying child is a parent of the individual, then any one of those parents may claim the individual as a qualifying child. (See Prop. Reg. 1.152 – 2 (g) (1) (i))

c. If the parents do not file a joint return together, the child will be treated as the qualifying child of:

- the parent with whom the child resided for the longest period of time during the tax year, or
- if the child resided with both parents for the same amount of time during the tax year, the parent with the higher AGI. (See Section 152 (c) (4) (B))

B. Head of Household: Con't

d. The same rule will apply where a child is a qualifying child of both parents who are registered domestic partners or partners in a similar formal relationship that isn't a marriage under state law.

e. If an individual's parents can claim the individual as a qualifying child but no parent does, another taxpayer may claim the individual as a qualifying child, but only if that taxpayer's AGI is higher than the highest AGI of any parent of the individual. (See Section 152 (c) (4) (C)))

B. Head of Household: Con't

4. Children of Divorced or Unmarried Parents – Form 8332

a. A taxpayer who is the custodial parent of either a qualifying child or qualifying relative who were ever married to the qualifying child or qualifying relatives non-custodial parent, may use Form 8332: Release of Claim to Exemption for Child of Divorced or Separated Parents to release the claim for the child or relative exemption to the Noncustodial Parent.

B. Head of Household: Con't

b. The custodial parent completes the form and signs it. The custodial then provides the form to the noncustodial parent who must attach the form or similar statement to the tax return for each year the exemption is claimed.

c. Part I of the form is completed if the custodial agrees to release the child exemption for the current tax year.

d. Part II is to be complete if the custodial agrees to release the child exemption for any future years. The specific years must be stated on the form.

B. Head of Household: Con't

e. The custodial and noncustodial parents are determined under Section 152 (e) and not under the decree of divorce or separation agreement. This is for divorces or separations that occurred after July 2, 2008. The rationale was to eliminate Private Letter Rulings on the determination of custodial and noncustodial. As such, a noncustodial parent cannot attack pages from the divorce decree to demonstrate an ability to claim a child.

f. Custodial Parent. The custodial parent is generally the parent who had custody of the qualifying child or qualifying relative for most of the tax year. Custody is referenced under Publication 501.

B. Head of Household: Con't

g. Custody. A parent can be considered to be a custodial parent if the child resides with the parent for the greatest number of nights during the tax year. A child is treated as having lived with a parent for a night the child sleeps at the parent's home regardless of whether or not the parents are present or in the company of a parent with whom the child does not sleep at a parent's home (vacation). If a parent works nights then the test would refer to days.

B. Head of Household: Con't

If a child is not with either parent on a particular night the child is treated as living with the parent with whom the child normally would have lived for that night. An example would be a child staying over at a friend's house. However, if it cannot be determined with which parent the child normally would have lived or if the child would not have lived with either parent that night, the child is treated as not living with either parent for that particular night.

B. Head of Household: Con't

h. Support Test. The period is also deemed to be the custodial parent if they provided over half of the child support during the tax year. Specifically, the custodial parent is treated as having provided over half of the child support if the child received over half of the total support for the year from one or both of the parents and the child was in the custody of one or both parents for more than half the year. For the support test to apply, the parents must be either divorced or legally separated under a decree of divorce or separation maintenance agreement, separated under a written separation agreement, or living apart at all times during the last six months of the year.

Note: The support test does not apply to parents who never married. In addition, if the support test applies and the other four dependency test are also met, the custodial parent can claim the exemption.

B. Head of Household: Con't

i. Exception. The custodial parent will not be treated as having provided over half of the child support if:

- The custodial parent agrees not to claim the child exemption by signing Form 8332 or providing a similar statement.
- The child is treated as having received over half of his or her support from a person under a multiple support agreement.
- A pre-1985 divorce decree a written separation agreement states that the noncustodial parent can claim the child as a dependent. Should be noted the noncustodial parent in this case must provide at least $600 for support during the year. This only applies to pre-1985 agreements.

C. Qualifying Child

1. Definition of Qualifying Child – Section 152 (c). The definition of a qualifying child is required for the child tax credit, child care credit, and education credits. To satisfy the definition of a qualifying child the taxpayer must satisfy the following:

- The child must be related to the taxpayer (Section 152 (f) (1))
- The child must not have obtained the age of 19 by the end of the calendar year or must be a student who has not attained the age of 24 by the end of the calendar year and must be younger than the taxpayer. (Section 152 (c) (3) and (f) (2) an exception to this exists for a dependent who is totally personally disabled at any time during the tax year.
- The child must have the same place of abode as the taxpayer for more than one-half the year (Section 152 (c) (1) (B))
- The child must not provide more than one half is support for the tax year (Section 152 (c) (1) (D))
- The child must not have filed a joint return other than a claim for refund (Section 152 (d) (1) (E))

Example

- **Gonzales v. Comm., TC Memo 2025 – 132.** A married couple was not entitled to child-related tax credits for the tax year at issue. The Tax Court concluded the dependent did not meet the qualifying child criteria under under Section 152 (c) due to insufficient evidence of shared residency. The couple initially filed separate returns, each claiming head of household status and listing different dependents. More than a year later, the couple submitted a joint return listing the same dependents, but with revised relationships and classifications. The IRS issued a notice of deficiency, disallowing multiple credits, including the child tax credit, earned income credit, and recovery rebate credit. The Tax Court found inconsistent testimony with one spouse being unable to recall when the child lived with the couple; the other cited pandemic-related school closures but admitted the child was never enrolled locally. Because the couple failed to demonstrate that the child shared their principal place of abode for more than half the tax year, the child was not a qualifying child under Section 152 (c).

Examples

Correll v. Comm., TC Memo 2025 – 31. The taxpayer is not entitled to the child tax credit because the child did not qualify as her dependent. The taxpayer was the non-custodial parent of the child. The child did not live with the taxpayer for more than one half the year so he was not her qualifying child under Section 152. Also, the child lived with the custodial parent for the entire year. The child's custodial parent did not sign a written declaration that the custodial parent will not claim the child and no such declaration was attached to the noncustodial parent's tax return.

Examples: Con't

Jaha v. Comm., TC Memo 2025 – 26. The taxpayer was only entitled to one qualifying child in relation to his 2019 tax return because the taxpayer was able to demonstrate that the child was a qualifying child that he lived with the taxpayer the majority of the year and the taxpayer provided support. The taxpayer argued that she should be entitled to both children but the evidence showed the second child did not reside with him for the tax year. The alternative argument of a qualifying relative failed because the taxpayer could not demonstrate he provided more than one half support for the year.

D. Qualifying Relatives

1. Section 152(a) defines a *"dependent"* to include a *"qualifying relative*."

2. To be a qualifying relative, an individual must:

- Not be a qualifying child of the taxpayer nor anyone else's qualifying child.
- The person must either have lived with the taxpayer for the entire year as a member of the household or be related to the taxpayer
- Have gross income less than the exemption amount for the calendar year and
- Receive more than one-half of their support from the taxpayer claiming the individual as a qualifying relative. (See Section 152(d)(1)(C))

D. Qualifying Relatives: Con't

3. For 2025, the exemption amount will be $5,200. (Rev. Proc. 2024 – 40; IR 2024 – 273)

4. The OBBBA makes the $500 dependent amount permanent.

5. For 2026, the exemption amount will be $5,300. (Rev. Proc. 2025 – 32)

E. Form 8867 – Paid Repairs Due Diligence Checklist

1. Form 8867, the tax preparer due diligence checklist for determining the eligibility of Head of Household Status, EITC, CTC/ACTC and AOTC has been revised.

2. For future years, a tax preparer not only must retain a copy of the form but any applicable from later of:

E. Form 8867 – Paid Repairs Due Diligence Checklist: Con't

- The due date of the tax return (not including extensions).
- The date the return was filed (if the taxpayer is signing a tax return prepared electronically filing the return).
- The date the return was presented to the taxpayer for signature.
- The date the taxpayer submitted to the tax preparer the return for which the taxpayers responsible for. Meaning, the signing of the return authorizing electronic filing.

E. Form 8867 – Paid Repairs Due Diligence Checklist: Con't

3. Revised! The tax preparer due diligence penalty has increased to $665 for the upcoming tax filing season). (See Rev. Proc. 2025 – 32)

4. Tax Preparer Liability for Failing to Comply with Due Diligence Requirements

Example

US v. Velarde, US District Court, CD California 2:11 –cv – 01458 –ODW, September 4, 2025) A tax preparer was found in contempt after a District Ct. in California determined that the preparer failed to comply with the due diligence requirements under Section 6695 for the year the preparer paid the return. The preparer knowingly submitted returns with fabricated Social Security numbers for qualified persons and admitted to using random nine digit numbers without making reasonable inquiries. Civil sanctions were imposed.

F. Estimated Tax Payments

1. Even if no tax return is filed for several years, estimated tax payments are still a requirement if liability exists.

Example

Standifird v. Comm., TC Memo 2024 – 30. The taxpayer did not file his individual income tax return for four years or make any estimated tax payments during that timeframe. The IRS determined income tax efficiencies and asserted additional taxes such as failure to file penalties and failure to pay estimated taxes. The IRS produced the taxpayer's transcript confirming no returns were filed in the court concluded the taxpayer was liable for the additions to tax including estimated tax penalties for not making quarterly estimated tax payments.

G. Proposed Changes to Form 1040

1. Listing Dependents. The draft of Form 1040 for 2025 has new areas associated with listing qualifying children and qualifying relatives as dependents. In addition to the name, so security number and relationship.

a. The form specifically asks if the dependent has lived with the taxpayer more than one half the year. If the answer is yes, the second part of the question asks if they've lived in the United States for more than one half the year. The form also asks if the eligible dependent is a full-time student, permanently and totally disabled, eligible for the child tax credit or other dependent credit.

G. Proposed Changes to Form 1040: Con't

b. The form also has a box to check if the taxpayer's filing status is married filing separate or head of household and that the taxpayer has lived apart from the spouse of the last six months of 2025 or if they are legally separated pursuant to a written separation agreement or separate maintenance agreement under state law in which the taxpayer resides.

2. Dividends. There will be a separate box to check if the qualifying dividends pertain to a child.

G. Proposed Changes to Form 1040: Con't

3. Retirement Distributions. For an IRA distribution there will be a separate box to check if it is a qualified charitable distribution.

4. Capital Gains or Losses. There will be a separate box to check if the capital gains pertains to a child.

5. Estimated Tax Payments. There will be a separate box to indicate if estimated tax payments were made jointly prior to a divorce. The provision will require the Social Security number of the former spouse to be included.

6. Death of the Taxpayer. If one needs to file a return for a taxpayer who died before filing a 2025 return, check the deceased box at the top of Form 1040 and enter the date of death.

SECTION II: INCOME AND EXCLUSIONS

I. Wages and Compensation

A. Social Security Wage Base

1. The Social Security Administration (SSA) Wage Base for 2025 is $176,100.

2. New! – On October 27, 2025, the Social Security Administration released the Wage Base for 2026. The amount will be $184,500. This represents a 2.8% cost-of-living increase.

3. New! – The 2026 wage base will also be the same base for self employment tax purposes.

B. Work Life Referral Services – IR 2024 – 110; Fact Sheet 2024 – 13

1. The IRS has issued frequently asked questions (FAQs) on the tax treatment of work-life referral services (sometimes called caregiver and caretaker navigation services), which are employer-funded benefits that help employees find resources and support for personal, work, or family challenges.

B. Work Life Referral Services – IR 2024 – 110; Fact Sheet 2024 – 13: Con't

2. These services are typically integrated into employee assistance programs or bundled with other employer services and can include guidance on accessing child and elder care, health care, financial and legal services, and assistance with related paperwork and administrative tasks. In the announcement, the IRS provides that these services are de minimis fringe benefits, exempt from income and employment taxes (FICA, FUTA, and income tax withholding).

C. Frivolous Unreported Wages and Unemployment Compensation – Code Section 61 and 85

1. Kelly El v. US , US District Court, ND, Ohio; 3:24 –cv – 1082, October 28, 2025). The taxpayer alleged that he was manipulated by the IRS in the filing tax returns and paying penalties. The taxpayer argued that the IRS forced him to classify income as wages was incorrect as that he was not obligated to pay taxes. And that the IRS had violated his unalienable right to life, liberty and the pursuit of happiness by classifying income as wages. The taxpayer was denied his claim for refund and had improperly submitted a Form 843 claim for refund.

C. Frivolous Unreported Wages and Unemployment Compensation – Code Section 61 and 85: Con't

2. PH Christiansen v. Comm., TC Memo 2025 – 21. A married couple could not establish that wages and unemployment compensation received during the tax years at issue were not includable in gross income. The couple was liable for income tax deficiencies assessed. The Tax Court determined the wages from multiple employers and unemployment compensation from the state constituted taxable income. The couple filed their tax returns reporting zero gross income and zero tax liability despite the fact they acknowledge they received the W-2s and the 1099 – G. The couple contended that Code Sections 61 and 85 lacked approval from the Office of Management and Budget thereby relieving them of any obligation to report the income. The Tax Court concluded that these arguments are frivolous in nature.

C. Frivolous Unreported Wages and Unemployment Compensation – Code Section 61 and 85: Con't

3. Manente v. Comm., 2025 – 1 USTC (CA 3). The Tax Court properly applied the presumption of correctness to an IRS determination regarding the taxpayers' wages and refund. The taxpayer and his ex-wife's received funds in the amounts listed in a deficiency notice issued by the IRS from their employers and state tax refunds. The taxpayers agreed they had received the funds. However, the taxpayer argued that the compensation received did not qualify as wages because he and his ex-wife were not employees under Section 3401 of the IRS code. The court of appeals rejected the taxpayer's argument because the statute provides the term employee includes government officers as well as private sector employees. The appeals court rejected the taxpayer's argument that his wages were not taxable income, and the IRS could only tax the gain on profit derived from his compensation.

C. Frivolous Unreported Wages and Unemployment Compensation – Code Section 61 and 85: Con't

4. Allen v. Comm., TC Memo 2024 – 5. The taxpayer was liable for taxes on income she omitted from original return but she subsequently admitted receiving said income. The taxpayer conceded that the only remaining issue in the case by submitting an amended return reporting the additional wages. The taxpayer did not dispute receiving the income and her concession supply a factual foundation leaking her to the income activity. The taxpayer asserted that her tax liability still remain zero because she allegedly reported the additional income on Form 709. The taxpayer contended her liability should not change. However, the taxpayer had submitted no evidence to show she reported the amount and paid the additional tax.

D. Form 4852: Substituted Form W – 2 and Form 1099 – R

1. If the taxpayer does not receive Form W – 2 from their employer by the end of February of each year, the taxpayer can contact the IRS for assistance. The IRS requires that taxpayers provide their name, address, phone number, Social Security number, and dates of employment. In addition, the Service requires the Taxpayer provide the employer's or payee's name, address and phone number. The Service contacts the employer and requests the missing form. If the missing form is not received in time to file the return, Form 4852 can be used as the alternative.

D. Form 4852: Substituted Form W – 2 and Form 1099 – R: Con't

2. Section 7434 does allow an individual to bring a civil lawsuit against another who files fraudulent information returns and to receive damages on account of such fraudulent actions. The individual seeking relief under this provision must prove that the defendant issued an information return which was fraudulent and that the defendant issued it willfully and with reckless disregard for the truth.

Example

Chen et al v. Wow Restaurant, LLC, DC MD Florida No. 8:23 – CB – 01502 (5/6/2024). The taxpayer received form W-2 from the employer reporting wages that were never allegedly received. The taxpayer alleged that she was required to accept W-2's reflecting wages and tips for the years 2020 – 2022 in amounts that were five times greater than the amounts the taxpayer actually received. The taxpayer was provided lodging in a company dormitory for 21 months and that was valued at approximately $250 per month. The employer filed payroll tax returns containing false and fraudulent information about the taxpayers wages.

Example: Con't

The taxpayer is allowed to seek relief under Section 7434 which involves the taxpayer being able to bring a lawsuit against the employer who fraudulently files information returns and to receive damages. The employer argued that this code provision does not apply because the corporate owner was separate from the Corporation and that there was no willfulness in filing fraudulent information returns and that the W-2s are not information returns. The court did not buy this and allowed the lawsuit to proceed.

E. New! Section 83 – Property Transferred in Connection with the Performance of Services

1. Under Section 83 (a), taxpayers generally must include in gross income the excess of any fair market value (FMV) of property received in connection with the performance of services over any amount paid for the property. This income inclusion occurs in the first tax year in which the rights of the person having a beneficial interest in the property are either transferable or not subject to a substantial risk of forfeiture (i.e., vested).

E. New! Section 83 – Property Transferred in Connection with the Performance of Services: Con't

2. Section 83 (b) allows a taxpayer to make an election within 30 days of the transfer of such property, such as restricted stock, to include the unvested property's FMV as income at the date of the grant. This election accelerates the inclusion of income and may be advantageous when the property is anticipated to increase in value before it vests.

3. The Service has published Form 15620: Section 83 (b) Election. The form was revised in April, 2025. The purpose of the form is to create a standardized format for taxpayers to make a Section 83 (b) Election.

E. New! Section 83 – Property Transferred in Connection with the Performance of Services: Con't

4. Previously, taxpayers were required to draft their own version of the election pursuant to Revenue Procedure 2012 – 29.

5. The use of Form 15620 is not a requirement but is designed to simplify the process of making the election.

6. Substantial Risk of Forfeiture – Transferable Property

E. New! Section 83 – Property Transferred in Connection with the Performance of Services: Con't

a. Under Section 83 (a), the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over the amount if any paid for the property shall be included in the gross income the person who perform such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable.

E. New! Section 83 – Property Transferred in Connection with the Performance of Services: Con't

b. Under Section 83 (c) (1), the rights of the person and property are subject to a substantial risk of forfeiture it's such person's rights to full enjoyment of such property are conditioned upon the performance of substantial services by any individual.

Example

Feige v. Comm., TC Memo 2025 – 88. Taxpayer was employed by a US subsidiary of an Australian corporation. As part of her compensation, taxpayer participated in the Company's Performance Rights Plan which permitted her to receive stock in exchange for services. Under an initial rights issue offer, taxpayer receives 60,000 vested rights subject to a three-year vesting schedule. She received 20,000 shares each year over a three-year timeframe. The taxpayer elected to sell one third of her vested shares to satisfy US tax obligations. The taxpayer subsequently accepted an additional allocation of 400,000 rights with a four-year vesting schedule, vesting 100,000 shares annually.

Example: Con't

Taxpayer instructed her employer to continue selling one third of the rights to cover her US tax obligation. All rights and all stock received were in connection with performance of services. Taxpayers employer got into financial difficulties and severed the relationship with the taxpayer. The taxpayers unvested performance rights were to be forfeited upon the termination of employment. The severance agreement contained no obligation, no covenant not to compete nor other conditions requiring the taxpayer to return any remuneration. Two days after separation, the taxpayer's former employer transferred 100,000 shares of its stock into the taxpayers Charles Schwab account taxpayer discovered the transfer attempted to contact her former employer but was unable to make any contact.

Example: Con't

Taxpayer provided no information that the transfer was not proper or was an error. Taxpayer received her final W-2 showing $75,660 as compensation for the exercise of nonstatutory stock options. Taxpayer contends she never sold any of the shares. Taxpayer prepared her own return and did not include the compensation in the return. A notice of deficiency followed. The taxpayer's position is that the inclusion on the W-2 of the $75,660 was incorrect. Specifically, she lacked dominion and control over the stock rights. The Tax Court focused on Section 83 and Compensation for Services. The court noted that Section 83 (a) provides that if property is transferred in the connection with the performance of services, the fair market value less any amount paid is included in gross income the first year the rights in the property are transferable and not subject to a substantial risk of forfeiture.

Example: Con't

A Substantial risk of forfeiture exists only if the property rights are conditioned upon the future performance of substantial services or upon the occurrence of a condition relating to the transfers purpose if the possibility of forfeiture is substantial. The court determined that the shares were not only property but were transferred in the connection with the performance of services. This specifically indicated she agreed and voluntarily participated in her employer's performance rights plan. The court held however there was no substantial risk of forfeiture shares were transferred to the taxpayer after employment terminated and she conceded no future services were expected.

Example: Con't

The separation agreement did not contain a covenant not to compete, ongoing obligations or condition requiring the return of remuneration. This fails the test of substantial risk of forfeiture under the code. The separation agreement did not supersede the Performance Right Plan at the taxpayer and signed also it was noteworthy that the former employer did not seek to recover any of the shares for months or years after the transfer. This strongly suggest that the shares rightfully belong to the taxpayer. As such the $75,660 is includable in gross income.

II. Interest Income

A. Income from US Savings Bonds used for Qualified Higher Education Expenses (Series EE & I Savings Bonds)

1. For 2025, the phase-out for excluding interest on U.S. savings bonds redeemed to pay qualified higher education expenses will begin at modified adjusted gross income (MAGI) above $99,500 ($149,250 on a joint return). (See Rev. Proc. 2024 – 40)

2. New! For 2026, the phaseout for excluding interest on US savings bonds redeemed to pay qualified higher education expenses will begin at modified adjusted gross income (MAGI) above $101,800 ($152,650 on a joint return) (See Rev. Proc. 2025 – 32)

B. Taxable interest or Nontaxable Interest

1. Interest paid on a child support arrearage is taxable interest under Section 61 (a) (4). The taxpayer has the burden to demonstrate such payment is either child support or alimony pursuant to judicial documents.

Example

Rodgers v. Comm., TC, 2023 – 56. The amount of income reported on Form 1099-INT and which the taxpayer admitted receiving was taxable interest income, not nontaxable child support as she claimed. While payment was made in connection with child support arrearages that the ex-husband owed the taxpayer, the record clearly showed it was interest. The taxpayer's argument that the arrearage principal may have been larger than the amount the state determined was irrelevant, in that any increase in principal would just have resulted in increased interest. The taxpayer received the amounts under the state of Alabama that issued child support payment and said state issued Form 1099 – INT taxpayer acknowledges ex-husband did not make timely child support payments that he was obligated to make and that the state court order directed payments of child support and interest due to being in arrears.

C. Income in Respect of Decedent: Taxation of Accumulated Interest on Savings Bonds

1. Generally, the taxpayer who inherits a savings bond containing accrued interest must recognize the accrued interest in gross income in the year of receipt or redemption of the bond.

Example

Hitchman v. Comm., TC Summary 2023 – 18. The Tax Court held that a taxpayer who inherited a savings bond from his father, then had the bond reissued in his name and redeemed it, had to include the accumulated interest on the bond in his gross income. The court rejected the taxpayer's argument that his interest income was limited to the interest that accrued from the time he had it reissued in his name; the court found that because the taxpayer's father did not report any interest income on the bond while he owned it, the interest therefore accumulated, and when the taxpayer redeemed the bond the accumulated interest was includible in his income as income in respect of a decedent under Section 691(a).

D. Nontaxable Loan Proceeds

1. Loan associated with a nontaxable event must still meet valid debtor-creditor relationship for interest to exist.

Example

Aulisio Jr. v. Comm., TC Memo 2024 – 29. Taxpayer, a CPA, failed to report interest income from a trust indicating that the amount received representing nontaxable loan proceeds rather than interest income. Taxpayer argued that his friend who prepared his return mistook loan deposits as income. The loan was not evidenced by any instrument and there was no valid debtor-creditor relationship to establish the loans existed much less to be nontaxable. Taxpayer went back and amended the return to include the interest to avoid penalties. The avoidance of the penalties did not prevail.

III. Qualifying Dividend Income and Capital Gains

A. 2025 Rates – Rev. Proc. 2024 – 40; IR 2024 – 273

1. For 2025, the 0% capital gains rate applies to adjusted net capital gain of up to:

- $96,700 for joint returns and surviving spouses
- $48,350 for single and married taxpayers filing separately
- $64,750 for head of household
- $3,250 for estates and trusts

A. 2025 Rates – Rev. Proc. 2024 – 40; IR 2024 – 273: Con't

2. For 2025, the 15% capital gains tax rate applies to adjusted net capital gain over the amount subject to the 0% rate, and up to:

- $600,050 for joint returns and surviving spouses
- $300,000 for married taxpayers filing separately
- $566,700 for heads of household
- $533,400 for single individuals
- $15,900 for estates and trusts

3. The 20% capital gains tax rate applies to adjusted net capital gain over the above 15% rates.

B. New – One Big Beautiful Bill Act

1. OBBBA retains the current net capital gain and qualifying dividend rates of 0%, 15% and 20%. The breakpoints will be adjusted annually for inflation using the chained CPI as with the individual tax rates and trusts and estate rates.

2. This section is effective for tax years beginning after December 31, 2025. (See Act Sec. 70101(c))

B. New – One Big Beautiful Bill Act: Con't

3. Again, those clients between the 12% and 22% tax brackets will be further away from the breakpoint between 0% and 15% capital gains brackets. As such, depending on the filing status taxpayers with capital gains in the 0 to 15% bracket will see savings between the $ 1000 and $1300. (Tax Foundation)

4. For purposes of determining the zero percent and 15 percent capital gains rates (Code Sections 1(h), 1(j)(5)), the adjusted income thresholds for taxable years beginning in 2026 are (Rev. Proc. 2025 – 32):

B. New – One Big Beautiful Bill Act: Con't

Filing Status	Maximum Zero Rate Amount	Maximum 15% Rate Amount
Married Individuals Filing Joint Returns and Surviving Spouse	$98,900	$613,700
Married Individuals Filing Separate Returns	$49,450	$306,850
Heads of Household	$66,200	$579,600
All Other Individuals	$49,450	$545,500
Estates and Trusts	$3,300	$16,250

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion

1. Section 1202 allowed noncorporate taxpayers that hold qualified small business stock (QSBS) for more than 5 years to potentially exclude all, or part of the gain realized on the sale or exchange of that QSBS from gross income.

2. There were a number of limitations on the exclusion, including a limitation that the aggregate amount of gain from dispositions of stock issued by the corporation that can be taken into account under the exclusion cannot exceed the greater of:

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion: Con't

- $10 million ($5 million for married taxpayers filing separate returns) minus the aggregate amount of eligible gain (gain on the sale or exchange of QSBS held for more than five years) excluded under Section 1202 for earlier tax years and attributable to dispositions of stock issued by the corporation and

- ten times the taxpayer's aggregate adjusted bases in QSBS issued by the corporation determined on the date the stock was originally issued) and disposed of by the taxpayer in the tax year.

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion: Con't

3. In addition, the aggregate gross assets of the issuing corporation (cash and the adjusted basis of its assets) generally must not have exceeded $50 million at any point before and immediately after the stock issuance (including amounts received in the issuance) at all times on or after the date of the enactment of the Revenue Reconciliation Act of 1993.

4. Under the Act, gain on the applicable percentage (50% for stock held for 3 years, 75% for stock held for 4 years, 100% for stock held for 5 years (See IRC Section 1202(a)(5) as amended by Act Sec. 70431(a)(2)) is eliminated for QSBS acquired after the applicable date (July 4, 2025. (See IRC Section . 1202(a)(1)(B) as amended by Act Sec. 70431(a)(2)); (Code Sec. 1202(a)(6)(A) as amended by Act Sec. 70431(a)(3))

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion: Con't

5. Stock that would otherwise be treated as having been acquired before, on, or after the applicable date, will be treated as acquired on the first day on which the stock was held by the taxpayer under the holding period rules under Section 1223. (See IRC Section 1202(a)(6)(B) as amended by Act Sec. 70431(a)(3))

6. The eliminated gain will not be treated as an alternative minimum tax preference.

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion: Con't

7. The limitation on the aggregate amount of gain from dispositions of stock issued by the corporation that can be taken into account under the exclusion is amended so that it is the applicable dollar limit. (See IRC Section 1202 (b) (1) (A) as amended by Act Sec. 70431(b)(1)

8. This limit is for:

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion: Con't

- stock acquired by the taxpayer before the applicable date, $10 million minus the aggregate amount of eligible gain taken into account by the taxpayer for earlier tax years and attributable to dispositions of stock issued by the corporation and acquired by the taxpayer before, on, or after the applicable date and

- stock acquired by the taxpayer after the applicable date, $15 million minus the aggregate amount of eligible gain taken into account by the taxpayer for earlier tax years and attributable to dispositions of stock issued by such corporation and acquired by the taxpayer before, on, or after the applicable date, plus the aggregate amount of eligible gain taken into account by the taxpayer for the tax year and attributable to dispositions of stock issued by such corporation and acquired by the taxpayer on or before the applicable date. (See IRC Section 1202(b)(4) as amended by Act Sec. 70431(b)(2))

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion: Con't

9. The $15 million limit will be increased for inflation by multiplying the amount by the cost-of-living adjustment for the calendar year in which the tax year begins, determined by substituting "calendar year 2025" for "calendar year 2016.". If any increase under this rule is not a multiple of $10,000, the increase is rounded to the nearest multiple of $10,000.

10. If for any tax year, the eligible gain attributable to dispositions of stock issued by a corporation and acquired by the taxpayer after the applicable date exceeds the applicable dollar limit, then notwithstanding the above inflation increase for any later tax year, the applicable dollar limit for the subsequent tax year will be zero. (See IRC Section 1202(b)(5) as amended by Act Sec. 70431(b)(2))

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion: Con't

11. Under pre-Act law, the $10 million limit is reduced to $5 million for married taxpayers filing separate returns and the limitation for stock acquired by the taxpayer after the applicable date is similarly reduced by one-half of the dollar amount otherwise in effect. See IRC Section 1202 (b) (3) (A) as amended by Act Sec. 70431(b)(3))

12. The Act also increases the $50 million aggregate gross asset limit to $75 million and provides for an inflation adjustment to the $75 million limit similar to the above adjustment to the $15 million limit (with rounding off to the nearest $10,000). (See IRC Section 1202 (d) as amended by Act Sec. 70431(c))

C. New and Revised! Expansion of Qualified Small Business Stock Gain Exclusion: Con't

13. The provision eliminating gain on the applicable percentage described above is effective for tax years beginning after July 4, 2025, although the elimination of the tax preference for the exclusion for alternative minimum tax purposes is effective as if included in Section 2011 of the Creating Small Business Jobs Act of 2010. (Act Sec. 70431(a)(6))

14. The increase in the limitation on the aggregate amount of gain is effective for tax years beginning after July 4, 2025. (See Act Sec. 70431(b)(4))

15. The increase in the gross asset limitation is effective for stock issued after July 4, 2025. (See Act Sec. 70431(b)(4))

Examples

Sophia is a single filer. On December 1, 2029, she sells QSB stock that she acquired for $2 million on September 15, 2025. The sales price of the shares is $52 million, resulting in a gain of $50 million ($52 million – $2 million). The gain exclusion percentage is 75% because the stock was held for more than four years but less than five years. So, the eligible gain amount is $37.5 million ($50 million × 75%).

Examples: Con't

The next step is to apply the gain limitations. The maximum amount of gain that Sophia can exclude is $20 million. That's the lesser of 1) the $37.5 million eligible gain, or 2) the greater of the two limitations. In this scenario, the greater of the two limitations is $20 million (10 x $2 million), which is more than the other limitation of $15 million. After applying the gain limitations, Sophia can exclude $20 million of her $50 million gain. The remaining $30 million of the gain is a taxable long-term capital gain ($50 million – $20 million). (This example ignores the fact that the $15 million gain limitation will be increased by annual inflation adjustments after 2026.)

Examples: Con't

Brock is a married joint filer. On December 1, 2029, he sells QSB stock that he acquired for $200,000 on September 15, 2025. The sales price of the shares is $40.2 million, resulting in a gain of $40 million. The gain exclusion percentage is 75% because the stock was held for more than four years but less than five years. So, the eligible gain amount is $30 million ($40 million × 75%).

Examples: Con't

The next step is to apply the gain limitations. The maximum amount of gain that Brock can exclude is $15 million. That's the lesser of 1) the $30 million eligible gain, or 2) the greater of the two limitations. In this scenario, the greater of the two limitations is $15 million, which is more than the 10-times-the-basis limitation of $2 million (10 x $200,000). After applying the gain limitations, Brock can exclude $15 million of his $40 million gain. The remaining $25 million of the gain is a taxable long-term capital gain ($40 million – $15 million). (Again, this example ignores the fact that the $15 million gain limitation will be increased by annual inflation adjustments after 2026.)

D. New! – Treatment of Capital Gains from Sale of Certain Farmland

1. OBBBA allows sellers of qualified farmland property to elect to pay capital gains tax resulting from the sale in four equal annual installments.

2. Qualified farmland property means real U.S. property used as a farm or leased to a qualified farmer. To qualify, the property must be used substantially for farming purposes for the 10 years preceding the sale.

3. The property must also be subject to prohibitions on non-farm use for at least 10 years after the sale.

4. A qualified farmer is an individual actively engaged in farming, as defined in the Food Security Act of 1986.

D. New! – Treatment of Capital Gains from Sale of Certain Farmland: Con't

5. The first installment payment is due with the tax return for the year in which the sale occurs. The following three payments are also due with the returns for the subsequent tax years. If a payment is missed, the entire remainder of the capital gains tax balance is then due immediately.

6. If the taxpayer is an individual who dies before paying all four installments, the unpaid installments are due with the last year's return. If the taxpayer is a C corporation, trust, or estate - and there is a liquidation, sale of substantially all assets, or cessation of business - then the unpaid installments are due immediately.

D. New! – Treatment of Capital Gains from Sale of Certain Farmland: Con't

7. In the event of a tax deficiency assessed because of the gain from the farmland sale, the deficiency is prorated across the remaining installments. However, this does not apply if the deficiency is due to negligence or fraud.

8. This section applies to sales or exchanges in tax years beginning after the date of enactment. (See Act Sec. 70437. Redesignates IRC Section 1062)

Notice 2026 – 3. IRS Grants Relief for Farmers Deferring Tax on Land Sales

- The IRS issued guidance providing penalty relief to individuals and corporations that make a valid election to defer taxes on gains from the sale of qualified farmland. Taxpayers who opt to pay their applicable net tax liability in four annual installments will not be penalized for underpaying estimated taxes in the year of the sale.
- The relief permits these taxpayers to exclude 75 percent of the deferred tax from their estimated tax calculations for that year. However, 25 percent of the tax liability must still be paid by the return due date for the year of the sale. The IRS emphasized that this waiver applies automatically if the taxpayer qualifies and does not self-report the penalty.

E. Virtual Currency and Digital Assets

1. Final Regulations on Reporting Requirements for Digital Assets – TD 10000

a. The Service has issued final regulations for reporting digital assets and guidance on information reporting along with the determination of the amount realized and basis for certain digital asset sales and exchanges.

b. The regulations require custodial brokers to report various sales and exchange transactions beginning in 2026 is for transactions in calendar year 2025.

E. Virtual Currency and Digital Assets: Con't

c. The final regulations require reporting by custodial brokers, who are brokers that take possession of digital assets being sold by their customers. Such brokers include operators of custodial digital asset trading platforms, certain digital asset hosted wallet providers, digital asset kiosks, and certain processors of digital asset payments. Real estate professionals are also required to report the fair market value digital assets paid by buyers and received by sellers in real estate transactions with closing dates on or after January 1, 2026.

E. Virtual Currency and Digital Assets: Con't

d. The final regulations do not require that taxpayers report transaction identifications on their Form 1099 – DA. However, they must collect the information and retain it for seven years and make it available to the IRS upon request.

e. The Regulations provide for backup withholding.

E. Virtual Currency and Digital Assets: Con't

2. IR – 2024 – 18. The digital asset question will appear on all income tax forms including 1040, 1041, 1065, 1120, 1120S and Form 990. The question must be answered by all taxpayers not just those who are engaged in a transaction involving digital assets in 2024.

a. At any time during the tax year, did you: (a) receive (as a reward, award or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?

E. Virtual Currency and Digital Assets: Con't

b. The question is to be answered yes if the taxpayer:

- received digital assets as payment for property or services provided,
- received digital assets resulting from a reward or award,
- received new digital assets resulting from mining, staking and similar activities,
- received digital assets resulting from a hard fork (a branching of a cryptocurrency's blockchain that splits a single cryptocurrency into two),
- disposed of digital assets in exchange for property or services,
- disposed of a digital asset in exchange or trade for another digital asset,
- sold a digital asset, or
- otherwise disposed of any other financial interest in a digital asset.

E. Virtual Currency and Digital Assets: Con't

c. The question is to be answered no if the activities were limited to one or more of the following:

- holding digital assets in a wallet or account,
- transferring digital assets from one wallet or account they own or control to another wallet or account they own or control,
- acquiring digital assets as an inheritance or bequest, or
- purchasing digital assets using U.S. or other real currency, including through electronic platforms.

F. Qualified Opportunity Zone (QOF)

1. Reporting Requirements

a. A taxpayer must annually report any QOF investment, as well as any deferred capital gains and the disposition of any QOF investments during the tax year, to the IRS on a Form 8997: Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments.

b. Form 8997 must be attached to the taxpayer's timely filed federal tax return, including extensions

F. Qualified Opportunity Zone (QOF): Con't

c. The failure to file Form 8997 will result in an inclusion event that terminates the taxpayer's qualifying investment in a QOF and triggers recognition of any deferred gain.

d. In addition, an entity that elected (or is electing) to be a QOF must annually file Form 8996: Qualified Opportunity Fund, with its timely filed federal tax return, including extensions.

F. Qualified Opportunity Zone (QOF): Con't

e. Form 8996 is used to report that the QOF meets the investment standards in Section 1400 Z – 2 or to figure the penalty if the entity fails to meet those investment standards.

f. A QOF must file Form 8996 even in years the entity has no taxable income.

G. Like Kind Exchanges

1. Section 1245 property associate with a like kind exchange is subject to taxation and will kill off the like kind exchange. (PLR 202335002)

Example

Gerhardt v. Comm., 160 TC No. 9. Taxpayers were not entitled to deferred gain on like-kind exchange involving the relinquishment of rental property in exchange for other rental property. Taxpayers did follow the like-kind exchange rules however stated gain had to be recognized as ordinary income because the property was depreciated under Section 1245.

G. Like Kind Exchanges: Con't

2. Update! – Related parties involved in a like kind exchange must file Form 8824: Like kind Exchanges in the Year of the Exchange for the next two years. This only applies to related parties.

3. Option Agreements between related parties can give rise to scrutiny in a like kind exchange.

Example

Parkway Gravel, Inc. v. Comm., TC Memo 2024 – 59. Two cousins subsequently became owners of a road construction business. They desire to expand the business upon assuming ownership. They not only owned the entity in question but also formed a general partnership to develop real estate. The cousins were the sole partners of the partnership. In a desire to sell a parcel of land used in the business, the corporation granted the partnership and option to acquire the property for its appraised value.

Example: Con't

The assignment stipulated that it execute any gain on sale above the appraised value would be allocated to the partnership. An outside developer agreed to purchase the property for almost twice the appraised value. The Corporation entered into a like kind exchange to deferred their portion of the gain associated with the sale. Upon examination, the IRS claimed the option agreement invalided the sale between the buyer and the Corporation resulting in an assignment of income. The Service argued that the partnership was merely a conduit for the sale.

Example: Con't

The IRS indicated it was a sham transaction with no substantial economic effect. The Tax Court decided in favor of the taxpayer. The court indicated that the clarity and completeness of the documentation to obtain proper zoning and permits to secure the sale and the long history of maintaining a separation agreement among the entities was a factor in their favor and granted the like kind exchange treatment. In other words, the transaction had documentation to indicate not to separate books and records but everything up to the exchange was arm's-length.

H. Bad Debt

1. A deduction is allowed for any debt that becomes worthless within the taxable year (See Sec. 166(a)(1)). A debt that becomes worthless, is a question of fact, but actual worthlessness is a condition that must be present for a bad debt deduction.

2. A debt is considered worthless when there are reasonable grounds for abandoning hope that the debt will be repaid and there is no longer any chance of the debt being collected. It is not necessary to wait until a debt becomes due to determine whether it is worthless, if the facts show that actual worthlessness exists before the due date (See Reg. Sec.1.166-2).

H. Bad Debt: Con't

3. Worthlessness is generally evidenced by an insolvent debtor not timely servicing the debt and refusing to pay any part of the debt in the future, declaring bankruptcy, or simply disappearing. A lawsuit is needed to enforce payment where the surrounding facts and circumstances indicate that, in all probability, the action would not result in an enforceable judgment in favor of the lender (Reg. Sec.1.166-2(b)).

H. Bad Debt: Con't

4. However, the debt must be a bona fide debt that arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money (See Reg. Sec.1.166-1(c)). The loan must be made with the understanding that it is to be repaid. Whether a debtor-creditor relationship exists depends on all the facts and circumstances, and generally no one fact is determinative. Factors to consider in determining whether there is a debtor-creditor relationship with a reasonable expectation of repayment are whether:

H. Bad Debt: Con't

- The existence of a written promissory note;
- Interest is stated and being charged on the note;
- There is a fixed schedule for repayment;
- Collateral exists in exchange for the note;
- A demand for repayment exists;
- The records reflect a loan;
- Repayments are or will been made; and
- The borrower was solvent at the time of the loan (See Hunt v. Comm., T.C. Memo. 1989-335).

H. Bad Debt: Con't

- **Fussell v. Comm., TC Memo 2025 – 131.** An individual was not entitled to deduct a claimed business bad debt arising from amounts advanced to a closely held corporation. The Tax Court found that the advances did not constitute a bona fide debt, as the individual failed to establish a valid debtor-creditor relationship. The Tax Court noted the absence of promissory notes, repayment terms, interest provisions, or evidence of repayment, and found that the individual did not prove when any alleged debt became worthless. Thus, no bad debt deduction or related offset was allowable for the tax year at issue.

Example

Anaheim Arena Management, LLC, H and S Investments I, LP, a Partner other than the Tax Matters Partner v. Comm., TC Memo 2025 – 68. A limited liability company treated as a TEFRA partnership was not entitled to a bad-debt deduction under Section 166 for advances made to operate a city-owned arena. The Tax Court held that the advances were not bona fide debt, as they lacked fixed maturity dates, enforceable repayment rights, and creditor-level protections. Citing traditional debt-equity factors, the Court found the arrangement lacked economic substance and resembled an equity investment. Accordingly, the advances were treated as capital contributions.

H. Bad Debt: Con't

5. Nonbusiness Bad Debt

a. A nonbusiness bad debt must be totally worthless before it may be deducted, and it may be deducted by taxpayers other than corporations only as a short-term capital loss. (See Sec.166(d)(1)(B)).

b. An S corporation's nonbusiness bad debt is a separately stated item (Rev. Rul. 93-36)

H. Bad Debt: Con't

c. The deduction for a nonbusiness bad debt must be taken in the year in which the debt becomes totally worthless (See Reg. Sec.1.166-5(a)(2)).

d. When specific debts are deducted, there must be an explanatory statement attached to return, showing the name of the debtor and any related party interest to the taxpayer, the nature and amount of the debt, the date the debt became due to efforts made to collect the debt, and the reason for determining the debt to be worthless (See IRS Pub. 17).

Example

Kelly v. Comm., US Court of Appeals 9th Cir.; 23 – 70040, June 5, 2025. IRS issued deficiency notices disallowing the taxpayer's nonbusiness bad debt deduction determining that the taxpayer had not established the elements for the deduction. The taxpayer had reported cancellation of debt income on the return but excluded it under the insolvency exception while claiming a short-term capital loss from the debt. The taxpayer argued the cancellation of debt between commonly controlled business entities automatically renders the debt worthless. The Court rejected the argument that the discharge of debt was automatically worthless. The court indicated that Section 166 requires objective evidence of complete worthlessness within the taxable year and a subjective belief is not enough to warrant a deduction of the debt. As such, the taxpayer did not meet the burden that the debt was totally worthless.

H. Bad Debt: Con't

6. Business Bad Debt

a. A business bad debt is a loss from the worthlessness of the debt that was either created or acquired in association with the trade or business or closely related to the trade or business when he became partially or totally worthless. The debt is closely related to the business at the primary motive for incurring the debt is a business reason. A bona fide debtor-creditor relationship is still required but the entire amount can be deductible if the debt is bona fide and in association with a valid trade or business.

b. Business bad debts are primarily the result of credit sales to customers. They can also be the result of loans to suppliers, clients, employees or distributors.

Example

Aboui v. Comm., TC Memo 2024 – 106. The Taxpayer was the sole shareholder of an S corporation which owns multiple used car lots. The taxpayer had contributed more than $5 million worth of used cars for its starting inventory. The Corporation kept its records on a hybrid method of accounting, with sales and costs of goods sold reported on the accrual basis in many other expenses reported on the cash basis of accounting. Many customers had poor credit, no checking accounts and paid the Corporation in cash. The corporation often repossessed cars within months of sale but not all cars were able to be repossessed. The IRS audited the taxpayer and the corporations for three years.

Example: Con't

It disallowed the S corporation's bad debt deductions for each year in its entirety, stating that the S Corporation did not properly report the amount of debt as income and therefore did not incur a loss when it repossessed the cars for the buyer's failure to make payments. The Tax Court ruled in favor of the taxpayer, stating that the records establish that the Corporation included all sales proceeds in income for the year of sale. The S Corporation did not repossess all cars. The loss of the cars adequately substantiated the amount of the bad debt deduction, and it was viewed as a business bad debt. To which the taxpayer was entitled to the deduction.

IV. FORM 2555 – Foreign Source Income and the Foreign Income Exclusion

A. General Rule

1. U.S. citizens generally living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income and foreign housing costs. In order to qualify for these exclusions, a U.S. citizen must be either a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year or present overseas for 330 days out of any 12 consecutive month period. In addition, the taxpayer must have his or her tax home in a foreign country.

2. Individuals who are not bona fide residents of a foreign country and fail to meet the 330-day physical presence test may be treated as dual if eligible for a waiver. Waivers may be issued to individuals who:

A. General Rule: Con't

- Were bona fide residents of, or were present in, a foreign country for any period during which individuals were required to leave such foreign country because of war, civil unrest, or similar adverse conditions which precluded the normal conduct of business by such individuals; and

- Were able to establish to the IRS that the time requirements of the foreign earned income exclusion could reasonably have been expected to have been met but for the conditions of war, civil unrest, or similar adverse conditions. The IRS annually publishes a list of foreign countries where war, civil unrest, or adverse conditions exist, and where the individual taxpayer could not stay the full 330 days. (See Rev. Proc. 2014-25)

B. Foreign Earned Income Exclusion

1. Foreign Earned Income Exclusion Amounts

a. The foreign earned income exclusion will be $130,000 in 2025. (See Rev. Proc. 2024 – 24)

b. Revised! The foreign earned income exclusion will be $132,900 in 2026. (Rev. Proc. 2025 – 32)

C. Revised! Foreign Housing Exclusion – IRS Notice 2025 – 16

1. The 2025 base housing exclusion amount is $20,800 ($130,000 x 16%)

2. The Housing expense amount is also limited based on a percentage of the maximum foreign income exclusion area amount. The limit is generally 30% of the maximum foreign earned income exclusion amount multiplied by the number of days in the applicable timeframe which the taxpayer was a qualified individual in a foreign country. A qualified individual whose entire year is within the timeframe is limited to a maximum housing exclusion amount of $39,000 ($130,000 x 30%) these are generally associated with high-cost areas. At the time of publication, the government has not issued the high-cost countries associated with the 30%.

D. Factors to Consider in determining whether a taxpayer is a bona fide resident of a foreign country. (Linde v. Comm. , TC Memo 2017 – 180., Also see Sohurek , CA 7, 1962, 9AFTR 2d 883)

1. Over time, the courts have developed factors to ascertain whether a taxpayer is a bona fide resident of a foreign country for purposes of the foreign income inclusion. Among the factors considered are the following:

- intention of the taxpayer;
- establishment of the taxpayer's home temporarily in the foreign country for an indefinite period;
- participation in the activities of the chosen community;
- physical presence in the foreign country consistent with the taxpayer's employment;
- nature, extent and reasons for temporary absences from the taxpayer's temporary foreign home;

D. Factors to Consider in determining whether a taxpayer is a bona fide resident of a foreign country. (Linde v. Comm. , TC Memo 2017 – 180., Also see Sohurek , CA 7, 1962, 9AFTR 2d 883): Con't

- assumption of economic burdens and payment of taxes to the foreign country;
- status contrasted to that of transient or sojourner;
- treatment of the taxpayer's income tax status by his or her employer;
- marital status and residence of the taxpayer's family;
- nature and duration of the taxpayer's employment;
- good faith in making the trip abroad, e.g., whether for the purpose of tax evasion

b. No one factor supersedes others.

D. Factors to Consider in determining whether a taxpayer is a bona fide resident of a foreign country. (Linde v. Comm. , TC Memo 2017 – 180., Also see Sohurek , CA 7, 1962, 9AFTR 2d 883): Con't

Diaz v. Comm., TC Memo 2024 – 45. Taxpayers, a married couple, were not entitled to a foreign income exclusion because they failed to prove that the closing agreement they had entered into was invalid. The husband was employed as a US defense contractor on a joint military base in Australia and was asked to sign a closing agreement with the IRS. In that agreement, the taxpayer had waived the right to claim the foreign income tax exclusion with respect to wages earned at the base. In exchange, Australia agreed that no Australian income tax would be withheld from wages. The taxpayers argued the signatures appearing above their names were not their signatures but were forged. The husband was not a credible witness he testified to a very different version of the timeline at trial and he relied heavily on forensic evidence presented by different versions of his signature on various documents.

D. Factors to Consider in determining whether a taxpayer is a bona fide resident of a foreign country. (Linde v. Comm. , TC Memo 2017 – 180., Also see Sohurek , CA 7, 1962, 9AFTR 2d 883): Con't

The husband alleged reasons for refusing to sign the closing agreement was that he did not forfeit the benefits of claiming the income exclusion which made no economic sense. The taxpayers offered no explanation as to who would forge their signatures on the document. The forensic evidence regarding taxpayer signature pointed out that they failed to carry their burden of proving that there signatures on the documents were in fact forged. The taxpayers had waived their ability to claim the income exclusion accordingly.

D. Factors to Consider in determining whether a taxpayer is a bona fide resident of a foreign country. (Linde v. Comm. , TC Memo 2017 – 180., Also see Sohurek , CA 7, 1962, 9AFTR 2d 883): Con't

Aubin v. Comm., TC Memo 2024 – 9. Taxpayer who executed closing agreement in which he waived his right to claim Section 911 foreign earned income exclusion for years during which he was working abroad for defense contracting co. in Australia, Tax Court rejected his argument that Section 7121 didn't apply to said agreement. Although taxpayer claimed that agreement didn't address "an actual liability" because none of years to which it related had ended, and 2 of those years had not yet begun, agreements under Section 7121 covered any period ending before or after agreement became effective.

D. Factors to Consider in determining whether a taxpayer is a bona fide resident of a foreign country. (Linde v. Comm. , TC Memo 2017 – 180., Also see Sohurek , CA 7, 1962, 9AFTR 2d 883): Con't

Henaire v. Comm., TC Memo 2023 – 131. The taxpayer was not entitled to exclude foreign-earned income that the taxpayer had received in the form of wages for services she provided for the Corporation in Australia. The taxpayer began her employment with the organization she signed a closer agreement which she waived her right to make an election under section 911. The closing agreement was signed by the director of the IRS the taxpayer argued the director lacked authority to sign the agreement.

D. Factors to Consider in determining whether a taxpayer is a bona fide resident of a foreign country. (Linde v. Comm. , TC Memo 2017 – 180., Also see Sohurek , CA 7, 1962, 9AFTR 2d 883): Con't

The Tasker concluded the director signed the agreement acting as the authority under 1982 tax treaty between the US and Australia. Likewise, the taxpayer was not allowed to exclude the value of housing provided while she was working in Australia. The taxpayer did not establish that her employer provided her lodging for its own convenience that she was required to accept the logic as a condition of her employment or that the lodgings were on the employer's premises.

V. Foreign Currency and Transaction Reporting

A. FBAR Rules

1. If the US person has a financial interest in or signature authority over a foreign financial account, including a bank account, brokerage account, mutual fund, trust or other type of foreign financial account and the amount exceeds $10,000 anytime during the year, the Bank Secrecy Act requires the US taxpayer to report the account yearly by filing electronically a Financial Crimes Enforcement Network (FinCEN) Form 114; Report of Foreign Bank and Financial Accounts (FBAR).

2. A US person, as well as certain domestic entities must file their report if:

A. FBAR Rules: Con't

a. The person has a financial interest in or signature authority (or other authority that is comparable to signature authority) over one or more accounts in a foreign country, and

b. The aggregate value of all foreign accounts exceeds $10,000 anytime during the calendar year.

3. An extension to file Form 114 is allowed for 6 month timeframe ending on October 15 to coincide with the filing of the taxpayers individual income tax return.

A. FBAR Rules: Con't

4. For taxpayers required to file Form 114 for the first time, any penalty for failure to timely request for file extension may be waived (See 2015 Highway Funding Bill)

5. Schedule B, Part III Foreign Accounts and Trusts. Form 1040, Schedule B, Part III must be completed if the taxpayer had over $1,500 of taxable interest or ordinary dividends; had a foreign account; or received a distribution from, or was a grantor of, or a transferor to, a foreign trust.

A. FBAR Rules: Con't

6. Line 7a and 7b of Part III requires a "yes" or "no" to the below two questions if the taxpayer has a signature authority over financial accounts in a foreign country of more than $10,000.

7. Form 114a, Record of Authorization to Electronically File FBARs must be signed by the taxpayer to allow third-party preparers to e-file the form. For those who are filing jointly, each spouse must sign the form. The form is not submitted with the electronic filing but is retained by the tax preparer for five years. Atty., CPAs, enrolled agents filing the FBAR on behalf of the client must register to become a BSA e-file or and file as an institution, rather than an individual.

A. FBAR Rules: Con't

8. There are exceptions to the FBAR reporting requirements. The exceptions are for the following US persons or foreign financial accounts:

- Certain foreign financial accounts jointly owned by spouses
- United States persons included in a consolidated FBAR
- Correspondent accounts
- Foreign financial accounts owned by a governmental entity
- Foreign financial accounts owned by an international financial institution
- Owners and beneficiaries of U.S. IRAs
- Participants in and beneficiaries of tax-qualified retirement plans
- Certain individuals with signature authority over, but no financial interest in, a foreign financial account
- Trust beneficiaries (but only if a U.S. person reports the account on an FBAR filed on behalf of the trust)
- Foreign financial accounts maintained on a United States military banking facility.

A. FBAR Rules: Con't

9. A person who holds a foreign financial account may have a reporting obligation even when the account produces no taxable income. The reporting obligation is met by answering questions on a tax return about foreign accounts (for example, the questions about foreign accounts on Form 1040 Schedule B) and by filing an FBAR.

B. Willful Failure to File and Penalty

1. A willful failure to file an FBAR may result in a civil penalty, which is assessed by the IRS. The penalty ranges from $129,210 up to 50% of the balance in the account at the time of the violation. (31 USC 5321(a)(5)(C))

2. Penalties for non-willful failures to file an FBAR are much lower: the maximum penalty is $12,921 per violation adjusted for inflation.

Examples

US v. Hughes, CA 9 (8/21/2024) 134 AFTR2d 2024 – 5107. The 9TH Circuit Court of Appeals ruled that a District Court applied the correct legal standard in determining that an owner of two New Zealand businesses owed penalties for failing to disclose foreign bank account records and that the failure to disclose was willful. The court determined willfulness can also be established by proof of recklessness as well as subjective intent. The taxpayer indicated she knew of the reporting requirement but did not do so.

Examples: Con't

US v. Schwarzbaum, CA 11 (8/30/2024) 134 AFTR2d 2024 – XXXX. The 11th Circuit found that the willful penalty imposed on a taxpayer from filing the foreign bank account reporting requirements is subject to the Eighth Amendment excessive fines clause. The case involved a naturalized US citizen with bank accounts in Costa Rica and Switzerland for the taxpayer was aware of the filing requirement but and failed to report accounts for three years resulting in penalties of $300,000 penalty assessed on one low value account. The appellate court agreed with the District Court that the failure to file the reports was with recklessness and willful. However, the penalty must be one that is to serve solely a remedial purpose.

Examples: Con't

The court noted that the willful penalties may be excessive irrespective of the magnitude of the financial injury caused to the government. The 11th Circuit was not persuaded by the first circuit court indicating such penalties are not excessive because they are designed to reimburse the government for generalized harm relating to concealment of money. The court determined Eighth Amendment analysis should be on account by account basis not an aggregate test. In this case the court determined that the penalty of $100,000 for willful violations was constitutionally excessive as to one of the taxpayers accounts as the balance never exceeded $16,000 for any relevant year and $100,000 per year fine for this account is grossly disproportional.

Examples: Con't

US v. Gaynor, 133 AFTR2d 2024 – 716. A Federal District Ct. in Florida concluded that a deceased heiress did not willfully evade FBAR reporting for three years where she answered no on the Schedule B regarding foreign accounts despite $ 31 million in a Swiss account and attempted to file back returns and FBAR through a silent disclosure provision.

Examples: Con't

US v. Kelly, 133 AFTR2d 2024 – 710. The Sixth Circuit Court of Appeals agreed with the lower District Court that the taxpayer's failure to file the FBAR report was willful and that he sought no professional advice prior to the closing of all his domestic bank accounts and opening accounts in Switzerland.

Examples: Con't

US v. Reyes, 133 AFTR2d 2024 – 468. A District Court judge found the taxpayers willfully failed to disclose your Swiss Bank accounts concluding that their statement on Schedule B that they had no interest in a foreign bank account showed that they recklessly disregarded the FBAR reporting obligations even though they stated they did not review their tax return.

C. Nonwillful Penalties

1. A US person who fails to report a reportable account on an FBAR may be subject to nonwillful penalty. The maximum amount for a non-willful penalty is $10,000 adjusted for inflation.

2. The failure to comply with the reporting requirements will not result in a penalty if the person's failure was due to reasonable cause. That is a facts and circumstance examination.

C. Nonwillful Penalties: Con't

3. The Service will not impose a penalty for the failure to file the delinquent FBAR if the taxpayer properly reports on the tax return and paid all taxes on the income from the foreign financial accounts reported on the delinquent FBAR and the taxpayer had not previously been contacted by the IRS regarding income tax examination or request for delinquent returns for the years for which the delinquent forms are submitted.

C. Nonwillful Penalties: Con't

4. Non- willful Penalty Applies on a Per Report Basis, not on a Per Account Basis.

a. Bittner v. US S. Ct. 10 – 28 – 23) 131 AFTR2d 2023 – 437. The US Supreme Court overturned the Fifth Circuit Court of Appeals and held that the $10,000 maximum Penalty for the non-willful failure to file an FBAR accrues on a per report basis not on a per account basis. The Ninth Circuit along with other district courts had held that the $10,000 penalty apply also on a per report basis and not in a per account basis. It is unclear the extent that this decision has a retroactive effect for assessments prior to 2023.

D. FBAR penalties are not taxes subject to the collection due process (CDP) requirements

1. In a recent Tax Court case, the court determined that FBAR penalties assessed against the taxpayer were the taxpayer was informed that funds would be withheld from the monthly Social Security to satisfy the penalty is allowed and the taxpayer is not allowed a collection due process hearing.

2. Tax Court indicated that the penalties are authorized and imposed by Title 31 not Title 26 which is associated with the Internal Revenue Code as such the Tax Court lacked jurisdiction. Under Title 31, the Treasury Secretary may impose a civil pendant any person it fails to file an FBAR as required by law as the penalty is a non-tax debt owed to the United States. (See Jenner v. Co., 163 TC No. 7)

E. Treaties May Protect Against FBAR Penalties

1. Lawful permanent resident of the US may not be liable for failing to file FBAR disclosing bank accounts in foreign country for being treated as a resident under a US – Mexico tax treaty

Aroeste v. US, 132 AFTR2d 2023 – 6577 (DC CA, 114/20/2023). The taxpayer was born in Mexico and live there all his life. He worked in Mexico until he retired in 2012. The taxpayers owned a condominium in Florida which they had used as a vacation home. No one lived in the vacation home on a full-time basis. The taxpayer always filed Mexican tax returns as a resident in Mexico. In 1984, the taxpayer applied for and received permanent residency status in the United States the green card. The status was never revoked. His wife became a naturalized US citizen in 2011 and she was a citizen during the tax years at issue.

E. Treaties May Protect Against FBAR Penalties: Con't

The parties agreed that the wife was a citizen and thus a US person required to file a Report of Foreign Bank and Financial Accounts (FBAR) for the tax years at issue. In 2012 and 13, the taxpayers had a financial interest or signature authority over five bank accounts in Mexico which exceeded in aggregate the balance of $10,000. With respect to their tax returns for 2012 and 2013, the taxpayers file an individual income tax return as married filing joint but did not submit Form 8833: Treaty Based Return Position Disclosure Under Section 6114 or 7701 (b) raising Article 4 of the US – Mexico income tax Convention. The taxpayer was previously advised to apply for and enter into the Offshore Voluntary Disclosure Program and the taxpayer did so but he did not file the FBAR for 2012 or 13.

E. Treaties May Protect Against FBAR Penalties: Con't

The taxpayer subsequently opted out of the disclosure program based upon legal advice regarding the US – Mexico Tax Treaty the IRS open examination and the taxpayer submitted an amended return indicating they were not required to file under the treaty. The taxpayer subsequently amended the return a second time to indicate married filing separate status with the wife would file the FBAR the husband would not. The willful penalty was assessed for both 2012 and 2013. The taxpayers sued the United States seeking to recoup penalty payments. The issue is whether the husband was a US person who had a financial interest in or signature authority over a foreign financial account requiring the reporting if the foreign bank account exceeds $10,000 at any time during the calendar year.

E. Treaties May Protect Against FBAR Penalties: Con't

A US person includes a resident of the United States as well as resident aliens. It is undisputed the taxpayer obtained green card and it was never revoked. The taxpayer fit the definition of a resident alien who may be subject to the reporting requirements. The services position is that the forms required to be exempt were as the beneficiary. The daughter is a non-eligible designated beneficiary. Not filed timely and could not be accepted in an amended fashion. The taxpayer asserts that the US-Mexico treaty prevails over late filing of the tax forms. Specifically, the taxpayer asserts that the failure to file Forms 1040 and are and Form 8833 deprives individuals of the treaty's benefits.

E. Treaties May Protect Against FBAR Penalties: Con't

The taxpayer argues that a taxpayer that fails to meets the requirements of the filing the forms should have a penalty equal to $1,000 for each failure not the FBAR penalty. The court determined that although the taxpayer did not give timely notice of his treaty position in the forms, the taxpayer did not waive the benefits of the treaty as asserted by the IRS. Hence the lower penalty provision would apply. The court found that the taxpayer is a US person but ceased to be a lawful permanent resident of the United States because the taxpayer commenced to be treated as a resident of Mexico under the treaty.

E. Treaties May Protect Against FBAR Penalties: Con't

The taxpayer did not waive the benefits of the treaty and notified the secretary of the treasury of such treatment. The taxpayer is not under the treaty subject to the FBAR penalties under the treaty. The taxpayer is a US person but ceased to be treated as a lawful permanent resident of the United States because the taxpayer commenced to be treated as a resident of Mexico under the treaty and did not waive the benefits of the treaty. In addition, the government must refund the penalty assessed and abate. The taxpayer is charged with the penalty per failure to timely report the treaty position which would have been a total of $2,000.

F. Form 8938: Statement of Specified Foreign Financial Assets

1. Form 8938, "Statement of Specified Foreign Financial Assets," is to be used by individuals to report an interest in one or more specified foreign financial assets under Section 6038D. The instructions reflect changes in the reporting requirements associated with the following:

2. Form 8938 disclosure statement requires the reporting of the maximum value of foreign assets during the tax year. The disclosure statement should also provide information regarding financial accounts, including the name and address of the foreign financial institution in which the account is maintained and the account number. In addition, the disclosure statement should also provide the name and address of foreign issuers of stocks or security and information that is as needed to identify the class of such stock or security. Also, foreign asset disclosure is required with respect to the issuance of foreign contracts, instruments or other interests.

F. Form 8938: Statement of Specified Foreign Financial Assets: Con't

3. Foreign real estate is not a reportable asset, this would include a personal residence or rental property. However, if the real property is held in a foreign entity the interest in the entity is a specified foreign financial asset that must be disclosed on Form 8938 if the total value of the financial assets falls within the threshold of reporting.

4. Tangible assets such as art, antiques, jewelry, cars and other collectibles directly held by the taxpayer or not specified foreign financial assets requiring disclosure. This would include precious metals. However. gold certificates issued by foreign person are a specified foreign financial asset would require disclosure.

F. Form 8938: Statement of Specified Foreign Financial Assets: Con't

5. A foreign pension plan or deferred compensation plan must be reported on Form 8938. In general, the value of the taxpayer's interest in the foreign plan is the fair market value of his or her beneficial interest on the last day of the year. However, if the taxpayer does not know nor has reason to know the fair market value of the plan's beneficial interest because such value is not readily accessible the maximum value is the value of cash property distributed to the taxpayer during the year. If there were no cash or property distributions from the form plan during the year and the taxpayer simply cannot readily determine the value, then it would not be reported.

6. The threshold for reporting on Form 8938 are shown below:

F. Form 8938: Statement of Specified Foreign Financial Assets: Con't

	If Total Value of Foreign Financial Assets Exceed		
Not Living Abroad	**On Last Day of the Year**		**At Any Time during the Year**
Single and MFS	$50,000	or	$75,000
MFJ	$100,000	or	$150,000
Living Abroad	**On Last Day of the Year**		**At Any Time during the Year**
Single and MFS	$200,000	or	$300,000
MFJ	$400,000	or	$600,000

F. Form 8938: Statement of Specified Foreign Financial Assets: Con't

7. It should be noted that the form 8938 and the instructions have been converted from an annual revision to continuous use. Both the form instructions will be updated on an as needed basis.

8. The currency exchange rate converter generally is what is used for the conversion to US dollars. The link ishttps://fiscaldata.treasury.gov/currency-exchange-rates-converter/

VI. Cancellation of Debt (COD)

A. General Rule

1. Gross income includes income from the discharge of indebtedness. This applies equally to debts discharged by commercial lenders and those canceled by private lenders (See Section 61 (a) (12)).

2. In essence COD income can occur in any of the following circumstances:

A. General Rule: Con't

- Modification of a debt, as defined in Regs. Section 1.1001-3;
- Issuance of equity in satisfaction of debt (see Sections 108(e)(8) and 108(e)(6));
- Acquisition of outstanding debt at a discount by a party related to the debtor, as defined in Section 108(e)(4);
- Issuance of a contingent value right or similar property right in satisfaction of debt;
- Discharge of the debt occurring either within or outside a bankruptcy proceeding; and
- An asset foreclosure or similar transaction satisfying the debt.

B. Forgiveness of Student Loan Debt

1. The American Rescue Plan Act of 2021 (ARPA) excluded from gross income in taxable years 2021 through 2025 amounts related to the discharge of certain student loan debt, whether federal or private. The exclusion is applicable to discharges of loans after December 31, 2020, and before January 1, 2026.

2. In a bankruptcy procedure forgiveness or discharge of debt can occur if there is undue hardship. This is the case with respect to student loan debt.

Example

In re Carney Bktcy Ct MA 131AFTR2d 2023 – 502. The taxpayer claimed discharge of her student loan debt was denied because of her failure to prove undue hardship. The taxpayer argued that she would be suffering the same hardship in terms of a cancellation or forgiveness of debt income that will result if or when the debt was forgiven. Her alternative request for cancellation that no income tax would arise from the discharge was also meaningless. She could not demonstrate that it was undue because it was mere speculative in nature at the time of the bankruptcy filing and she was seeking a Chapter 13 reorganization.

C. Insolvency can be a Reason for Exclusion from Gross Income

1. General Rule. Section 108(a) defines the amount of insolvency subject to exclusion from gross income to be the amount of liabilities exceeding the fair market value of assets. The burden to substantiate insolvency rests with the taxpayer.

Example

Henry v. Comm., TC Memo 2024 – 79. Taxpayers' cancellation of debt income exclusion was rejected by the IRS. Taxpayer maintained that he was insolvent when debts were canceled. Taxpayer acknowledged he received income from cancellation of debt and admitted he provided no information concerning his claim of insolvency. He asked at the Tax Court to provide additional information of his insolvency. The income recognition was not included in the IRS notice to him of additional liability. As such, the Service bears the responsibility to demonstrate the taxpayer was in fact solvent. Since the IRS was late the insolvency position stood and the cancellation of debt was excluded from income.

C. Insolvency can be a Reason for Exclusion from Gross Income: Con't

2. The insolvency worksheet and supporting documentation are required to have the exclusion from gross income accepted.

Example

White v. Comm., TC Memo 2023 – 7. The taxpayer was entitled to take advantage of the insolvency exception to exclude from gross income cancellation of debt income received in connection with the discharge of the business loan. The taxpayer attached worksheets at the time of the filing of the return showing that the debt had exceeded her assets and that she was insolvent at the time the business loan was discharged.

Example: Con't

The IRS argued that the loan was in association with equity and not debt. In the event the court deemed it debt, the IRS argued that an acceleration of payment is not to be construed as associated with a bona fide debt arrangement. In this particular case, the debt was associated with real property and was part of a landlord-tenant situation. The landlord did not pursue litigation for the outstanding liabilities that does not preclude the arrangement from not meeting the definition of a bona fide debtor-creditor arrangement. Even though the lessor did not sue the taxpayer or take other action other than eviction this does not mean that the debt was not otherwise bona fide debtor-creditor arrangement.

C. Insolvency can be a Reason for Exclusion from Gross Income: Con't

3. Defined Benefit Pension Plans. The Service has announced in action on decision that it will not acquiesce to the decision in the Schiener case (TC Memo 2017 – 32). In that case, the Tax Court held an interest in a defined benefit pension plan is not an asset for purposes of applying the insolvency exclusion under Section 108.

4. Related Party Debt. In determining insolvency of the taxpayer related party debt is not part of the determination of insolvency. Advances between related entities must establish a bona fide debtor-creditor relationship to be successful as a bad debt deduction.

D. Exclusion from Gross Income of Student Loans Discharge on Account of Death or Disability

1. Presently, any income resulting from the discharge of a student loan on account of death or disability of the student is excluded from taxable income. The provision is set to expire December 31, 2025

2. Section 110019 of the bill, would permanently extend the exclusion from the taxpayers income of any income resulting from the discharge of the student debt due to death or total disability of the student the one changes for the exclusion to be applicable the taxpayer's Social Security number must be provided in the year of the exclusion and demonstrated on the tax return. This provision will go into effect January 1, 2026.

E. Cancellation of Debt and Disregarded Entity

1. What is considered a discharge of debt in association with the disregarded entity?

Example

Jacobowitz v. Comm., TC Memo 2023 – 107. The taxpayer had an LLC in which he was the sole member. The LLC, through the taxpayer, executed a promissory note and security agreement for a business line of credit with the bank. Default occurred. The taxpayer claimed the cancellation of debt income should not be attributable to him personally but to the LLC. The taxpayer never filed Form 8832 electing to be treated as a corporation.

Example: Con't

For all purposes, he was treated as a disregarded entity. Cancellation of debt with respect to a disregarded entity is attributable to the individual taxpayer. In addition, the taxpayer failed to show the debt was discharged before the year at issue. The taxpayer also attempted to treat the cancellation of debt as capital gains, claiming that as an LLC the bank never agreed that the LLC would surrender any property in association with the line of credit and that the interest accrued was not associated with ordinary and necessary expenses of the business.

VIII. Personal Injury Awards

A. Compensation for Injury or Sickness and Punitive Damages – Section 104

1. Generally, compensation for personal injuries and sickness is excludable from gross income. The following are generally excludable:

a. Amounts received under Workmen's Compensation

b. Amount of damages received (other than punitive damages) on account of a personal physical injury or physical sickness. The exception excludes only physical injuries but not emotional distress because of age, race, gender, or disability, libel, slander and other nonphysical wrongs.

Example

Zajac v. Comm., TC Memo 2025 – 33. The taxpayer was partially entitled to exclude from gross income settlement proceeds received from a municipality. Tax Court determined that a portion of the payment was compensation for physical injuries and related emotional distress resulting from a false arrest making it excludable from gross income. The remainder of the settlement related to nonphysical claims and was determined to be includable in gross income

A. Compensation for Injury or Sickness and Punitive Damages – Section 104: Con't

c. Amounts received for accident or health insurance for personal injuries or sickness

d. Amounts received as a pension, annuity for personal injuries or sickness resulting from active service in the Armed forces, public health service for foreign service.

e. Amounts received as disability income attributable injuries occurred as a direct result of a terrorist or military action.

A. Compensation for Injury or Sickness and Punitive Damages – Section 104: Con't

2. Often several amounts received by compromise, mediation, arbitration or judgment are includable in gross income. The item that the settlement replaces must be considered. The following are generally includable as ordinary income:

a. Interest on any award.

b. Compensation for lost wages or lost profits.

A. Compensation for Injury or Sickness and Punitive Damages – Section 104: Con't

c. Damages for patent or copyright infringement, breach of contract, tortious interference with a business operation.

d. Back pay and damages for emotional distress under Title VII the Civil Rights Act of 1964.

e. Attorney's fees and costs where the online recovery is included in gross income.

f. Attorney's fees and costs way to wasn't going awards where the online recovery is included in gross income.

A. Compensation for Injury or Sickness and Punitive Damages – Section 104: Con't

3. IR 2023 – 81. The IRS posted FAQs on its website that address the income tax consequences of state compensation payments received by victims of forced, involuntary all coerced sterilization. Under the FAQ, some states compensate victims under state programs. These compensations are pursuant to state legislation. In general, the FAQ states the compensation payments for forced sterilization are excluded from gross income because the payments are compensatory damages for physical injuries.

A. Compensation for Injury or Sickness and Punitive Damages – Section 104: Con't

4. Amounts received by the employee through an accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts are attributable to contributions by the employer which were not includable in the gross income of the employee or are paid by the employer. (See Section 105 (a))

5. Workmen's Compensation

a. Service-connected disabilities generally excludable from gross income.

Examples

Tuma Se. v. Comm., TC Memo 2024 – 71. The IRS determined that the taxpayers railroad benefits and Social Security benefits received in the year at issue are not amounts that are associated with a disability excluded under Section 104. Merely making a claim that they are associated with disability is not enough.

Examples: Con't

Scott v. Comm., TC Memo 2024 – 27. The taxpayer received civil service retirement disability payments that were determined to be includable in the taxpayer's gross income because the payments were not attributable to an injury or illness sustained through the husband's active service in the arm forces. The exclusion of the payments under Section 104 does not apply. The taxpayer excluded the amounts on the federal return contending that the payments did not constitute taxable income. There was no evidence to suggest that the payments at issue were attributable to injury or illness sustained through the husband's active service in the Armed Forces.

A. Compensation for Injury or Sickness and Punitive Damages – Section 104: Con't

b. State Plan Related to Deaf for Permanent Disability – IRS Letter Ruling 202512001. Payments from a state plan to officers injured in the line of duty or to the families of officers killed in the line of duty are excludable from income. The plan provider for a one time payment of an amount to public safety officers who were determined by retirement board to either be personally disabled as a result of bodily injury or disease or who died in the line of duty.

A. Compensation for Injury or Sickness and Punitive Damages – Section 104: Con't

Under the plan, retirement board must determine that the permanent disability occurred in the line of duty and was not caused by intentional misconduct, intentional infliction of injury or voluntary intoxication. The payments under the plan are not based upon age, length of service or prior employee contributions in the lump sum is provided to a class that was restricted to employees with service-connected injuries.

6. Employment Discrimination. Rewards for employment discrimination or settlements do not fall within the Section 104 exclusionary requirements.

Examples

Paladino v. Comm., TC Memo 2025 – 101. The taxpayer is required to include in gross income settlement proceeds received from a former employer. The Tax Court found the payments arose from claims of sexual harassment, discrimination and retaliation and did not involve any allegations of personal physical injuries or physical sickness. The settlement agreement specifically referenced emotional distress and disclaimed physical injury.

Examples: Con't

Mennemeyer v. Comm., TC Memo 2025 – 80. The taxpayer receives settlement proceeds from a former employer and required to include them in gross income. The Tax Court found that the award rose from employment -related claims including defamation and economic harm and not from personal physical injuries or physical sickness. Settlement agreement made no reference to physical injuries and the record contained no credible evidence supporting an exclusion.

IX. Rental Property and PAL Rules

A. Section 469

1. Section 469 limits the taxpayer's ability to deduct the losses from businesses in which he or she does not materially participate, and this limitation also applies to rental activities. The passive activity loss rules apply at the individual level and extend beyond tax shelters to businesses reported on Schedule C, E, F and flow through entities such as partnerships, LLCs, S Corp. and trusts.

2. A passive activity loss is defined as the excess of the aggregate losses from all passive activities for the taxable year over the aggregate income from all passive activities for that year. (See Section 469(d)(1))

A. Section 469: Con't

3. A passive activity is any trade or business in which the taxpayer does not materially participate.(See Section 469(c)(1)). A taxpayer is treated as materially participating in an activity only if his or her involvement in the operations of the activity is regular, continuous, and substantial. (See Section 469(h)(1))

4. In essence, losses and credits from passive activities are deductible to the extent they exceed income from all activities. In other words, they are deductible as losses to the extent of income.

A. Section 469: Con't

5. There have always been two primary exceptions to this rule. The exceptions are associated with the status of being a real estate professional and secondly, the ability to deduct up to $25,000 of rental losses from actively managed real estate.

6. The rule remains that any passive activity loss not currently deductible is suspended and becomes deductible in a subsequent year which the taxpayer either has net passive activity income or completely disposes of the passive activity property to an unrelated party.

A. Section 469: Con't

7. Generally, any rental activity is per se a passive activity (See Section 469 (c) (2)). It is the taxpayer burden to overcome this by demonstrating material participation or the taxpayer is a real estate professional.

8. The regulation list exceptions to the definition. Specifically, an activity involving the use of property is not a rental activity for a taxable year if:

A. Section 469: Con't

- The average period of customer use for the property is 7 days or less;
- The average period of customer use for such property is 30 days or less, and significant personal services are provided by or on behalf of the owner of the property connection with making the property available for use by customer;
- Extraordinary personal services are provided by on behalf of the owner of the property connection with making such property available for use by customers;
- The rental of such properties treated as incidental to a non-rental act the taxpayer; the taxpayer customarily makes the property available during defined business hours for nonexclusive use by various customers; or
- The provision of the property for use in an activity conducted by a partnership, S corporation or joint venture in which the taxpayer owns an interest is not a rental activity.

B. Material Participation

1. An individual is treated as participating "materially" for the taxable year if the individual's participation meets one of the participation tests listed in Reg. Sec. 1.469-5T(a)(1)-(7).

- The individual participates in the activity for more than 500 hours during such year;
- The individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for such year;

B. Material Participation: Con't

- The individual participates in the activity for more than 100 hours during the taxable year, and such individual's participation in the activity for the taxable year is not less than the participation in the activity of any other individual (including individuals who are not owners of interests in the activity) for such year;
- The activity is a significant participation activity (for the taxable year, and the individual's aggregate participation in all significant participation activities during such year exceeds 500 hours;

B. Material Participation: Con't

- The individual materially participated in the activity for any five taxable years (whether or not consecutive) during the ten taxable years that immediately precede the taxable year;
- The activity is a personal service activity and the individual materially participated in the activity for any three taxable years (whether or not consecutive) preceding the taxable year; or
- Based on all of the facts and circumstances the individual participates in the activity on a regular, continuous, and substantial basis during such year.

C. Real Estate Professionals

1. A taxpayer's rental real estate activities in which he or she materially participates are not subject to limitation under the passive loss rules if the taxpayer meets eligibility requirements relating to real property trades or businesses in which the taxpayer performs services. This means that real estate investors who qualify are permitted to deduct their rental real estate losses against other income sources (e.g., commissions, wages, etc.) (See Sec.469(c)(7)). The eligibility requirements include the following:

C. Real Estate Professionals: Con't

a. The taxpayer owns an interest in the real property. (See (Reg. Sec.1.469–9(b)(6)).
b. More than 50% of the individual's personal services during the tax year must be performed in real property trades or businesses in which the individual materially participates, and
c. The individual must perform more than 750 hours of service in those same trades or businesses.
d. The total time spent in any combination real estate related activities is used to determine if the 50% and the 750-hour tests are met.
e. Real property trade or business means "*any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage or trade or business"* (See Section 469(c)(7)(C)).

C. Real Estate Professionals: Con't

2. Aggregation of Rental Real Estate When a Real Estate Professional

a. Each interest of the taxpayer in rental real estate is to be considered as a separate activity, but a taxpayer **may elect** to treat all interests in real estate, including real estate held through pass-through entities, as one activity (See Section 469(c)(7)(A)).

C. Real Estate Professionals: Con't

b. The aggregation option permits the investor to meet the material participation test after cumulatively materially participating in all the real estate rentals. Without the aggregation option, the investor would be required to materially participate in each activity, making it more difficult to get around the passive loss limitations.

c. The election to treat all interests in rental real estate as a single rental real estate activity is binding for all future years unless there is a material change in a taxpayer's facts and circumstances.

C. Real Estate Professionals: Con't

d. The taxpayer makes the election by filing a statement with his or her original income tax return. This statement must contain a declaration that the taxpayer is a qualifying taxpayer for the taxable year and is making the election pursuant to Section 469(c)(7)(A) (See Reg. Sec.1.469-9(g)).

e. Taxpayers that are real estate professionals may make a late election to group rental activities if they represent on a statement, filed under penalty of perjury that they meet the following requirements:

C. Real Estate Professionals: Con't

- The only reason that the election was not made timely was not because the taxpayer did not file the statement with his or her return the first year, they became a real estate professional.
- The taxpayer fought all required federal tax return consistent with the requested grouping for all years including and following the year the taxpayer intended the grouping to be effective.
- The taxpayer timely filed each return that would've been affected by the election if the grouping has been timely filed and the tax bill we treated as having timely filed the return was filed within six months after the due date including extensions.
- The taxpayer had reasonable cause the failure to meet the requirements to file timely.

C. Real Estate Professionals: Con't

3. Substantiation

a. With respect to the evidence that may be used to establish hours of participation, the extent of an individual's participation in an activity may be established by any reasonable means.

b. Time reports, logs, or similar documents are not required if the extent of such participation may be established by other reasonable means. Reasonable means may include, but are not limited to, the identification of services performed over a period of time and the approximate number of hours spent performing such services during such period, based on appointment books, calendars, or narrative summaries (See Reg. Sec. 1.469-5T(f)(4)).

Examples

Gossain v. Comm., TC Memo 2024 – 97. Taxpayers rented out property and provided audit activity logs stating that the husband worked on the property 751 hours for 2009, 751 hours for 2010, 757 hours for 2011, 753 hours for 2014, and 752 hours for 2016. A second rental property was purchased in 2016. The taxpayer had a full-time job working at least 40 hours a week. Taxpayer argues he materially participated in the rental properties for the timeframe stated herein. The court looked at whether the taxpayer was a real estate professional. The logs were not contemporaneous. The hours in question include personal work on the property when it was not rented.

Examples

- **Mirch v. Comm., TC Memo 2025 – 128.** A married couple was not entitled to business expense deductions, rental activity losses, or a net operating loss deduction for the tax years at issue. The Tax Court found the deductions were unsubstantiated and the rental losses were passive under the PAL rules.
- The couple operated a law firm and claimed deductions for insurance, pension contributions, medical expenses, and travel. The Court held that general records such as ledgers and bank statements did not meet the substantiation requirements under Section 274 (d). The wife managing the properties did not meet the 750-hour threshold to qualify as a real estate professional.

Examples: Con't

Foradis and Moore v. Comm., TC Summary 2024 – 13. The couple filed a joint return claiming a rental real estate loss deduction of $22,376 from their newly constructed carriage house property. Both taxpayers work full-time jobs earning over $75,000 each. The taxpayer spent time constructing the carriage house after work and on weekends and while maintaining full-time employment. The property began as a short-term rental operation managed by a real estate management company.

Examples: Con't

The court found that the taxpayer who claim to be a real estate professional failed to meet the more than 50% of all personal services test. The taxpayer testified to spending approximately 2,500 hours constructing the carriage house. The court found this claim implausible given his full-time employment of about 2,000 hours per year. The court concluded the taxpayer could not prove he spent more than half of this total personal services on the rental real estate during the year at issue and thus did not qualify as a real estate professional as such the losses were limited.

D. Self-Employment Tax Issues Regarding Rentals

1. Generally, rents from rental arrangements are not subject to self-employment tax.

2. Section 1402 (a) (1) provides an exclusion from such self-employment income for gross income that individuals other than real estate dealers earn from *"rentals from real estate and from personal property leased with the real estate."*

D. Self-Employment Tax Issues Regarding Rentals: Con't

3. A real estate dealer is *"an individual who is engaged in the business of selling real estate to customers with a view to the gains and profits that may be derived from such sales."* (See Section 1221)

4. The regulations also provide that *"an individual who merely holds real estate for investment or speculation and receives rentals therefrom is not considered a real-estate dealer."* The courts have traditionally used the following factors (Winthrop, Ada Belle v. Tomlinson, (CA-5) 69-2 USTC ¶9686, 417 F2d 905)):

D. Self-Employment Tax Issues Regarding Rentals: Con't

- The reason and purpose the property was acquired and/or disposed;
- The length of time the property was held;
- The number and frequency of sales, usually annually;
- The continuity of sales or sales-related activity over a period of time;
- Overall reluctance to sell the property;
- The substantiality of the gain obtained on the sale
- The extent to which the taxpayer or his or her agents engaged in sales activities by developing or improving the property, soliciting customers, or advertising;
- The substantiality of sales when compared with other sources of the taxpayer's income; and
- The desire to liquidate unexpectedly obtained land holdings

E. CCA 202151005- Income from Short-term Rental Includable in Self Employment Income

1. The Service recently in a CCA discussed 2 examples when income from short-term rentals is includable in self-employment income. Under Section 1402 (a)(1), net rental income generally is not included as income subject to self-employment tax unless the income is received by a real estate dealer or the rent includes substantial services provided to the occupant for the occupants convenience.

2. A rental activity is not a passive activity if the average period of customer use the property is 7 days or less in addition, rental activity is not passing if the taxpayer materially participates in the activity (Section 469)

Example 1

Individual who is not real estate dealer has been renting a fully furnished vacation property via an online. The individual provides daily housekeeping services, access to Wi-Fi, a beach and recreation equipment for occupants during their stay and prepaid vouchers for ride share services between the property and nearby business. The customers used the property on average for 7 days. The activity is not considered a rental activity for purposes of the passive activity loss rules.

Example 1: Con't

The CCA notes that the taxpayer provided services for the occupants that are not clearly required to maintain the property in condition for occupancy and are of **such a substantial nature** that the compensation for those services constitutes a material portion of the rent. As such the net rental income is included in income subject to self-employment tax.

Example 1: Con't

Note: The assumption is the activity is not a rental activity because of the seven day or less average requirement. Further, the assumption is that the taxpayer materially participates within the meaning of Section 469 (h) (1). As such the activity is not passive in nature. Thus, the net rental income is subject to self-employment tax because what the taxpayer provides is substantial services beyond what is required to maintain the space in a condition suitable for occupancy.

Example 2

An individual who is not a real estate dealer has a business renting fully furnished rooms and bathrooms in their home via an online rental marketplace. Renters only have access to the common areas of the home to enter and exit the room and bathroom and have no access to other common areas such as the kitchen and laundry area. The taxpayer cleans the room and bathroom in between each occupants stay. For the tax year at issue, the average period of customer use of the property 7 days and the taxpayer materially participates in the activity. The activity is not passive for purposes of the passive activity loss rules.

Example 2: Con't

Taxpayer's net income from renting of the living quarters is not income subject to self-employment tax because no services are rendered to the occupants. Taxpayer cleans and maintains the property so that it remains suitable for occupancy. The services are not furnished primarily for the occupants convenience.

Example 2: Con't

Note: the net rental income is not subject to self-employment tax even though the taxpayer may materially participate in the activity which would make the activity active in nature. It is not subject to self-employment tax because the taxpayer is not providing substantial services beyond what is required to maintain the space in a suitable condition for occupancy.

F. Reg § 1.1402(a)-4. Rentals from Real Estate

1. Rentals from real estate and the deductions attributable thereto, unless the rentals are received by the taxpayer in the course of a trade or business as a real estate dealer are excluded from self-employment tax as a general rule.

2. Obviously, a taxpayer who holds real estate for investment or speculation and receives rentals is not a real estate dealer.

F. Reg § 1.1402(a)-4. Rentals from Real Estate: Con't

3. Where a real-estate dealer holds real estate for investment or speculation in addition to real estate held for sale to customers in the ordinary course of his trade or business as a real-estate dealer, only the rentals from the real estate held for sale to customers in the ordinary course of his trade or business as a real-estate dealer, and the deductions attributable thereto, are included in determining net earnings from self-employment; the rentals from the real estate held for investment or speculation, and the deductions attributable thereto, are excluded.

F. Reg § 1.1402(a)-4. Rentals from Real Estate: Con't

4. Under Regulation 1.1402 (c) – 4, payments or the use or occupancy of entire private residences or living quarters in duplex or multiple-housing units are generally rentals from real estate. Except in the case of real-estate dealers, such payments are excluded in determining net earnings from self-employment even though such payments are in part attributable to personal property furnished under the lease.

F. Reg § 1.1402(a)-4. Rentals from Real Estate: Con't

5. Likewise, payments for the use or occupancy of rooms or other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, or payments for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rentals from real estate; consequently, such payments are included in determining net earnings from self-employment.

F. Reg § 1.1402(a)-4. Rentals from Real Estate: Con't

6. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only.

7. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, the collection of trash, and so forth, are not considered as services rendered to the occupant.

F. Reg § 1.1402(a)-4. Rentals from Real Estate: Con't

8. Substantial Service Dilemma. The exclusion of rental activities from self-employment tax does not apply if substantial services are provided to the tenant or occupant. The determination of substantial services is a facts and circumstance examination.

a. The Regulation states that substantial services provided by a landlord or homeowner to a tenant/occupant involve a level of service that exceeds those usually or customarily rendered in connection with the rental of rooms or other spaces of occupancy.

F. Reg § 1.1402(a)-4. Rentals from Real Estate: Con't

b. In applying the above example there is no bright line test to determine substantial services. In examining the CAA the closest definition or test of substantial services is whether or not the occupant or tenant is receiving a **convenience or a benefit from the services provided**.

9. Despite the exposure for self-employment tax, the taxpayer if they provide substantial services and there is a loss the passive activity rules and at risk rules may place a limitation period. In the alternative, if the self-employment tax is not applicable the taxpayer may have some exposure under Section 1411 to the net investment income tax.

F. Reg § 1.1402(a)-4. Rentals from Real Estate: Con't

10. The Service has determined that if the taxpayer provide substantial services to an occupant/guest the income may need to be reported on Schedule C is the subject to self-employment tax. From a planning perspective, taxpayers may wish to consider alternatives such as moving the property into a S Corporation to mitigate FICA tax. Despite that movement, the taxpayer still would have to demonstrate material participation even in an S Corporation to obtain a loss deduction in the event that occurs.

F. Reg § 1.1402(a)-4. Rentals from Real Estate: Con't

11. To date there are no revenue rulings, revenue procedures, court cases that have addressed a definition of substantial services. This is going to be an issue going forward in the gig economy.

12. Obviously, and as previously stated, if the client does not provide substantial services then the net income from the rental would not be subject to self-employment tax and would be identified on Schedule E. It is still important to meet the 14 day or 10% test so that the deductions can occur.

X. Section 165 Losses

A. General Rule

1. Section 165(a) allows a deduction for *"any loss sustained during the taxable year and not compensated for by insurance or otherwise."*

2. The basis for determining the amount of the deduction for any loss shall be the adjusted basis for determining the loss from the sale or other disposition of the property. (See Section 160 5B)

A. General Rule: Con't

3. In the case of an individual taxpayer the deduction shall be limited to losses incurred in a trade or business, losses incurred in a transaction entered into for profit, though not conductive the trade, or and except as otherwise provided, loss of property not connect with the trade or business or transactions entered into for profit if such losses arise from fire, storm, shipwreck or other casualty or from theft business.(See Section 165 (c).

4 Any theft loss arising from theft shall be treated as sustained or the taxable year in which the taxpayer discovers the loss.

Examples

Root v. Comm., TC Memo 2025 – 51. The taxpayers were not entitled to claim a loss under Section 165 48 guest lodge because the Lodge in property in question was not incurred in a trade or business as required. The enterprise never became optional and did not host customers, employees staff or conduct business activities. Because it was not active the expenses were deemed to be personal in nature.

Examples: Con't

Hampton v. Comm., TC Memo 2025 – 32. The taxpayer was not entitled to deduct losses from the forfeiture of his funds that were seized by the US marshals service. The taxpayer had pled guilty to bribery charges, fraud and money laundering. US marshals seized assets from several bank accounts in the taxpayer's name as well as his corporations. The taxpayer claimed a loss deduction related to the seized assets. Public policy has always dictated that a theft loss deduction does not involve the seizure of assets.

Examples: Con't

Weston v. Comm., TC Memo 2025 – 16. The taxpayers could not claim theft loss or ordinary trade or business loss deductions due to a lack of substantiation. The taxpayers did not provide books and records for their business nor any evidence regarding gross receipts or deductible expenses. The taxpayers were mere investors in the business and did not materially participate in the active conduct of the trade or business. There activities did not rise to the level of a trade or business to warrant a theft loss deduction. The taxpayer also showed that they had not been a prospect of recovery required for theft loss deduction.

XI. Other Gross Income Recognition Matters

A. Gambling Winnings and Losses

1. Gambling income. Gambling income isn't limited to in-person winnings at horse races, and casinos. It may also include winnings from playing online games and participating in television game shows. Gambling income includes both cash winnings and the fair market value of prizes, such as cars and trips.

2. Payors required to report income. Anyone who pays out gambling winnings must issue the winner a Form W – 2 G: Certain Gambling Winnings when the taxpayer's winnings are:

A. Gambling Winnings and Losses: Con't

- $1,200 or more (not reduced by the wager) from a bingo game or slot machine,
- $1,500 or more (reduced by the wager) from a keno game,
- More than $5,000 (reduced by the wager or buy-in) from a poker tournament,
- $600 or more and at least 300 times the amount of the wager (except winnings from bingo, slot machines, keno, and poker tournaments) reduced, at the option of the payer, by the wager, or
- Subject to federal income tax withholding (either regular gambling withholding or backup withholding).

A. Gambling Winnings and Losses: Con't

3. A payer that withholds tax from a gambler's winnings should always file a Form W-2G with the IRS (and provide a copy to the winner) that shows how much the individual won and the amount of tax withheld.

4. Taxpayers who have gambling winnings must report all such income on Form 1040, U.S. Individual Income Tax Return, or Form 1040 – SR, U.S. Tax Return for Seniors. This includes amounts that are not reported on a Form W – 2 G.

5. Gambling winnings are reported on Schedule 1 (Form 1040).

A. Gambling Winnings and Losses: Con't

- **6.** Generally, income tax is withheld from gambling winnings of more than $5,000 from a:
  - sweepstakes,
  - wagering pool,
  - poker tournament,
  - lottery, or
  - any other wager if the proceeds are at least 300 times the amount of the bet.

7. Usually, income tax is withheld at a flat 24% rate. Income tax is not usually withheld from gambling winnings from bingo, keno, and slot machines.

B. Gambling Losses

1. Gambling losses are an itemized deduction taken on Schedule A (Form 1040). Nonprofessional gamblers can't deduct gambling losses that exceed the gambling income reported on their return. Gambling losses can be claimed up the amount of gambling income as "Other Itemized Deductions" on Schedule A.

Example

Kalk v. Comm., TC Memo 2024 – 82. Taxpayer was entitled to deduct gambling losses up to the amount of her gambling winnings to the extent substantiated. The taxpayer substantiated losses with casino win loss statements. The taxpayer did not obtain deductions for other years because of the lack of substantiation the signing in of a casino member card is not enough to substantiate deduction.. The court will allow a non-contemporaneous documentation to prove losses as well as bank statements.

B. Gambling Losses: Con't

2. The bill requires that all deductions for expenses related to wagering be limited to the extent of winnings. (Section 110014)

C. Crowdfunding Distributions – FS – 2024 – 28

1. The IRS on its website released a fact sheet reminding taxpayers that crowdfunding distributions may be includable in gross income of the person receiving them depending upon facts and circumstances.

2. In addition, the crowdfunding site or its payment processor may be required to report these distributions to the IRS on Form 1099 – K.

3. Crowdfunding involves funding a project by raising contributions of a large number of people typically through online websites. Often they are associated with a charitable cause that does not involve a recognized 501(c)(3).

C. Crowdfunding Distributions – FS – 2024 – 28: Con't

4. The American Rescue Plan Act of 2021 clarifies that crowdfunding websites or their payment processors may not be required to file Form 1099 – K with the IRS or furniture to the persons whom the distributions are made if the payments are not made in exchange for goods or services.

5. Originally, the reporting threshold for Form 1099 – K were distributions to a person exceeding $20,000 from more than 200 transactions.

C. Crowdfunding Distributions – FS – 2024 – 28: Con't

6. Notice 2023 – 10 and Notice 2023 – 74. For 2024, the IRS announced a plan threshold to be reduced to $5,000 as a phase in of the new 1099 – K reporting requirement.

7. The IRS also indicated that in some instances it may be possible to treat these distributions as gifts. The service acknowledged that some contributions may qualify as a gift if it is made as a result of the contributors detached and disinterested generosity.

D. Home Energy Rebates Not Includable in Gross Income – IRS Announcement 2024 – 19

1. Rebates paid at the time of sale under two home energy rebates programs that were created in the Inflation Reduction Act are not includable in the individual purchases gross income or cost basis.

2. The Inflation Reduction Act of 2022 appropriated money and authorized the Energy Department to administer to rebate programs under Sections 50121 and 50122, one for whole house retrofits and the other for high energy home electrification projects.

D. Home Energy Rebates Not Includable in Gross Income – IRS Announcement 2024 – 19: Con't

3. A rebate paid to or on behalf of a purchaser will be treated as a purchase price adjustment and is not includable in the purchases gross income under Section 61.

4. A rebate paid the time of sale is not includable in the purchases cost basis under Section 1012. By way of illustration, if the purchaser receives a $500 rebate at the time of sale of the property with the sales price of $600, the purchases cost basis in the property is $100.

D. Home Energy Rebates Not Includable in Gross Income – IRS Announcement 2024 – 19: Con't

5. The amount of rebate provided later constitutes an adjustment to basis under Section 1016. By way of illustration, if a purchaser spent $600 to buy eligible property but later receives a $500 rebate purchasers cost basis is reduced to $100 when the rebate was provided.

6. The payor of the rebate is not required to file information return with the IRS or seek a statement to the purchaser to report the payments of a rebate to the purchaser.

D. Home Energy Rebates Not Includable in Gross Income – IRS Announcement 2024 – 19: Con't

7. Rebate payments made directly to a business taxpayer in connection with the business taxpayer sale of goods or services to a purchaser are not excluded from the taxpayer's gross income.

8. The rebates coordinate with Section 25 C credit that allows taxpayers receive a credit up to 30% of certain qualified expenditures that go toward energy efficient improvements to the home.

D. Home Energy Rebates Not Includable in Gross Income – IRS Announcement 2024 – 19: Con't

9. Taxpayers to receive rebates under the Department of Energy home energy rebate programs and who are also eligible for the credit must reduce the amount of the qualified expenditures used to calculate the credit by the amount of the rebate.

10. The taxpayer purchases an item or the item is eligible for both rebates and the Section 25 C credit, to determine the amount paid for the item, the taxpayer allocate the rebates pro rata individually itemized expenditures as a share of the total project cost.

Example

A taxpayer receives a $2,000 rebate for a whole house energy savings retrofit and allocates it proportionately, 60% to $3,000 in qualifying expenditures for a heat pump ($1,200 of the $2,000 rebate) and 40% to $2,000 in qualifying expenditures for insulation ($800 of the $2,000 rebate). The taxpayer may treat the amount paid or incurred for the heat pump as $1,800 ($3,000 less $1,200 allocated portion of the rebate) and the amount paid or incurred for the installation is $1,200 ($2,000 less the $800 allocated portion of the rebate).

E. Qualified Wildfire Relief Payments

1. If the taxpayer receives such payments during the years these are nontaxable, the taxpayer should consult Publication 547.

XII. Section 529 Plans

A. New! – Additional Expenses Treated as Higher Education Expenses

1. OBBBA provides that tax-exempt distributions from 529 savings plans that fund education expenses can be applied to expenses attributable to enrollment or attendance at an elementary or secondary public, private, or religious school. In other words, is it expanded list of eligible education expenses that can be distributed out of the 529 plan.

2.The expanded list of eligible education expenses includes the following:

A. New! – Additional Expenses Treated as Higher Education Expenses: Con't

- Tuition (public, private or religious schools
- Curriculum and curricular materials
- Books or other instructional materials
- Online educational materials
- Tuition for tutoring or educational classes outside of the home
- Fees for nationally standardized tests, advanced placement exams, and college admission exams
- Fees for dual enrollment at higher education institutions
- Educational therapies for students with disabilities that are provided by a licensed or accredited professional.

A. New! – Additional Expenses Treated as Higher Education Expenses: Con't

3. The Provisions of the Act increase the annual limit for 529 account distributions from $10,000 to $20,000. This limitation applies only to K-12 expenses. The limit no longer pertains to strictly tuition but now includes tuition and expanded list of education expenses identified herein.

4. The effective date for the expanded expenses applies to distributions made after the date of enactment, and the doubled limitation applies to tax years beginning after December 31, 2025. (See Act Sec. 70413. Amending IRC Section 529 (c) (7))

B. New! – Qualified Higher Education Expenses Expanded

1. OBBBA allows 529 savings plan tax-exempt distributions to apply to "qualified postsecondary credentialing expenses." It creates a new code section IRC Section 529 (f).

2. Under this new code section, such expenses include tuition, fees, books, supplies, and equipment required for enrollment or attendance at a recognized postsecondary credential program. This also includes fees for testing or continuing education required to obtain or maintain a recognized postsecondary credential.

B. New! – Qualified Higher Education Expenses Expanded: Con't

3. A recognized postsecondary credential program is one that is:

- On a state list under the Workforce Innovation and Opportunity Act.
- Listed in the public directory of the Web Enabled Approval Management System of the Veterans Benefits Administration.
- Prepares individuals for an exam required for a credential; or 4) is identified as reputable for obtaining a recognized postsecondary credential.

B. New! – Qualified Higher Education Expenses Expanded: Con't

4. A recognized postsecondary credential means any postsecondary employment credential program

- accredited by the Institute for Credentialing Excellence, the National Commission on Certifying Agencies, or the American National Standards Institute; or
- included in the Credentialing Opportunities On-Line directory maintained by the Department of Defense or by any branch of the Armed Forces.

B. New! – Qualified Higher Education Expenses Expanded: Con't

5. In the alternative, credentials may be deemed industry recognized by the Secretary of Labor.

6. Recognized postsecondary credentials also include certificates of completion of an apprenticeship registered and certified with the Secretary of Labor; occupational or professional licenses issued or recognized at the state or federal government level; and credentials as defined in Section 3(52) of the Workforce Innovation and Opportunity Act.

B. New! – Qualified Higher Education Expenses Expanded: Con't

7. This section applies to distributions made after the date of enactment. (See Act Sec. 70414. Amends IRC Section 529)

8. The rollover limit of $35,000 lifetime from a Section 529 plan to a Roth IRA as a direct trustee to trustee rollover remains in play.

C. The SECURE Act Made Two Changes to Section 529 Plans

1. Student loans. Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE) provided that up to $10,000, reduced by the amount of distributions so treated for all prior taxable years, could be withdrawn from a Section 529 plan for the purpose of paying principal or interest on any qualified education loan of the beneficiary or his or her siblings. This is effective for distributions made after December 31, 2018.

C. The SECURE Act Made Two Changes to Section 529 Plans: Con't

2. Apprenticeship programs. SECURE also provided that a qualified distribution includes tuition, books, supplies, and equipment required for Apprenticeship Programs if the program is properly registered and certified by the Department of Labor. This is effective for distributions made after December 31, 2018.

D. SECURE 2.0 Allows Rollover to Roth IRA Beginning in 2024 for Some Section529 Plans

1. Beginning in 2024, some Section 529 funds may be rolled over tax-free to a Roth IRA for the beneficiary in a trustee-to-trustee transfer. This change allows unused college savings to be transferred to the beneficiary's retirement account without taxes.

2. The life-time rollover limit is $35,000 and the Section 529 account must have been open for at least 15 years. The annual rollover amount cannot exceed the annual contribution limit for Roth IRAs, but there are no AGI limits. Section 529 contributions and earnings on those contributions in the last 5 years may not be rolled over.

XIII. ABLE Accounts

A. Overview

1. Under current law, the additional contribution to an ABLE (Achieving a Better Life Experience) account is the lesser of the applicable federal poverty level for a one-person household in the prior year or the beneficiary's compensation for the year.

2. Additional contributions to an ABLE account for employed individuals with disabilities were available through 2025. Additional contributions were limited to the lesser of the applicable federal poverty level for a one-person household in the prior year, or the beneficiary's compensation for the year.

A. Overview: Con’t

3. Also, beneficiaries who made qualified contributions to their ABLE accounts were eligible for the Saver's Credit.

4. In addition, tax-free rollovers from Section 529 qualified tuition programs to qualified ABLE programs were permitted. However, the provisions were set to expire December 31, 2025.

B. New! – Changes

1. OBBBA permanently provides for additional contributions to ABLE accounts for employed individuals with disabilities. It also adjusts the base limit amount by one year for inflation.

2. The Act also permanently allows beneficiaries who make qualified contributions to their ABLE account to qualify for the Saver's Credit. It provides an additional calculation formula for qualified retirement contributions, elective deferrals, and voluntary employee contributions made in tax years before 2027.

B. New! – Changes: Con't

3. The Act also increases the credit amount to $2,100 beginning in the 2027 tax year. (Act Sec. 70116, amending

4. In addition, the Act permanently allows tax-free rollovers of amounts in Section 529 qualified tuition programs to qualified ABLE programs.

5. The provisions, except for the Saver's Credit amount increase, apply for tax years beginning after December 31, 2025. The increase in the Saver's Credit amount is effective for tax years beginning after December 31, 2026.

XIV. Trump Accounts – New!

A. Overview

1. OBBBA creates a new tax-deferred investment account for children, called a "Trump account." Specifically, these accounts are eligible to receive contributions from parents, relatives, employers, and other taxable entities as well as non-profit and government entities.

2. To be eligible for an account, the child must be a U.S. citizen and have a Social Security number (SSN). Trump account funds must be invested in a diversified fund that tracks an established index of U.S. equities and grow tax deferred.

A. Overview: Con't

3. Contributions to a Trump account are limited to $5,000 annually of after-tax dollars. The $5,000 contribution limit is indexed for inflation. Employers can only contribute up to $2,500, adjusted for inflation starting in 2027, which counts against the $5,000 total. The $2,500 does not count for the gross income of the employee, so it is not subject to tax at either the employer or employee level.

4. Contributions provided to Trump accounts from tax exempt entities, such as private foundations, are not subject to the $5,000 annual limit. Contributions made by parents or beneficiaries are not tax-exempt.

A. Overview: Con't

5. Contributions into these accounts must be invested in qualified mutual funds. Qualified mutual funds must follow either the S&P 500 stock market index or another index comprised of equity investments in primarily US companies, and for which regulated futures contracts are traded on a qualified board or exchange. Such a fund cannot include an industry or sector-specific index, but it may include an index based on market capitalization. The mutual fund also cannot have annual fees or expenses more than 0.1 percent of the balance of the investment in the fund.

A. Overview: Con't

6. These contributions from unrelated third parties must be provided to all children within a qualified group (i.e., all children in a state, specific school district or educational institution, etc.).

7. No additional contributions shall be made to Trump accounts after the beneficiary has attained age 18.

A. Overview: Con't

- Annual contributions cannot exceed the applicable dollar limit (for 2025, $7,000, and $8,000 for age 50 or older), and there must be earned compensation at least up to the amount of the contribution.
- Roth IRA contributions aren't permitted. However, it appears that pre-age-18-year contributions (and earnings) could potentially be converted to a Roth IRA on or after the age-18 year.
- Contributions can be deductible if the individual is not an active plan participant in a workplace plan or, if he is an active participant, has modified adjusted gross income below the applicable phase-out dollar limit.
- Contributions (and earnings) can be withdrawn at any time but are subject to taxes and penalty like traditional IRAs. Accounts are subject to RMDs at the normal RMD age.
- Post-age-18-year contributions and earnings (along with all dollars contributed before the age-18 year) can be invested in any vehicle other than collectibles, life insurance and S-corporation stock (i.e., the same limitations as IRAs).

A. Overview: Con't

8. Subject to some exceptions as deemed by the IRS these account holders may not take distributions until age 18. It appears that contributions to these accounts after the child turned age 18 can occur however it would follow traditional IRA contribution rules and not wrong. These rules include the following:

9. Under a newborn pilot program, for U.S. citizens born between January 1, 2025, and December 31, 2028, the federal government will contribute $1,000 per child into every eligible account.

A. Overview: Con't

10. If the IRS determines that an eligible individual does not have an account opened for them by the first 10ax return where the child is claimed as a qualifying child, the IRS will establish an account on the child's behalf. Parents have the option to opt out of the account.

11. This section is effective for tax years beginning after December 31, 2025. (See Act Sec. 70204(e). Adding IRC Sections 530A, 128, 139J, and 6434)

A. Overview: Con't

12. Similar to a 529 plan or an education savings account, the child is the owner of the Trump account and is referred to as the beneficiary. All Trump account rules are designed with the child as the owner.

13. The IRS will update Form W – 2 for 2026 to reflect the Trump Account Contributions. The new code appears to be Code TA – Employer Contributions to Trump Accounts and it will appear in box 14 of Form W-2.

Notice 2025 – 68; IR 2025 – 117 – Initial Questions Related to Trump Accounts

- 1. The IRS has answered initial questions regarding Trump accounts, which it intends to address in forthcoming proposed regulations. The guidance addresses general questions relating to the establishment of the accounts, contributions to the accounts, and distributions from the accounts under Sections 128, 530A and 6434.
-
- 2. An account may be established for the benefit of an eligible individual by making an election on Form 4547, Trump Account Election(s), or through an online tool or application on trumpaccounts.gov. A Trump account may be created at the same time that an election is made to receive a pilot program contribution.
-
- 3. A Trump Account is deemed to be a traditional individual retirement account.
-

Notice 2025 – 68; IR 2025 – 117 – Initial Questions Related to Trump Accounts

- 4. A rollover Trump account can only be established after the initial Trump account is created and during the growth period of the account, which is the period that ends before January 1 of the calendar year in which the account beneficiary attains age 18. A rollover account must first be funded by a qualified rollover contribution before receiving any other contribution. Additional rules regarding the choice of trustee, rollover accounts, and the written government instrument requirements are discussed herein.
-
- 5. The election to receive a pilot program contribution is made on Form 4547 or through the online tool, once available. Pilot program contributions will be deposited into the Trump account of an eligible child no earlier than July 4, 2026.

Notice 2025 – 68; IR 2025 – 117 – Initial Questions Related to Trump Accounts

- 6. Only permitted distributions, which are qualified rollover contributions or qualified ABLE rollover contributions, excess contributions, or distributions upon the death of an account beneficiary, are allowed during the growth period. Hardship distributions during the growth period are not allowed. If an account beneficiary dies after the growth period, the rules that apply to other individual retirement accounts after the death of the account owner apply. If the Trump account beneficiary dies during the growth period, the account ceases to be a Trump account and an IRA as of the date of death.

- 7. Annual reporting by the Trump account trustee is required. Forms and instructions will be issued in the future.

C. Section 529 Plans v Trump Accounts

1. From a planning perspective understand the differences between a section 529 plan versus a Trump account is important from a planning perspective the differences are as follows:

a. Purpose. The Purpose of the 529 plan is education focused with a limitation on rolling a 529 plan to a Roth of up to $35,000. The Trump account is not education focused but rather is long-term focused specifically on savings and does contain potential government seeds.

C. Section 529 Plans v Trump Accounts: Con't

b. Ownership. The Section 529 plan is old and controlled by the adult who opens the account. With a Trump Account the child gains full control upon turning age 18.

c. Contribution Limits. Section 529 plans contribution limits are very by state law. Under the Trump Account the limit on contributions is $5,000 per child, per year including employer and family contributions.

C. Section 529 Plans v Trump Accounts: Con't

d. Tax Treatment. With respect to Section 529 plans these plans grow tax free with tax-free withdrawals for education purposes. Many states offer a tax deduction or credit on contributions made. Under the Trump Account does grow but it is tax deferred, withdrawals of earnings are taxed as ordinary income. Government seed money and employer contributions are fully taxable upon withdrawal.

C. Section 529 Plans v Trump Accounts: Con't

e. Use of Funds. Under Section 529 plan, the funds are used for qualified education expenses. Under the Trump Account, can be used after the child reaches age 18 for any purpose but is subject to taxation at the ordinary income tax rate and it appears the 10% early withdrawal penalty applies for age 59. The current exceptions to the 10% would apply to these accounts.

C. Section 529 Plans v Trump Accounts: Con't

f. Access Before Reaching Age 18. Under a Section 529 plan the amount that can be withdrawn is limited to $10,000 per year from K – 12.

g. Financial Aid Impact. Under Section 529 plans, these plans are considered a parent. A asset and have minimal impact on financial aid eligibility. As far as Trump Accounts the impact on financial aid is unknown at the present time.

C. Section 529 Plans v Trump Accounts: Con't

h. Investment Options. With respect to section 529 plans, the investment options are limited to what is allowed in the plan. Regarding Trump Accounts investment is limited to low-cost US stock index funds yet to be identified.

2. One advantage that stands out with Trump Accounts is the ability for employers to contribute up to $2,500 per child, per year. Employer contributions are not considered income to the parent and may be deductible as a business expense.

C. Section 529 Plans v Trump Accounts: Con't

3. When used for qualified education expenses, 529 plans offer a rare combination: potential state tax deductions on contributions, tax-deferred growth, and tax-free withdrawals.

4. Additionally, 529 plans are treated as parent assets on the FAFSA, so they have a much smaller impact on financial aid eligibility

SECTION III: ADJUSTMENTS TO GROSS INCOME

I. Health Savings Accounts

A. 2025 Figures – Rev. Proc 2024-25

1. The 2025 maximum contribution to an HSA that may be made for calendar 2025 by an individual with self-only coverage will be $4,300, a $150 increase from 2024. For an individual with family coverage, the maximum contribution will be $8,550, which is $250 higher than the current limit.

2. The $1,000 "catch-up" additional contribution that may be made by individuals who are age 55 or older before the end of the tax year is unchanged.

A. 2025 Figures – Rev. Proc 2024-25: Con't

3. Likewise, the HDHP must have an annual deductible of at least $1,650 for self-only coverage ($50 higher than for 2024) or $3,300 for family coverage (a $200 increase).

4. The, annual out-of-pocket expenses, including deductibles, co-payments, and other amounts exclusive of premiums may not be more than $8,300 for self-only coverage or $16,600 for family coverage.

B. 2026 Figures – Rev, Proc. 2025 – 19

1. For 2026, the maximum contribution to an HSA that may be made by an individual with self-only coverage under a high-deductible health plan (HDHP) will be $4,400, a $100 increase from 2025. For an individual with family coverage, the maximum contribution will be $8,750, which is $200 higher than the current limit.

2. The $1,000 “catch-up” additional contribution that may be made by individuals who are age 55 or older before the end of the tax year is unchanged because it is set by statute (Sec. 223(b)(3)).

B. 2026 Figures – Rev, Proc. 2025 – 19: Con't

3. An eligible individual may make limited annual cash contributions to an HSA to pay the qualified medical expenses of account beneficiaries, up to the annual sum of monthly limitations for months during the tax year in which the individual is eligible.

B. 2026 Figures – Rev, Proc. 2025 – 19: Con't

4. For 2026, a qualifying HDHP must have an annual deductible of at least $1,700 for self-only coverage ($50 higher than for 2025) or $3,400 for family coverage (a $100 increase). In addition, annual out-of-pocket expenses, including deductibles, co-payments, and other amounts, exclusive of premiums, may not be more than $8,500 for self-only coverage or $17,000 for family coverage — increases, respectively, of $200 and $400.

5. For plan years beginning in 2026, the maximum amount that may be made newly available for an excepted-benefit HRA under Regs. Sec. 54.9831-1(c)(3)(viii) is $2,200, which is $50 higher than the 2025.

C. OBBBA Changes

- **1.** The OBBA made a few key changes to HDHPs and, by extension, HSAs.
-
- a. The Act it made permanent a safe harbor for HDHPs that have no deductible for telehealth and other remote care services. The OBBBA permanent extension applies retroactively after December 31, 2024.
-
- b. Thee term HDHP now includes any plan under the Patient Protection and Affordable Care Act (ACA) (P.L. 111-148) that is available as individual coverage through an exchange, including bronze and catastrophic plans. Before the OBBBA was enacted, many bronze plans did not qualify as HDHPs because the plans' out-of-pocket maximum exceeded the statutory limits for HDHPs or because they provided benefits that were not preventive care without a deductible. Similarly, catastrophic plans could not be HDHPs because they were required to provide three primary care visits before the minimum deductible was satisfied and to have an out-of-pocket maximum that exceeded the statutory limits for HDHPs. This provision amending the definition of an HDHP applies for months after December 31, 2025.

C. OBBBA Changes

- c. Direct primary care service arrangements (DPCSA) are no longer treated as a health plan for purposes of determining HSA eligibility and enrollment, and enrolling in a DPCSA will not cause a taxpayer to fail eligibility to contribute to an HSA. These DPCSAs changes would apply after December 31, 2025.
-
- 2. Along these lines, the IRS provided guidance on these provisions under Notice 2026 – 5; IR 2025 – 119.

II. Medical Savings Accounts

A. 2025 – Rev. Proc. 2024 – 40

1. Self-only coverage. For taxable years beginning in 2025, the term " high deductible health plan" as means, for self-only coverage, a health plan that has an annual deductible that is not less than $2,850 and not more than $4,300, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $5,700.

A. 2025 – Rev. Proc. 2024 – 40: Con't

2. Family coverage. For taxable years beginning in 2025, the term " high deductible health plan" means, for family coverage, a health plan that has an annual deductible that is not less than $5,700 and not more than $8,550, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $10,500.

B. 2026 –Rev. Proc. 2025 – 32

1. Self-only coverage. For taxable years beginning in 2026, the term "high deductible health plan" means, for self-only coverage, a health plan that has an annual deductible that is not less than $2,900 and not more than $4,400, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $5,850.

B. 2026 –Rev. Proc. 2025 – 32: Con't

2. Family coverage. For taxable years beginning in 2026, the term "high deductible health plan" means, for family coverage, a health plan that has an annual deductible that is not less than $5,850 and not more than $8,750, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $10,700.

C. Limit on Health FSA Salary Reduction Contributions under a Cafeteria Plan

- **1. 2025.** For purposes of determining whether a health FSA benefit will be a "qualified benefit" for the 2025 plan year, the cafeteria plan must provide the employee may not elect to have a salary reduction contributions exceeding $3,300. (See Rev. Proc. 2024 – 40)
-
- **2. 2026**. For purposes of determining whether health FSA benefits will be a "qualified benefit" for the 2026 plan year, the cafeteria plan must provide the employee may not elect to have a salary reduction contribution exceeding $3400. If the plan permits the carryover of unused amount, the maximum carryover is now $680. (See Rev. Proc. 2025 – 32)

III. Student Loan Interest Deduction

A. General Rule

1. A taxpayer may deduct the lesser of $2,500 or the amount of interest paid on a qualified student loan. The deduction is subject to a phased-out based upon modified adjusted gross income in association with the taxpayers filing status.

2. The loan must be a qualified student loan. A qualified student loan is a loan the taxpayer took out only to pay qualified education expenses that were:

- For the taxpayer, spouse, or a person who was your dependent when the taxpayer took out the loan;
- Paid or incurred within a reasonable period of time before or after the taxpayer took out the loan;
- For education provided during an academic period for an eligible student.

B. Phase outs

1. For 2025, the deduction phases out ratably for taxpayers other than joint filers with MAGI between $85,000 and $100,000, and MAGI between $170,000 and $200,000 for joint filers. (See Rev. Proc. 2024 – 40)

2. New! For 2026, the deduction phases out ratably for taxpayers other than joint filers with MAGI between $85,000 and $100,000 and between $175,000 and $205,000 for married filing joint. (See Rev. Proc. 2025 – 32)

a**. Important! – Note.** For 2026 the phase out of the interest expense on education loans is higher for married filing joint but remains the same for all other taxpayers.

IV. Educators Expense Deduction

A. Present

1. The educator expense deduction remains capped $300 per educator. In other words, a joint filing can claim up to $600 if both spouses are eligible.

2. The tax benefit covers out-of-pocket expenses on classroom items like books, supplies, and equipment (including computers and software) as well as COVID-19 safety measures such as masks, disinfectants, and air purifiers.

A. Present: Con't

3. Costs for homeschooling or nonathletic supplies for courses in health or physical education are not included.

4. The tax benefit may also be used to offset expenses for professional development courses relevant to teaching, though the IRS said it could be more advantageous to use other educational tax benefits like the lifetime learning credit.

B. 2026 Changes – New

1. For tax years beginning in 2026, the amount deduction allowed consisting of expenses paid or incurred by eligible educators in connection with books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment including related software and services and other equipment and other supplemental material shall not exceed $350. This is an increase of $50 over the prior year.

B. 2026 Changes – New: Con't

2. Beginning in 2026, the $300 above the line deduction remains.

3. Additional qualifying educator costs become itemized deductions if the taxpayer can itemize.

4. Eligible costs are broadened to include athletic supplies for health and physical education.

B. 2026 Changes – New: Con't

5. The deduction is broadened in the sense of the word shifts from in the classroom to as part of instructional activity.

6. Sports administrators, interscholastic sports and coaches will qualify as educators.

7. As such, books, supplies, computers, software, equipment and Certain professional development expenses in 2025 remain with athletic supplies and coaches being added in 2026.

Example

In 2026, a taxpayer purchases a $1400 projector. That could mean $300 as an above the line the deduction plus $1100 as an itemized deduction if the client the definition of qualified educator and is able to itemize.

V. Adjustments to Gross Income Eliminated

A. Elimination! – Moving Expense

1. Under the Tax Cuts and Jobs Act, both the exclusion for qualified moving expense reimbursement and the deduction for moving expenses are set to return after December 31, 2025.

2. OBBBA permanently eliminates the exclusion and deduction for moving expenses except for active-duty members of the armed forces.

B. Elimination! – Qualified Bicycle Commuting Reimbursement Exclusion

1. Presently, the $20 per month qualified bicycle commuting reimbursement exclusion received by an employee from employer is set to return for taxable years beginning after December 31, 2025.

2. OBBBA contains a provision that would permanently eliminate the qualified bicycle commuting reimbursement exclusion.

C. Alimony – Revised and Eliminated

1. The provision under the Tax Cuts and Jobs Act regarding the exclusion of income recognition and denial of the deduction was set to end after December 31, 2025.

2. The OBBBA extends the exclusion of alimony income to the recipient and the denial of the deduction by the pay or on a permanent basis.

Alimony Deduction Due To Post Death Payment Obligations

- **DiTuallio v. Comm., TC Memo 2025 – 120**. Taxpayer and his wife divorced in 2017 during the marriage taxpayer sustained a severe work injury and applied for disability pension benefits. In the final judgment of divorce, the document stated that if the taxpayer received retroactive benefits, his wife would be entitled to a share in those benefits. The judgment also provided that a Qualified Domestic Relations Order would be prepared. The parties never did prepare that document. The taxpayer received over $156,500 in a lump sum distribution from his retirement system. He agreed to pay his ex-wife $50,000 and they executed a consent order that eliminated the Qualified Domestic Relations Order. The taxpayer paid the wife and wrote equitable pension distribution in the memo line of the check deducted the $50,000 as alimony. The IRS disallowed the deduction. The IRS's position was the taxpayer failed the requirement that provide the pay or must have no liability to make any payment after the death of the paying spouse. The court ruled in favor of the IRS finding that the sent order create a payment obligation that would survive the former spouse's death. The court noted that when divorce documents are silent on post death obligations, payments may be satisfied if state law terminates payments upon the former spouse's death. However state law is ambiguous the Tax Court and district courts will examine the instrument. In this case neither the consent order nor the final judgment addressed both death terminations, state law was deemed to be ambiguous and thus the court held the alimony is not deductible.

VI. Transfer Incident to a Divorce

A. General Rule

1. Under Section 1041, no gain or loss is recognized on a transfer of property from an individual to a spouse or former spouse if the transfer is incident to the divorce. A transfer property is incident to the divorce if the transfer occurs within one year after the date the marriage ceases or is related to the cessation of the marriage.

2. A transfer is related to the cessation of the marriage if it is pursuant to a written divorce or separation agreement and the transfer occurs within six years of the divorce.

3 A transfer of property incident to a divorce can include business property or the transfer of business interests and thus not result in the transfer being considered a taxable event. (See Belote v. Comm. TCM 2016 – 113)

VII. Retirement and Individual Retirement Accounts

A. Traditional IRA Contributions – 2025; IR 2025 – 285; Notice 2024 – 80

1. The contribution amount is the lesser of:

- $7,000 or
- the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.

2. Catch-up Contribution. For 2025, the taxpayer can make a catch-up contribution of $1,000 if they are age 50 or older. The SECURE 2.0 Act of 2022 allows for an annual cost of living adjustment starting next year.

A. Traditional IRA Contributions – 2025; IR 2025 – 285; Notice 2024 – 80: Con't

3. MAGI Phase out Limitation. For 2025, the active participation MAGI limitation phase- out is as follows:

Filing Status	**Amount**
Single (HOH)	$79,000 – $89,000
Married Filing Joint	$126,000 - $146,000
Married Filing Separately	$0 – $10,000

4. For 2025, a nonworking spouse may make IRA contributions based on the earned income of his or her spouse. For an IRA contributor who is not covered by workplace retirement plan and is married to one who is covered, the MAGI deduction phase out for 2024 is between $236,000 – $246,000.

B. Traditional IRA Contributions – 2026; IR 2025 – 111; Notice 2025 – 67

- **1.** The contribution amount is the lesser of:

- $7,500 or
- the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.

- **2. Catch-up Contribution**. For 2026, the taxpayer can make a catch-up contribution of $1,010 if they are age 50 or older. The SECURE 2.0 Act of 2022 allows for an annual cost of living adjustment starting next year.

B. Traditional IRA Contributions – 2026; IR 2025 – 111; Notice 2025 – 67

- **3. MAGI Phase out Limitation.** For 2026, the active participation MAGI limitation phase- out is as follows:

Filing Status	**Amount**
Single (HOH)	$81,000 – $91,000
Married Filing Joint	$129,000 – $149,000
Married Filing Separately	$0 – $10,000

- 4. For 2026, a nonworking spouse may make IRA contributions based on the earned income of his or her spouse. For an IRA contributor who is not covered by workplace retirement plan and is married to one who is covered, the MAGI deduction phase out for 2024 is between $242,000 – $252,000.

C. Roth IRA Contributions – 2025; IR 2025 – 285; Notice 2024 – 80

1. The contribution amount is the lesser of:

- $7, 000 or
- the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.

2. **Catch-up Contribution**. For 2025, the taxpayer can make a catch-up contribution of $1000 if they are age 50 or older. The SECURE 2.0 Act of 2022 allows for an annual cost of living adjustment starting next year.

C. Roth IRA Contributions – 2025; IR 2025 – 285; Notice 2024 – 80: Con't

3. Limitation. For 2024, the maximum contribution to a Roth IRA is the lesser of $6,000 for the individuals' compensation for the year. The contribution limit is reduced to the extent that a taxpayer makes contributions to any other IRA for the same tax year. The Roth IRA MAGI threshold is shown below:

Filing Status	**Amount**
Single (HOH)	$150,000 – $165,000
Married Filing Joint	$236,000 – $246,000
Married Filing Separately	$0 – $10,000

D. Roth IRA Contributions – 2026; IR 2025 – 111; Notice 2025 – 67

- 1. The contribution amount is the lesser of:
-
- $7, 500 or
- the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.
-
- 2. **Catch-up Contribution**. For 2026, the taxpayer can make a catch-up contribution of $1,100 if they are age 50 or older.
-
- **3. Limitation.** The contribution limit is reduced to the extent that a taxpayer makes contributions to any other IRA for the same tax year. The Roth IRA MAGI threshold is shown below:
-

Filing Status	**Amount**
Single (HOH)	$153,000 – $168,000
Married Filing Joint	$242,000 – $252,000
Married Filing Separately	$0 – $10,000

E. Other Retirement Plan Amounts

1. Defined Benefit Plan.

- For 2025, the maximum single life annuity for a defined benefit plan will be $280,000 (Notice 2024 – 80)
- For 2026, the maximum single life annuity for a defined benefit plan will be $290,000 (Notice 2025 – 67)

2. Defined Contribution Plan.

- For 2025, the maximum annual addition to defined contribution plan will be $70,000 (Notice 2024 – 80)

- For 2026, the maximum single life annuity for a defined benefit plan will be $ 72,000 (Notice 2025 – 67)

E. Other Retirement Plan Amounts: Con't

3. Annual Contribution Limit

- For 2025, the maximum amount of compensation that can be taken into account under a qualified plan allocation or benefit formula will be $350,000. (Notice 2024 – 80)
- For 2026, the maximum amount of compensation that can be taken into account under a qualified plan allocation or benefit formula will be $360,000. (Notice 2025 –67)

4. SIMPLE Plan.

- For 2025, the amount deferral is $16,500. (Notice 2024 – 80
- For 2026, the amount deferral is $ 17,000. (Notice 2025 – 67)

E. Other Retirement Plan Amounts: Con't

5. SEP

- The dollar amount will remain the same for 2025. (Notice 2023-75, 2024 – 80)
- The dollar limit will rise to $800 for 2026. (Notice 2025 – 67)

6. 401(k) or 403(b) Plan.

- For 2025, the max amount deferral $23,500 (Notice 2024 – 80)
- For 2026, the max amount deferral is $24,500 (Notice 2025 – 67)

E. Other Retirement Plan Amounts: Con't

7. Highly Compensated Employee.

- For 2025, the minimum compensation of employee owning less than 5% the stock of the employer to be treated as a highly compensated employee shall be $160,000. For 2026, the maximum compensation will be the same as 2025. (Notice 2025 – 67)

8. Key employee in top-heavy plan.

- For 2025 the dollar limit is $230,000. (Notice 2024 – 80)
- For 2026, the dollar limit is $235,000. (Notice 2025 – 67)

9. Government, etc. deferred compensation plans.

- For 2025, the limit on deferrals is $23,500 (Notice 2024 – 80)
- For 2026, the limit on deferrals is $24,500 (Notice 2025 – 67)

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act

1. The IRS has issued final regulations updating the required minimum distribution (RMD) rules applicable to qualified plans, including 401(k) plans, to reflect changes made by the SECURE and SECURE 2.0 Acts. These regulations generally follow proposed regulations released in 2022, with some changes and clarifications.

a. Ann. 2025 – 02, 2025 – 2IRB. The Service has announced that the final regulations are required minimum distributions will not apply until the 2026 distribution calendar year.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

2. The IRS has also released proposed regulations addressing additional RMD issues under the SECURE 2.0 Act that are specifically reserved in the final regulations.

3. The final rules generally apply when determining RMDs for calendar years beginning on or after January 1, 2025, using a reasonable, good faith interpretation of SECURE Act amendments and, for 2023 and 2024 distribution calendar years, SECURE 2.0 Act amendments.

E. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

4. Distributions Beginning During Employees Life. Generally, the required beginning date (RBD) is April 1 of the year after the later of the year the employee reaches the applicable age or retires. The applicable age varies:

- 70-1/2 for those born before July 1, 1949;
- 72 for those born on or after July 1, 1949, and before January 1, 1951;
- 73 for those born on or after January 1, 1951, and before January 1, 1959; and
- 75 for those born on or after January 1, 1960.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

a. Plans can provide for a uniform RBD of the calendar year following the year an employee attains age 70-1/2 for administrative ease. The proposed regulations would resolve a conflict in the SECURE 2.0 Act regarding applicable ages for employees born in 1959 by providing an applicable age of 73.

5. The final regulations reflect the Code's changes regarding RMDs for designated beneficiaries of employees who die before their RBD, including that only "eligible" designated beneficiaries may receive distributions over their life expectancy.

E. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

a. The final regulations provide that the non-eligible designated beneficiaries of a decedent's account where the decedent died after their required beginning date (RBD) must take annual distributions for years 1-9 using the age of the beneficiary for the calculation of the RMD account. The entire account balance must be distributed by the end of the 10th year. If the decedent dies before the RBD, the beneficiary is not required to take distributions before the 10th year.

Example

Jane is age 65 and died June 1, 2024. She owned a traditional IRA and named her daughter as a non-eligible designated beneficiary. She does not have to take RMDs during years 1 – 9 because her mother died before her required beginning date (RBD). The daughter must withdraw the entire inherited IRA by the end of the 10th year. However, if Jane was 75 at the time of her death she would have passed the beginning date for RMD's. The daughter would be required to take the RMD four years 1 – 9 based upon Jane's life expectancy and again must withdraw the entire balance by the end of the 10th year.

E. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

b. The 10 year timeframe ends on December 31 of the 10th year after the calendar year of the account owner's death. It is not the 10th year anniversary of the date of death.

c. If a non-designated beneficiary does not take RMD's in years 1 – 9 or does not withdraw the balance in the inherited IRA by the end of the 10th year in excess accumulation penalty applies

d. If an employee's entire interest is in a designated Roth account, no lifetime distributions are required.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

6. Eligible Designated Beneficiary. An eligible designated beneficiary is a designated beneficiary who is:

- A surviving spouse
- A minor child
- Disabled
- Chronically Ill or
- 10 or fewer years younger than the employee

Example

S.Y. Liu v. Kaiser (DC ND Cal . 23 – CB – 03109 – AMO) An individual was not entitled to her sister's death benefits arising from a pension plan (the plan) under the Employee Retirement Income Security Act (ERISA). The individual's sister did not complete the benefit election process before her death – she did not finalize the selection of a Benefit Starting Date or designate the individual as her beneficiary. Since the plan participant did not make a valid benefit election before her death to designate the individual as her beneficiary, the individual was not entitled to benefits under a plain reading of the plan.

Example: Con’t

The individual asserted that under Section 401 (a) (9) (E) (ii), an "eligible designated beneficiary" included an individual who is not more than 10 years younger than the employee, and, because the individual was less than 10 years younger than her sister, she was an eligible designated beneficiary under the Plan. However, this Code Section did not apply here, as it applies only to defined contribution plans and not defined benefit plans such as the plan. Even if it did, it would not render the individual her sister’s designated beneficiary.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

a. Minor Children. The final regulations clarify the 10 year rule for the decedents of minor children. Specifically, children are considered minors until they reached their 21st birthday regardless of the age of the majority defined in state law. The stretch RMD rules thus apply until the child's 21st birthday. After the 21st birthday the 10 year rule applies.

Example

During 2024 Moe, age 10, inherited an IRA from his mother. Moe is a designated beneficiary and can receive distributions based on his single life expectancy until he reaches age 21. Upon reaching age 21, he must withdraw the funds based on the 10 year rule. Since his mother had not reached her required beginning date (age 73) at the time of her death, Moe is not required to take RMD's in years 1 – 9. He must withdraw the full account balance by the end of the 10th year. If Moe had inherited his mother's IRA when mom died at age 75, he would continue taking RMD's based on his single life expectancy even after reaching age 21. In years 1 – 9 he would take RMD's. However, in year 10 the remaining balance is withdrawn.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

b. Disabled or Chronically Ill. Beneficiaries under the age of 18 must have a medically determinable physical or mental impairment resulting in marked and severe functional limitations and expected to result in death or to be of the long and indefinite duration.

i. A safe harbor allows beneficiaries to be deemed disabled for RMD purposes if they are determined to be disabled by the Social Security Commissioner.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

ii. Documentation of a disability or chronic illness must be provided to the plan administrator no later than October 31 of the calendar year following the calendar year of the employee's death.

iii. In certain cases, certifications from licensed health care practitioners are required. Plan administrators may not rely on a beneficiary's self-certification of disability or chronic illness.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

7. Partial account purchase of annuity contracts. A plan may allow employees to elect to have an RMD distributed for a calendar year in an amount equal to the excess of the total of the required amount for that year over the annuity amount.

a. As an alternative to the general bifurcation rule, a plan may allow an employee to satisfy the RMD requirement applicable to the annuity contract and the remaining account balance by adding the fair market value of the annuity contract to the remaining account balance and treating the payments under the annuity contract as distributions from the individual account.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

b. Under the proposed regulations, the fair market value of the annuity would be determined as of December 31 of the calendar year preceding the distribution calendar year.

8. Distributions after employee's death. The final regulations maintain the requirement in the 2022 proposal for continued annual distributions when employees die on or after their RBD.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

a. The annual distributions generally must continue when an individual has started RMDs, even though the Code provides that full distribution must be made by the tenth anniversary of the employee's death.

Also maintained is the obligation for ongoing annual distributions for a period of up to ten years following:

- the death of an eligible designated beneficiary who was taking life expectancy payments, or
- attainment of the age of majority by an eligible designated beneficiary who was a minor child of the employee receiving life expectancy payments.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

9. Surviving spouses. Consistent with the SECURE 2.0 Act, a surviving spouse who is the employee's sole beneficiary may elect to be treated as the employee for certain purposes.

a. The proposed regulations would provide that if the employee dies before the RBD and the sole beneficiary is the surviving spouse who is subject to the life expectancy rule, then the spouse would automatically be treated as making the election.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

b. If the employee dies on or after the RBD, then the corresponding election would not apply automatically, unless the plan's written terms made the election automatic.

10. Multiple designated minor beneficiaries. If an employee has more than one child as eligible designated beneficiaries, a full distribution is not required until ten years after the youngest of the employee's children who are designated beneficiaries attains the age of majority or, if earlier, ten years after the last of those minor children dies.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

11. Designated Roth accounts. When determining the account balance subject to the RMD rules, amounts held in a designated Roth account are disregarded. Under the proposed regulations, distributions from designated Roth accounts would not count toward satisfying any RMD but could be rolled over to a Roth IRA if they otherwise qualified as eligible rollover distributions.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

12. Corrective distributions. The final regulations provide an automatic waiver of the Section 4974 excise tax associated with a beneficiary's failure to take a RMD in the calendar year in which an individual died if that individual had not already satisfied the RMD for that year, provided that the failure is corrected by the end of the following calendar year. This corrective distribution is not eligible for rollover.

F. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

a. Under the proposed regulations, if a missed RMD is corrected by a distribution in a subsequent calendar year, the RMD for that subsequent year would have to be made in addition to the corrective distribution.

13. Trusts as designated beneficiaries. Certain beneficiaries of a see-through trust are regarded as beneficiaries of an employee if specific conditions are met. The trust must

- be valid under state law or would be if it had corpus;
- be irrevocable or become irrevocable upon the employee's death;
- have identifiable beneficiaries; and
- meet documentation requirements.

E. IRS Issues Final RMD Regulations Reflecting SECURE and SECURE 2.0 Act: Con't

a. When determining whether there are identifiable beneficiaries, beneficiaries are treated as if they could receive amounts in the trust representing the employee's interest in the plan, regardless of whether those amounts are disbursed directly to the beneficiaries or indirectly for their benefit . For example, in the case of payments to a custodial account for the benefit of a minor child.

b. With respect to the documentation requirement, the plan administrator may require a trustee to provide a list of trust beneficiaries with a description of the conditions on their entitlement, instead of a trust document.

G. SECURE 2.0 Provisions going into effect in 2025

1. Automatic Enrollment.

a. Section 101 of SECURE 2.0 requires all 401(k) qualified cash or deferred arrangements (CODAs) and 403(b) plans established after December 29, 2022, the SECURE 2.0 enactment date, to incorporate an eligible automatic contribution arrangement (EACA).

G. SECURE 2.0 Provisions going into effect in 2025: Con't

b. This requirement applies to plan years beginning after December 31, 2024, unless an exception applies. The Internal Revenue Service (IRS) provided some guidance in Notice 2024-2, detailing the criteria for when a qualified CODA is considered established, and clarifying how the rules apply in cases of mergers or spinoffs.

G. SECURE 2.0 Provisions going into effect in 2025: Con't

c. The e automatic enrollment requirement also applies to multiemployer plans that add a 401(k) feature after December 29, 2022. This poses significant challenges for these collectively bargained plans, as employees may work for multiple participating employers.

d. Payroll providers and administrators would have to coordinate to track deferrals, manage opt-out elections, and ensure compliance with timely remittance requirements.

G. SECURE 2.0 Provisions going into effect in 2025: Con't

2. Higher catch-up contributions for ages 60 through 63

a. Section 109 of SECURE 2.0 permits 401(k), 403(b), and governmental 457(b) plans[1] to offer higher catch-up contributions beginning in 2025 for participants attaining ages 60, 61, 62, or 63 before the end of the taxable year. These are voluntary contributions.

G. SECURE 2.0 Provisions going into effect in 2025: Con't

b. For 2025, the maximum catch-up limit is the greater of $10,000 or 150% of the regular catch-up limit, and this amount will be adjusted for inflation. The regular catch-up limit for 2025 for participants under age 60 is projected to be $7,500, and the catch-up limit for those aged 60 to 63 is projected to be $11,250.[2]

G. SECURE 2.0 Provisions going into effect in 2025: Con't

c. The above plans are not required to offer catch-up contributions. However, they can be amended to add this feature and allow participants who are aged 50 or older during the tax year to make catch-up contributions above the regular elective deferral limit under Internal Revenue Code (IRC) section 402(g), or the identical limit under IRC 457(b)(2) pertaining to 457(b) plans.

d. SECURE 2.0 allows plans to increase the catch-up contribution limit further for those aged 60, 61, 62, and 63, beginning in 2025.

F. SECURE 2.0 Provisions going into effect in 2025: Con't

3. Coverage for long-term part-time employees

a. Eligibility requirements for long-term part-time (LTPT) employees were initially established under section 112 of the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act). These requirements pertain to eligibility for contributing to CODAs under 401(k) plans, effective for plan years beginning after December 31, 2020. The first potential 401(k) LTPT employee became eligible in the 2024 plan year under the SECURE Act, provided they completed three consecutive 12-month periods, each with at least 500 hours of service. Sections 125 and 401 of SECURE 2.0 lowered these LTPT eligibility requirements and expanded them to include ERISA-covered 403(b) plans starting in 2025.

G. SECURE 2.0 Provisions going into effect in 2025: Con't

b. Beginning with plan years after December 31, 2024, LTPT employees will be eligible to participate in a 401(k) qualified CODA or ERISA-covered 403(b) plan if they have completed at least 500 hours of service in each of two consecutive 12-month periods and have attained age 21 by the end of the second 12-month period.

F. SECURE 2.0 Provisions going into effect in 2025: Con't

c. On November 27, 2023, the IRS issued proposed regulations related to LTPT employees in 401(k) plans, applicable to plan years beginning on or after January 1, 2024. These proposed regulations define LTPT employees and former LTPT employees and specify methods for crediting their service. Upcoming final regulations related to these employees will not apply earlier than plan years beginning on or after January 1, 2026. Until final regulations are released, 401(k) plan sponsors may rely on the guidance in the proposed regulations related to 401(k) LTPT employees.

G. SECURE 2.0 Provisions going into effect in 2025: Con't

d. On October 3, 2024, the IRS issued guidance on LTPT employees in ERISA-covered 403(b) plans, applicable to plan years beginning after December 31, 2024. The IRS plans to issue proposed regulations specific to LTPT employees in ERISA-covered 403(b) plans, which are expected to be similar to the 401(k) LTPT employee rules.

G. SECURE 2.0 Provisions going into effect in 2025: Con't

e. Plans must be amended to incorporate any changes related to SECURE 2.0 by December 31, 2026. For collectively bargained plans, the deadline is December 31, 2028, and, for most governmental plans, it is December 31, 2029. This is contingent on the plan having operated in compliance with such changes as if the amendment was in effect from its applicable effective date (or, if later, the date optional SECURE 2.0 provisions were put into place operationally.

G. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91

1. The IRS issued final regulations addressing catch-up contributions pertaining to SECURE 2.0. The final regulations address provisions regarding catch-up contributions made by various high income participants to be designated as after-tax Roth contributions. The final regulations provide guidance for plan administrators to implement comply with these new rules. Final regulations also provide guidance related to increase catch-up contribution limits under the Act for certain plan participants, particularly those between age 60 and 63 in newly established SIMPLE plans.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

2. As indicated, the final regulations require employers that offer catch-up contributions to treat those contributions made by "high wage earners" as post tax Roth contributions.

a. The final regulations do not apply to SARSEP, SIMPLE IRA, Starter 401(k)s or Safe Harbor 403 (b) plans.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

3. A "high wage earner" under the Act is an employee whose wages from the employer sponsoring the plan during the preceding calendar year exceeded $145,000 (indexed annually). The wage threshold is based on Social Security (FICA) wages paid to the individual by the employer sponsoring the plan.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

4. The final regulations allow the employer sponsoring the plan to combine the wages of other related employers (who also employ the employee participant) using a common paymaster to determine if the $145, 000 threshold is met. Briefly stated, a common paymaster is an entity within the group of related employers that is designated to handle payroll and taxes for all related companies on a combined basis.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

5. For plans that use concurrent elections (meaning the plan permits participants to make separate elections for regular and catch-up deferrals during each payroll), the plan may automatically deem the separate catch-up election as Roth. This is the case even if as of the end of the year, those contributions turn out not to be catch-up contributions (the participant's total deferrals have not exceeded the annual contribution limit, $23,500 for 2025).

Example

Bubba is a participant who is over age 50 and had prior wages exceeding hundred $45,000. Elects to defer a annual total of $14,000 in pretax dollars and has a $5000 as a catch-up.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

6. Catch-up contributions are defined as being in excess of other plan limits as of the end of the plan year. Therefore, the separate, concurrent $5,000 deferral for this participant wouldn't normally be considered catch-up since they did not exceed the annual contribution limit. However, under the final regulations the plan may consider the separate $5,000 deferral as a Roth catch-up election even though the participant never exceeded their annual pre-tax limit of $23,500.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

7. The IRS confirmed that a plan is not required to offer participants within the ages of 6263 the opportunity to make enhanced catch-up contributions. If the plan does provide for these enhanced contributions, it must generally offer them to all participants eligible for catch-up contributions. The final regulations include exceptions to the requirement to offer them to all participants. The plan may exclude employees subject to a collectively bargained agreement (CBA) and non-resident aliens.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

8. SIMPLE IRA limits. The SIMPLE IRA employee contribution limit for 2025 is $16,500 and the catch-up limit for those age 50 and over is $3,500. Those age 60-63 can contribute $5,250 as a "super" catch-up contribution.

a. SECURE 2.0 increases the contribution limits for a SIMPLE plan sponsored by an employer with 25 or fewer employees to 110% of the standard limits. For those employees, the contribution limit is $17,600 and the catch-up limit is $3,850 for those age 50 and older.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

b. The final regulations clarify that a SIMPLE plan that is eligible to offer the 10% increase to the regular catch-up contribution limit may instead permit employees attaining age 60 through 63 to contribute catch-up contributions up to the super catch-up limit. A SIMPLE plan cannot simultaneously provide for both the additional 10% and the super catch-up to apply to a participant. So, for those age 60-63 in 2025, the super catch-up would remain $5,250.

G. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

9. The final regulations state that a plan cannot make all catch-up contributions Roth. Specifically, non-high wage earners (e.g. an employee whose wages from the employer sponsoring the plan during the preceding calendar year does not exceed $145,000 (indexed annually) must have the opportunity to make catch-up contributions on a pre-tax basis.

10. The final regulations confirm that a plan does not need to allow for Roth contributions. In that case, however, high wage earners will not be permitted to make catch-up contributions.

H. Final Regulations Regarding Catch-up Rules for High Earners under Secure 2.0 – IR 2025 – 91: Con't

11. The final regulations confirm that the Roth catch-up mandate does not apply to the special catch-up contribution rules applicable to 403(b) and 457(b) plans.

12. In general, the regulatory provisions apply to contributions in taxable years beginning after December 31, 2026. The final regulations do not modify or amend the transition rules that run through the end of 2025.

I. Retirement Rollovers

1. Amounts received from an IRA or qualified plan may be rolled over tax-free within 60 days of the date of the distribution. The IRS may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster or other events beyond the reasonable control of the individual subject to such requirement.

I. Retirement Rollovers: Con't

2. Self-Certification Procedure for Certain Failed 60-Day Rollovers Modified – Rev. Proc. 2020-45. This revenue procedure modifies and updates Rev. Proc. 2016-47, 2016-37 I.R.B. 346. Section 3.02(2) of Rev. Proc. 2016-47 provides a list of permissible reasons for self-certification of eligibility for a waiver of the 60-day rollover requirement.

H. Retirement Rollovers: Con't

a. Effective August 24, 2016, the IRS has provided a self-certification procedure designed to help recipients of retirement plan distributions who inadvertently miss the 60-day rollover time limit for properly rolling these amounts into another retirement plan or IRA.

I. Retirement Rollovers: Con't

b. A taxpayer may make a written certification to a plan administrator or an IRA trustee that a contribution satisfies the conditions in Section 3.02 of this revenue procedure. This self-certification has the effects described in Section 3.04 of this revenue procedure. Taxpayers may make the certification by using the model language in the appendix on a word-for-word basis or by using language that is substantially similar in all material respects. A copy of the certification should be kept in the taxpayer's files and be available if requested on audit.

I. Retirement Rollovers: Con't

c. Conditions for self-certification.

. The IRS must not have previously denied a waiver request with respect to a rollover of all or part of the distribution to which the contribution relates.

. The taxpayer must have missed the 60-day deadline because of the taxpayer's inability to complete a rollover due to one or more of the following reasons:

I. Retirement Rollovers: Con't

- an error was committed by the financial institution receiving the contribution or making the distribution to which the contribution relates;
- the distribution, having been made in the form of a check, was misplaced and never cashed;
- the distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan;
- the taxpayer's principal residence was severely damaged;
- a member of the taxpayer's family died;

I. Retirement Rollovers: Con't

- the taxpayer or a member of the taxpayer's family was seriously ill;
- the taxpayer was incarcerated;
- restrictions were imposed by a foreign country;
- a postal error occurred;
- the distribution was made on account of a levy under § 6331 and the proceeds of the levy have been returned to the taxpayer;
- the party making the distribution to which the rollover relates delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information; or
- the distribution was made to a state unclaimed property fund.

I. Retirement Rollovers: Con't

- The contribution must be made to the plan or IRA as soon as practicable after the reason or reasons listed in the preceding paragraph no longer prevent the taxpayer from rolling over the amount distributed (which includes any amount withheld for income tax) or a lesser amount if the taxpayer wants to roll over less than the total amount distributed or if part of the amount distributed is ineligible for rollover. This requirement is deemed to be satisfied if the contribution is made within 30 days after the reason or reasons no longer prevent the taxpayer from making the contribution.
- An IRA trustee that accepts a rollover contribution after the 60-day deadline reports on Form 5498 that the contribution was accepted after the 60-day deadline.

I. Retirement Rollovers: Con't

3. Inherited IRAs and Surviving Spouse Rollovers.

a. Taxpayer as surviving spouse would be treated as having acquired the IRA upon decedent's death passing to a trust of which the taxpayer was the sole trustee and beneficiary as if it was directly from the decedent rather than from the trust. Taxpayers eligible to roll over the IRA distribution to an IRA or establish and maintain an IRA in her own name provide the rollover occurs within 60 days. (PLR 202404003, 202322013, 202322014)

I. Retirement Rollovers: Con't

b. Surviving Spouse was eligible to roll over proceeds of IRA that were not in excess of stated percent of specified residue of trust to IRA set up and maintain in surviving spouse's name provided the rollover curve within 60 days after the proceeds were distributed. Except in the case of a rollover to a Roth IRA none of the proceeds would be includable in spouse's gross income. (PLR 202348009)

I. Retirement Rollovers: Con't

c. A decedent's spouse was treated as the payee or distributee of an IRA because the IRA was not considered an inherited IRA with respect to the taxpayer. The surviving spouse was the sole executor and sole beneficiary of the estate and could effectively treat the IRA as her own for purposes of the rollover. (LTR 202509005, 202525008, 202508002, 202538004)

H. Retirement Rollovers: Con't

d. Surviving spouse was treated as the payee or distributee of IRA proceeds issued to a decedent by a company. The decedent was survived by the spouse into children. As the surviving spouse, the taxpayer was not permitted to treat the IRA as her own because the estate was the designated beneficiary. However, the IRA was maintained effectively for the benefit of the surviving spouse. The taxpayer could roll over the IRA proceeds paid to the estate and subsequently received by the surviving spouse into an IRA established and maintain in her name. This did take beyond 60 days and was allowed as a waiver. (LTR 202519010)

I. Retirement Rollovers: Con't

4. Waivers Granted Beyond self certification

a Fraud. The IRS waived the 60 day rollover requirement with respect to a distribution of an amount from an IRA were the taxpayer could not complete the rollover timely due to being a victim of a fraud scheme. (LTR 202535015, 202441015, 202430010, 202244029)

I. Retirement Rollovers: Con't

b. Medical Condition and Spouse Death. The taxpayer had a severe medical condition diagnosed before the tax year at issue. She withdrew amounts from her 401(k) and IRA plan in the same year and failed to roll either distribution over. Her husband had manage her financial affairs but he died before the distributions were taken, the 60 day rollover period expired. The taxpayer survived and recovered from her health issues and submitted a request of waiver of the 60 day rollover requirement based upon medical condition and spouse's death. The taxpayer was required to prove the medical condition and death and the service waive the requirement. (LTR 202218028)

I. Retirement Rollovers: Con't

c. **Financial Institution Error**. The IRS declined to waive the 60-day rollover requirement with respect to the distribution of an amount from a plan to a traditional individual retirement arrangement (IRA) with a financial institution. The taxpayer had participated in the plan and requested a trustee to trustee transfer of the amount from the plan to a traditional IRA, established by the financial institution. However, the amount was deposited into a Roth IRA. The waiver of the 60-day rollover requirement was not granted because the taxpayer did not demonstrate that they failed to accomplish a rollover of the amount due to any of the factors cited in Rev. Proc. 2003-16 or that financial institution error caused the taxpayer to miss the 60-day rollover period. (LTR 202423009)

I. Retirement Rollovers: Con't

5. Bankruptcy Issues

a. Taxpayers are entitled to bankruptcy exemption relief regarding early retirement plan distributions made before turning age 59 ½ where the early distribution was also associated with a claimed disability exemption. (In re Majeski, Bktcy Ct MI 131 AFTR 2d 2023 – 655)

I. Retirement Rollovers: Con't

b. Taxpayers were entitled to bankruptcy exemption regarding IRA up to amount of IRA contribution limit for the stated year under bankruptcy, amounts in excess of the limit are considered excess distribution and are not exempt from the bankruptcy. (In re Brainard, Bktcy Ct 131 AFTR2d 2023-694)

c. Taxpayers are not entitled to bankruptcy exceptions involving improper rollovers of IRAs, Roth IRAs into 401(k)s and distributions as they are no longer considered essential characteristics of such with retirement funds protected from bankruptcy. (In re Jacobs, Bktcy Ct. 132 AFTR 2d 2023 – 5337)

I. Retirement Rollovers: Con't

d. Taxpayers lost their right to claim funds from IRA as exempt assets due to transfers of funds from the IRA to the taxpayer's businesses which were used to pay for both business and personal expenses. Such transfers are viewed as prohibited transactions under Code Section 4975 (c). Which caused the IRAs to lose their status as qualified IRAs and are now non-exempt property available for creditors. (In Re Langston, Bktcy Ct, ND Texas, 132 AFTR2d 2023 – 5067)

I. Retirement Rollovers: Con't

e. Qualified versus Nonqualified Plans. The taxpayer chose to participate in his employer's Section 409A deferred compensation plan was allowed only if the employee no longer contributed to the employer's 401(k) plan. Subsequently, the employer filed for bankruptcy protection. The employer liquidated the plan and made secure claim distributions to nonqualified participants believing that the taxpayer and other employees were not qualify to participate originally in the 409A plan.

H. Retirement Rollovers: Con't

Benefits were distributed less 20% federal withholdings. The bankruptcy court indicated could not orders the funds from a nonqualified plan be deposited into a qualified plan and that the taxes were properly withheld. The court determined that the employees including the taxpayer had been given enough disclosure that the Section 409A plan was not a qualified plan when the taxpayer voluntary decided to participate. (See Palaniappann v. Comm., No. 2:2 2 – CV – 01685 (DC Arizona 3/28//24)

J. Tax Free Charitable Donation Limit from IRA – IR – 2024 – 289

1. The IRS reminded individual retirement arrangement (IRA) owners age 70Â½ and older that they can make tax-free charitable donations of up to $105,000 in 2024 through qualified charitable distributions (QCDs), up from $100,000 in past years.

2. For those aged 73 or older, QCDs also count toward the year's required minimum distribution (RMD).

3. The following are the steps for reporting and documenting QCDs for 2024:

J. Tax Free Charitable Donation Limit from IRA – IR – 2024 – 289: Con't

- IRA trustees issue Form 1099 – R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., in early 2025 documenting IRA distributions.
- Record the full amount of any IRA distribution on Line 4a of Form 1040, U.S. Individual Income Tax Return, or Form 1099 – SR, U.S. Tax Return for Seniors.
- Enter "0" on Line 4b if the entire amount qualifies as a QCD, marking it accordingly.
- Obtain a written acknowledgment from the charity, confirming the contribution date, amount, and that no goods or services were received.

J. Tax Free Charitable Donation Limit from IRA – IR – 2024 – 289: Con't

4. To ensure qualified charitable deductions (QCD) for 2024 are processed by year-end, IRA owners should contact their trustee soon. Each eligible IRA owner can exclude up to $105,000 in QCDs from taxable income. Married couples, if both meet qualifications and have separate IRAs, can donate up to $210,000 combined.

J. Tax Free Charitable Donation Limit from IRA – IR – 2024 – 289: Con't

5. For 2024, the QCD limit is subject to annual adjustments for inflation.

6. For 2025, the limit will be $108,000 and Publication 526, Charitable Contributions and Publication 590 – B Distributions from Individual Retirement Arrangements (IRAs) have also been modified.

J. Tax Free Charitable Donation Limit from IRA – IR – 2024 – 289: Con't

7. One issue with the expansion of the RMD is that SECURE does reduce the allowable QCD apply and IRA deduction allowed for a taxpayer over age 70 ½. Specifically, the amount of distributions not includible in gross income shall be reduced (but not below zero) by an amount equal to the excess of the aggregate amount of deductions allowed to the taxpayer for all taxable years ending on or after the date the taxpayer attains age 70½ over the aggregate amount of reductions for all taxable years preceding the current taxable year.

Example

Joe made traditional IRA contributions at age 71 and 72 for a total of $14,000. A few years later, Joe directs the custodian of his IRA to make a qualified charitable distribution of $25,000 to the Salvation Army. The first $14,000 of the distribution is not treated as a QCD. Thus, $14,000 will be included in Joe's income as a taxable distribution, and Joe may deduct $14,000 on his Schedule A as a charitable contribution.

K. Early Withdrawal Penalties

1. Section 72(t)(1) imposes a 10% additional tax on distributions from qualified retirement plans. However, Section 72(t)(2) lists the following exceptions to the imposition of the 10% additional tax on the distributions :

a. On or after the account owner reaches age 59 ½ .
b. The death of the account owner.
c. After the permanent disability of the account owner.
d. At age 55 if from an employer plan and separated from service (does not apply to IRAs).
e. A series of substantially equal periodic payments made for the life of the employee or the joint lives of the employee and his beneficiary.

K. Early Withdraw Penalties: Con't

f. Distribution made incident to a divorce or made to an alternate payee under a QDRO.

g. IRS levies.

h. For extraordinary medical expense that exceed 7 ½ % of AGI.

i. Qualified disaster-relief distribution not in excess of $100,000.

j. Public safety employees taking plan distributions if separating from service and over age 50.

k. Reservists called to active duty for at least 179 days.

K. Early Withdraw Penalties: Con't

l. For health insurance premiums during long term unemployment (12 consecutive weeks).- IRA ONLY

m. For qualified higher education expense – IRA ONLY.

n. For a qualified 1st time home buyer (a $10,000 lifetime limit) – IRA ONLY.

o. 10% Penalty Exception for Qualified Reservists

p. Financial Hardship Does not Count as far as an IRA. (Prichard V. Comm., TCM 2017 – 136; Cheves v. Comm., TCM 2017 – 22)

Examples

Lucas v. Comm., US Court of Appeals 9th Cir., 23 – 3403, October 24, 2025. The Tax Court properly upheld an IRS deficiency against the taxpayer. The taxpayers retirement distribution was taxable the taxpayer failed to demonstrate an exception from the additional 10% on early withdrawal. The taxpayer failed to show that his diabetes prevented him from engaging in his customary or any comparable substantial gainful activity at the time of the distribution, and that his condition constituted a disability. The taxpayer received premature distributions his qualified retirement plan due to financial problems after the loss of his job.

Examples: Con't

Campana v. Comm., TC Memo 2025 – 23. The taxpayer withdrew funds from a qualified retirement accounts before reaching age 59 ½.The taxpayer contended that a prior refund would offset the liability. There were no other valid reasons for the withdraw and thus the 10% penalty was properly assessed.

Examples: Con't

Hutchinson v. Comm., TC Memo 2025 – 1. A married couple failed to substantiate claims that funds diverted from retirement plans were used for retirement plan investments. The Tax Court determined that the 10% early withdrawal penalty should be assessed. The diversion was fraudulent in nature and no known exception should apply.

Examples: Con't

Moran v. Comm., TC Memo 2024 – 67. Taxpayer was under age 59 ½ and took a distribution from an IRA in the amount of $2,417. The IRS assessed the additional 10% tax on early retirement plan distributions. Taxpayer failed to provide any exception to the additional tax other than stating it was unfair.

K. Early Withdraw Penalties: Con't

2. The SECURE 2.0 Act adds a number of exceptions from the Section 72 (t) tax on early distributions from retirement accounts. These include the following:

a. Penalty Free Emergency Withdrawals. The new exception applies to certain distributions used for emergency expenses, which are used for meeting unforeseeable or immediate financial needs relating to necessary personal or family emergencies. One distribution is allowed per year of up to $1,000. Taxpayers have the option to repay the distribution within three years. No further emergency distributions are allowed during the three-year repayment period unless repayment has been made. The exception is available for distributions made after December 31, 2023.

Example

Campana v. Comm., TC Memo 2025 – 23. The taxpayer failed to demonstrate an error in the IRS determination of the deficiency for unreported income. The Tax Court determined that the retirement distribution was includable in gross income subject to the additional tax of 10% because it was withdrawn early before the threshold age without meeting any statutory exception. The IRS satisfied its burden of proof by presenting third-party information returns and verifying the unreported income which shifts the burden to the taxpayer to show that it should not be reported as income. The taxpayer argued that the withdrawal was for emergency purposes but this was prior to the change under SECURE 2.0

K. Early Withdraw Penalties: Con't

b. Penalty-free withdrawals for domestic abuse victims. The act amends Section 72(t) to allow domestic abuse victims to take distributions of up to $10,000 (adjusted for inflation after 2024) from a qualified retirement plan without being subject to the 10% additional tax for early withdrawals. "Domestic abuse" includes physical, psychological, sexual, emotional, or economic abuse by a spouse or domestic partner. Employees or participants can self-certify that they qualify for the exception. The provision is effective for distributions made after December 31, 2023.

K. Early Withdraw Penalties: Con't

c. Penalty-free withdrawals for individuals with terminal illness. The act amends Section 72(t) to allow individuals with a terminal illness to take distributions from a qualified retirement plan without being subject to the 10% additional tax for early withdrawals. Employees or participants will need a physician's certification to qualify for the exception. A terminally ill person is defined as someone who has an illness or physical condition that can reasonably be expected to result in death in 84 months or less after the date of the certification. The provision is effective for distributions made after December 31, 2023.

K. Early Withdraw Penalties: Con't

d. Penalty-free withdrawals in connection with qualified disasters. The act allows penalty-free withdrawals of up to $22,000 for "qualified disaster recovery distributions." These are defined as any distribution made on or after the first day of the "incident period" of a qualified disaster and before 180 days after the "applicable date" for that disaster. Eligible individuals must have their principal place of abode within the qualified disaster area and must have sustained an economic loss as a result of the qualified disaster. The "incident period" means the period designated by the Federal Emergency Management Agency as the period during which the disaster occurred.

K. Early Withdraw Penalties: Con't

The "applicable date" is the latest of (i) the date of enactment of the act, (ii) the first day of the incident period, or (iii) the date of the disaster declaration. Any amount of a qualified disaster recovery distribution that an individual must include in income will be included ratably over a three-year period. The provision applies to distributions with respect to disasters for which the incident period begins on or after January 26, 2021 (30 days after the enactment of the Taxpayer Certainty and Disaster Relief Act of 2020, P.L. 116-260). The provision is effective for distributions made after December 31, 2023.

K. Early Withdraw Penalties: Con't

e. Qualified Birth and Adoption Distributions. Distributions for the birth or adoption of a child of up to $5,000 per individual are penalty-free withdrawals from an IRA and a qualified pension plan. To meet the requirements of the qualified birth or adoption distribution, the individual must take a distribution during the one-year period beginning on either the date of birth of the child, or the date of the final adoption of the child (under age 18). An individual taking a distribution for the birth or adoption of a child may make an additional contribution back to the plan from which the distribution was made or to an IRA within three years of the date of the distribution.

SECTION IV:

STANDARD DEDUCTIONS AND ITEMIZED DEDUCTIONS

I. Standard Deduction

A. General Rule

1. The standard deduction is the sum of the basic standard deduction based on filing status and the additional standard deduction amounts for age 65 and older, and/or blindness. These amounts are indexed annually for inflation.

2. Under TCJA, for tax years 2018 through 2025, the TCJA temporarily increased the basic standard deduction amounts, but not the additional standard deduction.

A. General Rule: Con't

3. For tax years 2018 through 2025, the basic standard deduction statutory amounts (before any inflation adjustment) are as follows:

- $24,000 for joint filers and surviving spouses (computed as 200% of the single filers' amount);
- $18,000 for heads of household; and
- $12,000 for singles and marrieds filing separately.

A. General Rule: Con't

4. The TCJA also modified the rules for the inflation indexing of the statutory base standard deduction amounts to require that they be adjusted annually for inflation each tax year using the percentage by which the Chained Consumer Price Index for all Urban Consumers ("chained CPI") for the prior year exceeds the chained CPI for 2017.

B. 2025 Thresholds

1. For 2025, the basic standard deduction will be:

- Joint return or surviving spouse $30,000
- Single (not head of household or surviving spouse) $15,000
- Head of household $22,500
- Married filing separate returns $15,000

B. 2025 Thresholds: Con't

2. For an individual who can be claimed as a dependent on another's return, the basic standard deduction for 2025 will be $1,350, or $450 plus the individual's earned income, whichever is greater. The standard deduction may not exceed the regular standard deduction for that individual.

3. For 2025, the additional standard deduction for married taxpayers 65 or over or blind will be $1,600. For a single taxpayer or head of household who is 65 or over or blind, the additional standard deduction for 2025 will be $2,000.

C. New! OBBBA for Tax Years 2026 and Beyond

1. For tax years beginning after December 31, 2025, the basic standard deduction amounts were scheduled to revert to the pre-TCJA statutory amounts. They were un-inflated-adjusted amounts shown below:

- for a joint return or surviving spouse, 200% of the dollar amount in effect for an unmarried individual;
- for a head of household, $4,400; and
- for a single or married-filing-separate return, $3,000.

C. New! OBBBA for Tax Years 2026 and Beyond: Con't

2. Initially, OBBBA increases the basic standard deduction statutory amounts for tax years beginning after 2025 (Act Sec. 70102(c)) as follows:

- $31,500 for joint filers and surviving spouses (computed as 200% of the single filers' amount);
- $23,625 for heads of household; and
- $15,750 for singles and marrieds filing separately. (See Act Secs. 70102(a), 70102(b)(1) and 7010(b)(2) amend IRC Section 63 (c) (7))

C. New! OBBBA for Tax Years 2026 and Beyond: Con't

3. The section also modifies the inflation adjustment for the basic standard deduction for tax years beginning after 2025, to make the base tax year for measuring the prior year chained CPI, 2024 (instead of 2017). (See Act Secs. 70102(b)(1), 70102(b)(2), 70102(b)(3) and 70102(b)(4) amend IRC Section 63 (c) (7) (B) (ii))

4. The section is effective for tax years beginning after December 31, 2024. (Act Sec. 70102(c))

D. Revised 2026 Standard Deduction Amounts – Rev. Proc. 2025 – 32

1. For 2028, the basic standard deduction will be:

- Joint return or surviving spouse $32,200
- Single (not head of household or surviving spouse) $16,100
- Head of household $24,150
- Married filing separate returns $16,100

D. Revised 2026 Standard Deduction Amounts – Rev. Proc. 2025 – 32: Con't

2. For an individual who can be claimed as a dependent on another's return, the basic standard deduction for 2026 will be $1,350, or $450 plus the individual's earned income, whichever is greater. The standard deduction may not exceed the regular standard deduction for that individual. **This is the same as 2025**.

3. For 2026, the additional standard deduction for married taxpayers 65 or over or blind will be $1,650. For a single taxpayer or head of household who is 65 or over or blind, the additional standard deduction for 2026 will be $2,050.

E. New! – Permit Charitable Deduction for Taxpayers Who Do Not Itemize

1. OBBBA provides that non-itemizers may claim a charitable deduction, not in excess of $1,000 ($2,000 for a joint return). (See Act Sec. 70424(a))

2. To qualify for the non-itemizers' charitable deduction, contributions must be in cash, must be made to a public charity, and must meet substantiation requirements for cash contributions.

E. New! – Permit Charitable Deduction for Taxpayers Who Do Not Itemize: Con't

3. The non-itemizers' charitable deduction is a below-the-line deduction, deducted from adjusted gross income in arriving at taxable income.

4. The provision applies for tax years beginning after December 31, 2025. (See Act Sec. 70424(b))

II. Itemized Deductions

A. Medical Expenses

1. Standard Mileage Rate. Presently, for 2025, the standard mileage rate for medical expenses is $0.21 per mile. (IR 2024-312)

Note: the IRS will not announce the standard mileage rates until December. The projection is that the mileage rate for medical expenses will remain the same.

2. Long Term Care Premium Limits

A. Medical Expenses: Con't

a. 2025 Premium Limits - Rev. Proc. 2024 – 40

Not more than 40	**$480**
More than 40 but not more than 50	**$900**
More than 50 but not more than 60	**$1,800**
More than 60 but not more than 70	**$4,810**
More than 70	**$6,020**

A. Medical Expenses: Con't

b. 2026 Premium Limits – Rev. Proc. 2025 – 32

Not more than 40	**$500**
More than 40 but not more than 50	**$930**
More than 50 but not more than 60	**$1,860**
More than 60 but not more than 70	**$4,960**
More than 70	**$6,200**

A. Medical Expenses: Con't

3. Payments received under qualified long-term care insurance.

a. 2025. Amounts received under a qualified long-term care insurance contract are generally excludable as amounts received for personal injuries and sickness, subject to a per diem limitation, which will be $420 in 2025. (Rev. Proc 2024 – 40)

b. 2026. Amounts received under a qualified long-term care insurance contract are generally excludable as amounts received for personal injuries and sickness, subject to a per diem limitation, which will be $430 in 2026. (Rev. Proc. 2025 – 32)

A. Medical Expenses: Con't

4. **Medical Expenses Involving IVF Were Deductible – LTR 202518023.** The IRS ruled that medical expenses related to in vitro fertilization (IVF) including) screenings, fertility medication and treatment, and egg and sperm retrieval, were deductible as medical care expenses. However, deductions were denied for payments related to gestational surrogacy, including pre-transfer testing costs, certain embryo transfer and storage fees, and legal fees to establish parentage.

A. Medical Expenses: Con't

5. **Amounts Involving Reproductive Technologies and Directly Attributable to Taxpayers Were Deductible – LTR 202505002.** The IRS ruled that medical costs and fees of assisted reproductive technologies; and (2) other medical care directly attributable to a married couple were deductible under as medical expenses including sperm donation. The taxpayers used a pregnancy surrogate and in vitro fertilization (IVF), and a third party's donated egg.

A. Medical Expenses: Con't

However, payments related to products and services involving assisted reproductive technologies not being performed on taxpayers were not deductible under These included egg donor costs, egg retrieval, sperm freezing, IVF medical costs, legal and agency fees for the surrogacy, childbirth expenses related to the surrogate pregnancy, surrogate medical insurance related to the pregnancy, and other medical costs and fees effectuating and arising from the surrogate pregnancy.

A. Medical Expenses: Con't

7. **Notice 2024 – 71: Condoms are Considered Qualified Medical Expenses**

a. The IRS established a safe harbor for expenses for the purchase of condoms to be treated as a qualified medical expense. As such, those expenses can be reimbursed by a health flexible spending arrangement, a health reimbursement arrangement, or a health savings account.

A. Medical Expenses: Con't

8. **IR 2023-47, new IRS FAQ and what constitutes deductible medical expenses.** The IRS has posted answers to FAQs about when certain costs related to nutrition, wellness and general health are deductible medical expenses paid or reimbursed under a health savings account, health flexible spending arrangement, Archer medical savings account, health reimbursement arrangement as well as deductible subject to the AGI limitation.

a. To be deductible, the qualified medical expenses must be incurred primarily to alleviate or prevent a physical or mental disability or illness.

A. Medical Expenses: Con't

b. Qualified medical expenses include the costs of diagnosis, cure, mitigation, treatment, or prevention of disease that affects any part or function of the body, as well as payments for legal medical services rendered by physicians, surgeons, dentists, and other medical practitioners. They also include costs for equipment, supplies and diagnostic devices, medicines and drugs that are prescribed by a doctor. Qualified medical expenses generally do not include expenses that are merely beneficial to general health.

A. Medical Expenses: Con't

c. The IRS' new FAQs cover questions about whether the costs of items such as gym memberships, weight loss programs and special foods can be deducted as qualified medical expenses. For example,

- FAQ 9 says that the cost of weight-loss programs is deductible or reimbursable by a medical savings account when the program treats a specific disease i.e., obesity, diabetes, hypertension, or heart disease diagnosed by a doctor.
- FAQ 10 says that gym memberships are deductible but only when the membership is purchased for the sole purpose of affecting a structure or function of the body (i.e., a prescribed plan for physical therapy to treat an injury) or for the sole purpose of treating a specific disease (i.e., obesity, hypertension, or heart disease) diagnosed by a physician.

A. Medical Expenses: Con't

- FAQ 12 finds that the costs of food and beverage is deductible but only when (1) the food or beverage doesn't satisfy normal nutritional needs, (2) the food or beverage alleviates or treats and illness, and (3) the need for the food or beverage is substantiated by a doctor. In this case the medical expense deduction is limited to the amount by which the cost of the food or beverage exceeds the cost of a product that satisfies normal nutritional needs.
- FAQ 13 says that the cost of over-the-counter drugs and medicines generally can't be deducted as a medical expense. However, these costs (and menstrual care products) may be paid or reimbursed by a medical savings account.

A. Medical Expenses: Con't

d. Qualified medical expenses generally do not include expenses that are merely beneficial to general health.

9. **IR 2024-65: Misrepresentation on General Health and Wellness Expense Deductions.** The IRS has issued an alert for taxpayers and health spending plan administrators to remember that personal expenses for general health and wellness are not considered medical expenses under the tax law. The warning came in response to aggressive marketing claims by some companies that misrepresent the circumstances under which food and wellness expenses can be paid or reimbursed under FSAs and other health spending plans.

A. Medical Expenses: Con't

According to the IRS, notes from physicians that are solely based on self-reported data are insufficient as they fail to meet the requirement that the note be related to a diagnosis-specific activity or treatment. FSAs and other health spending plans that pay for, or reimburse, non-medical expenses are not qualified plans. If the plan is not qualified, all payments made to taxpayers under the plan, even reimbursements for actual medical expenses, are includible in income.

10. 7.5% AGI Threshold. For 2024, the threshold for deducting medical expenses is 7.5%. This threshold also applies for alternative minimum tax (AMT) purposes and is permanent in nature.

B. SALT – New!

1. The TCJA capped the individual deduction for state and local taxes at $10,000 ($5,000 for marrieds filing separately). (See Section 164 (b) (6)) That cap was slated to sunset December 31, 2025.

2. OBBBA retroactively increases the individual SALT deduction cap from $10,000 to $40,000 for 2025.

3. It further increases the cap to $40,400 in 2026, and by an additional 1% in 2027, 2028, and 2029.

B. SALT – New!: Con't

4. The Act phases out the deduction for taxpayers with modified adjusted gross income (MAGI) greater than $500,000 in 2025. The phaseout threshold increases to $505,000 in 2026, and by an additional 1% after.

5. For higher-income taxpayers, in tax years before January 1, 2030, the cap is reduced by 30% of the excess of the taxpayer's MAGI over the threshold amount. The Act provides, however, that the deduction will not be reduced below $10,000.

6. Under the Act, the individual SALT deduction cap will revert to $10,000 beginning in 2030.

B. SALT – New!: Con't

7. The provision is effective for tax years beginning after **December 31, 2024**. (See Act Sec. 70120, amends IRC Section 164 (b)(6))

8. The final version retains the full deductibility of state and local taxes paid through state enacted pass-through entities.

9. The SALT Deduction is not deductible under AMT.

B. SALT – New!: Con't

10. Other Matters

a. A deduction for taxpayers share of real estate taxes paid by the cooperative housing corporation cannot be used in computing the taxpayers AMTI.

Example

Ostrow & Teiger v. Comm., US Court of Appeals Second Circuit, 430 F3d 581. The Court of Appeals for the Second Circuit affirmed that the taxpayers who are tenants stockholders in a cooperative housing corporation deducted 10,004 $80 from their tax return representing their proportionate share of real estate taxes incurred by the housing cooperation. The deduction is generally allowed. The taxpayers however include the deduction in computing alternative minimum taxable income.

Example: Con't

The IRS issued a notice of deficiency asserting that the deduction is not allowed for AMT purposes. Section 216 is the governing provision and indicated that in the case of a tenet stockholder there shall be allowed as a deduction amounts paid or accrued to a cooperative housing corporation within the taxable year only to the extent it represents their pro rata or proportionate share of real estate taxes. The court determined that the statute is silent on AMT or AMTI.

B. SALT – New!: Con't

b. Taxpayer has the burden of proof to show state and local taxes were paid, the IRS cannot arbitrarily deny such amounts.

Examples

Schneider v. Comm., TC Memo 2024 – 104. Taxpayer was denied state and local tax deduction originally by the IRS despite the fact that having proven that the amount paid exceeded the standard deduction amount. The Tax Court indicated that the taxpayer is entitled to a deduction for state income taxes deducted on his W-2. That is all the substantiation that is required.

Examples: Con't

Bubba and Bubbet , file a joint return. They have $550,000 of Adjusted Gross Income in 2025. This exceeds the $500,000 threshold by $50,000. In applying to 30% phaseout, $15,000 of the deduction will not be allowed. The deduction will be at $25,000. ($40,000 $-15,000)

Assume the same trouble as AGI of $750,000 there AGI is $250,000 over the threshold resulting in a $75,000 reduction in their allowable deduction. Since this exceeds the $40,000 The deduction would phase down to the minimum of $10,000.

B. SALT – New!: Con't

11. The final version of the Act does not include any restrictions on deductions for pass-through entity taxes (P T E T) as a result, this deduction remains available.

12. It should be noted that PTET elections are enacted in 36 jurisdictions. 26 states and localities, including New York State/City, New Jersey, and Connecticut, have enacted permanent PTET regimes and five states (Colorado, Iowa, Massachusetts, Michigan, and Minnesota) have regimes linked to the federal SALT cap.

B. SALT – New!: Con't

Consequently, these regimes will continue to be available with the passage of the OBBBA. However, four states (Illinois, Oregon, Utah, and Virginia) have PTET programs scheduled to sunset on December 31, 2025, and will need to pass legislation to extend these regimes. California's statute was similarly set to expire but the state recently passed new legislation extending its PTET program for an additional five years.

C. Interest Expense: Con't

1. Mortgage Interest Deduction Modified Through 2025 . The Tax Cuts and Jobs Acts provides that for tax years beginning after December 31, 2017 and beginning before January 1, 2026, a taxpayer may treat no more than $750,000 as acquisition indebtedness ($375,000 in the case of married filing separately). For tax years beginning after December 31, 2025, the acquisition indebtedness goes back to $1 million ($500,000 for married filing separately).

C. Interest Expense: Con't

2. Home Equity Indebtedness – Section 163 (h) (3) (C) (i). Under the Tax Cuts and Jobs Act deduction on home equity indebtedness was suspended from 2018 through 2025. Technically, the taxpayer cannot claim the deduction for interest on home equity debt whether the debt is new or old. Under the provision, interest on a home equity loan used to build in addition to an existing home is deductible. However, interest on that same loan used to pay personal living expenses is not deductible. There is a box to check on this respect to Schedule A.

C. Interest Expense: Con't

3. New! — Limitation Deduction for Qualified Residence Interest Extended

a. OBBBA permanently lowers the deduction for qualified residence interest to $750,000 in home mortgage acquisition debt. It also permanently treats certain mortgage insurance premiums on acquisition indebtedness as qualified residence interest.

b. This provision applies to tax years beginning after December 31, 2025. (Act Sec. 70108, amends IRC Section 163 (h) (3) (F)))

C. Interest Expense: Con't

4. **Substantiation**

a. Substantiation for interest expense requires the debt constituting acquisition and the debt must be associated with a qualified residence. In addition, the substantiation requirement also applies to mortgage insurance premium payments on a principal residence.

Examples

Aulisio, Jr. v. Comm., TC Memo 2024 – 29. The taxpayer who was a CPA was not entitled to Schedule A deductions for mortgage interest expense and real estate property taxes. The taxpayer failed to provide documents or evidence substantiating that he made the mortgage payments. Without bank records, bank statements, canceled checks, receipts or the records the taxpayer was unable to substantiate that he made the mortgage payments. The taxpayer further was unable to substantiate that he paid real property taxes that were entitled to a deduction. As far as the mortgage and taxes, a trust to purchase the property in question. It was not a revocable trust and the taxpayer had not signed on to the mortgage. Thus there was no evidence of direct ownership.

Examples: Con't

Tucker v, Comm., TC Memo 2023 – 87. The taxpayers were denied interest expense deductions for property the husband owned as a joint tenant with an unrelated third party. The taxpayers produce Forms 1098 from various banks but did not substantiate that the husband in fact made said payments.

Examples: Con't

Shilgevorkyan v. Comm., TC Memo 2023-12. The taxpayer was not entitled to mortgage interest deduction regarding property which one of taxpayer's brother originally purchased and taxpayer alleged a half interest in upon taxpayer's acquisition another brother. Taxpayer did not have legal title to property because the brother from whom he allegedly purchased his interest was only an accommodation party to construction loan and did not himself have interest to transfer to taxpayer. Taxpayer also did not hold equitable title. Taxpayer did not show that property qualified as his principal residence for these purposes in year at issue, during which he stayed at and listed another property as his residence.

D. Charitable Contributions

1. **Standard Mileage Rate.** The standard mileage rate is $.14 per mile for use of an automobile in services to a charitable organization. (Notice 2023 – 3). The standard mileage rate will remain the same for 2026.

Note: at the time of the publication, the IRS has not announced the standard mileage rate for 2026. It is anticipated that will remain the same.

D. Charitable Contributions: Con't

2. Required Documentation for Charitable Contributions – Publication 1771

i. The IRS imposes recordkeeping and substantiation rules on donors of charitable contributions and disclosure rules on charities that receive certain quid pro quo contributions.

D. Charitable Contributions: Con't

- Donors must have a bank record or written communication from a charity for any monetary contribution before the donors can claim a charitable contribution on their federal income tax returns.
- Donors are responsible for obtaining a written acknowledgment from a charity for any single contribution of $250 or more before the donors can claim a charitable contribution on their federal income tax returns.

- Charitable organizations are required to provide a written disclosure to a donor who receives goods or services in exchange for a single payment in excess of $75.

D. Charitable Contributions: Con't

ii. A donor cannot claim a tax deduction for any contribution of cash, a check or other monetary gift unless the donor maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or a written communication from the charity (such as a receipt or letter) showing the name of the charity, the date of the contribution and the amount of the contribution.

D. Charitable Contributions: Con't

iii. For charitable contributions made by payroll deduction, the donor may use a pledge card prepared by or at the direction of the charitable organization, along with one of the following a pay stub, Form W-2, Wage and Tax Statement, or other employer-furnished document that shows the amount withheld and paid to a charitable organization.

D. Charitable Contributions: Con't

iv. If a donor makes a single contribution of $250 or more by payroll deduction, the pledge card or other document from the organization must also include a statement to the effect that the organization does not provide goods or services in whole or partial consideration for any contributions made to the organization by payroll deduction.

v. Each payroll deduction of $250 or more is treated as a separate contribution for purposes of the $250 threshold requirement for written acknowledgments.

D. Charitable Contributions: Con't

vi. Written Acknowledgment. A donor cannot claim a tax deduction for any single contribution of $250 or more unless the donor obtains a contemporaneous, written acknowledgment of the contribution from the recipient organization. An organization that does not acknowledge a contribution incurs no penalty; but, without a written acknowledgment, the donor cannot claim the tax deduction. Although it's a donor's responsibility to obtain a written acknowledgment, an organization can assist a donor by providing a timely, written statement containing:

D. Charitable Contributions: Con't

- the name of organization,
- the amount of cash contribution,
- a description (but not the value) of non-cash contribution,
- a statement that no goods or services were provided by the organization in return for the contribution, if that was the case,
- a description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution,
- a statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits (described later in this publication), if that was the case.

D. Charitable Contributions: Con't

vii. A separate acknowledgment may be provided for each single contribution of $250 or more, or one acknowledgment, such as an annual summary, may be used to substantiate several single contributions of $250 or more. Letters, postcards or computer-generated forms with the above information are acceptable. An organization can provide either a paper copy of the acknowledgment to the donor, or an organization can provide the acknowledgment electronically, such as via an email addressed to the donor.. Separate contributions of less than $250 will not be aggregated. An example of this could be weekly offerings to a donor's church of less than $250 even though the donor's annual total contributions are $250 or more.

D. Charitable Contributions: Con't

viii. For the written acknowledgment to be considered contemporaneous with the contribution, a donor must receive the acknowledgment by the earlier of the date on which the donor actually files his or her individual federal income tax return for the year of the contribution; or the due date (including extensions) of the return.

D. Charitable Contributions: Con't

ix. The acknowledgment must describe goods or services an organization provides in exchange for a contribution of $250 or more. It must also provide a good faith estimate of the value of the goods or services because a donor must generally reduce the amount of the contribution deduction by the fair market value of the goods and services provided by the organization. Goods or services include cash, property, services, benefits or privileges.

D. Charitable Contributions: Con't

x. If a donor makes a single contribution of $250 or more in the form of unreimbursed expenses, for example, out-of-pocket transportation expenses incurred to perform donated services for an organization, then the donor must obtain a written acknowledgment from the organization containing a:

- description of the services provided by the donor
- statement of whether the organization provided goods or services in return for the contribution
- description and good faith estimate of the value of goods or services, if any, that the organization provided in return for the contribution
- statement that goods or services, if any, that the organization provided in return for the contribution consisted entirely of intangible religious benefits.

Example

Johnson v. Comm., TC Memo 2025 – 87. The taxpayer was not allowed to a charitable contribution deduction because he failed to meet the substantiation requirements. The claimed donation was not supported by contemporaneous records or credible documentation. The acknowledgment letter lacked reliability and the taxpayer's close association with the charitable organization raise concerns about authenticity and self-dealing. The taxpayer explained that the cash contribution to the charity made in the tax year in question was to support the charitable efforts. The charity did not provide a letter until one year later of the transaction.

Example: Con't

The letter acknowledged different dates than what the taxpayer had indicated to the IRS. The letter was not provided during the audit examination. The taxpayer claimed the contribution was in association with unreimbursed expenditures made incident to the rendering of services to the charity. The regulations require the taxpayer to have some form of substantiation including but not limited to a canceled check, a receipt from the charity or an absence of either written reliable evidence.

Example: Con't

The contribution was viewed as one in excess of $250 which requires contemporaneous written acknowledgment from the charity that specifies the amount of cash and whether any goods or services were provided in exchange. Since he had no records to reflect the exact amount of the contributions and all acknowledged was overturned and $50 the contemporaneous rules kicked in and the deductions were disallowed.

D. Charitable Contributions: Con't

All Summary of Required Documentation for Charitable Deductions

Type	Documentation
Single cash contribution of less than $250	Cancelled check, bank record, credit card statement, or written acknowledgment from the charity. Sec.170(f) (17); IR-2006-192
Single cash contribution of $250 or more	Written acknowledgment from the charity. Sec.170 (f)(8)
Payroll deduction	Pledge card and W-2, paystub, etc. Sec.1.170A-13(c); Notice 2008-16
Noncash contributions less than $250	Written acknowledgment from the charity or other reliable record. Sec.1.170A-13(b)(1)
Noncash contribution of $250 but not more than	Written acknowledgment from the charity$ 500 1.170A-13(b)(3)

D. Charitable Contributions: Con't

All Summary of Required Documentation for Charitable Deductions

Noncash contribution over $500 under $5,000	Written acknowledgment from the charity and Form 8283, part A. Sec.1.170A-13(b)(3)
Noncash contribution of >$5,000	Written acknowledgment from the charity, appraisal and Form 8283, part B. Sec.170(f)(11)(c)
Noncash contribution > $500,000	Written acknowledgment from the charity, appraisal, and Form 8283, part B. Attach appraisal to the return.Sec.170(f)(11)(D)
Noncash contribution of auto, boat, or airplane with a value of $ 500 or more	Written acknowledgment from the charity.

D. Charitable Contributions: Con't

All Summary of Required Documentation for Charitable Deductions

	Attach Form1099-C and for 8283 Sec.170(e)(11)(c); IR-2006-192
Noncash contribution of publicly traded stock	Written acknowledgment from the charity and Form 8283, part A. Sec.1.170A-13 (c)(7)(xi)(B)
Noncash contribution of privately traded stock > $ 5,000	Written acknowledgment from the charity, and Form 8283-part B. If the privately traded stock is valued at $10,000 or more, attach an appraisal to the return.Sec.1.170A-13 (c)(2)(ii)(B)(1)
Noncash contribution of art valued at more than $20,000	Written acknowledgment from the charity, appraisal, Form 8283, part B. Appraisal and a photo of the art must be attached to the return. Rev. Proc. 96-15

D. Charitable Contributions: Con't

3. Qualified Appraisal Requirement

a. A qualified appraisal is an appraisal document prepared by a qualified appraiser in accordance with generally accepted appraisal standards. These standards include:

b. A qualified appraisal must include: (See Reg. Sec. 1.170A-17)

- Information about the contributed property, including a description in sufficient detail under the circumstances, taking into account the value of the property, that a person not generally familiar with the type of property can ascertain that the appraised property is the contributed property.

D. Charitable Contributions: Con't

- In the case of real property or tangible personal property, the condition of the property.
- The valuation effective date, which must be no earlier than 60 days before the date of the contribution and no later than the due date, including extensions, of the tax return on which the deduction for the contribution is first claimed.
- The date, or expected date, of the contribution, not be earlier than 60 days before the date of the contribution and no later than the date of the contribution.
- The fair market value of the contributed property on the valuation effective date.

D. Charitable Contributions: Con't

c. The qualified appraiser must possess the required education and experience in valuing the type of property including successfully completing professional or college coursework in valuing the type of property pursuant to the appraisal, or earn a recognized appraisal designation.

Examples

Green 1193 Dynasty Trust V. Comm., 165 TC No. 7, October 2, 2025. The taxpayers failed to secure a judgment on charitable contribution deductions. The IRS argued the substantiation requirements were not met. The taxpayers disagreed indicating that they had relied on advisors and ordinary business care. The trust in question owned Hobby Lobby. Hobby Lobby made non-cash charitable contributions of 23,000,060 $1 million. The trust picked up their allocable share of the deduction Form 8283 was attached stating that non-cash contribution amount. The A2 E3 indicated the date of purchase and the aggregate basis and fair market value at the time of contribution.

Examples: Con't

The appraisal provided a fair market value but did not identify the acquisition date nor the basis of the contribution. The appraisal report describe the credentials of the appraisers but did not include a declaration from two of the four appraisers. The Service indicated that there is no automatic reasonable cause exception required. The circuit court disagreed and sent back to the lower court for the showing of evidence that the professionals had made an appropriate appraisal of the property. There was no indication that they appraisers were not qualified to do the work.

Examples: Con't

Rock Cliff Reserve, LLC v. Comm., TC Memo 2025 – 73. The partnership's non-cash charitable contribution deduction were disallowed in full because the attached appraisals were not qualified appraisals. Specifically, the appraisals were written long after the taxpayer agreed on a value of the non-cash contribution. The tax matters partner knew that the value the non-cash contribution was worth less than 1.5 million not 14.4 million on the return. The appraiser merely went with what the tax matters partner had asked for. The qualified appraiser had no expertise nor background in the property that was the subject of the non-cash contribution.

Examples: Con't

Cade v. Comm., TC Memo 2025 – 20. The taxpayers were not entitled to charitable deduction for donating tangible personal property to a charity. The taxpayers failed to obtain qualified appraisals for their contribution. The taxpayers were required to secure a contemporaneous written acknowledgment of the gifts. The taxpayers argued that Form 8283, Noncash Charitable Contributions, served as a CWA. However, Form 8283 did not contain a statement on whether the donee organization provided any goods or services in consideration for the gift and could not serve as a CWA. Additionally, there were questions about the authorship and authenticity of the putative CWA that taxpayers later supplied.

Examples: Con't

Further, the taxpayers contended that they secured qualified appraisals, and a Form 8283 was sufficient to satisfy the "qualified appraisal" requirement. However, Form 8283 is the form that the IRS prescribes for an appraisal summary, and it is not the same as an appraisal. Additionally, the taxpayers submitted statements from their appraisers, but those statements did not provide critical information about the method of valuation used to determine the fair market value. Moreover, the taxpayers failed to provide these statements before the deadline. The taxpayers failed to meet the requirements of a qualified appraiser under the code.

D. Charitable Contributions: Con't

iv. Qualified Appraisal Required to Deduct Charitable Contributions of Cryptocurrency – CCA 202302012. The Service disallowed taxpayers charitable contribution deduction of more than $5,000 of crypto current because the taxpayer failed to obtain a qualified appraisal of the donated crypto. The taxpayer's reliance on the cryptocurrency exchange value of the donated property is not a reasonable cause for not obtaining an appraisal.

D. Charitable Contributions: Con't

The Service indicated that the taxpayer must satisfy the substantiation requirements and that cryptocurrency is viewed as a non-cash charitable contribution. It is not deemed to be a readily valued property like cash, publicly traded securities, intellectual properties and certain vehicles. In addition, the Form 8283 was not completed properly to even allow for a reasonable cause exception.

D. Charitable Contributions: Con't

d. **IR 2023 – 185: Danger of Improper Art Work Donation Deductions**. The Service has issued information release caution taxpayers to be on the alert for promotions involving exaggerated artwork donation deductions. The basic scheme is for promoters to encourage taxpayers to buy artwork at a discounted price while promising that the art is worse and typically more than the purchase at the discounted price.

D. Charitable Contributions: Con't

The promoters encourage purchasers to purchase the artwork hold it for a year and then claim a charitable contribution upon a transfer to a valid charity. In essence the deduction would be an inflated fair market value. The IRS in the notice warns taxpayers about such schemes and that a qualified appraisal is still a requirement to be associated with the contribution.

Example

WT Art Partnership, LP v. Comm., TC Memo 2025 – 30. A limited partnership was partially entitled to channel reduction for donations of Chinese paintings to the museum. The Tax Court found that although the partnership failed to satisfy certain appraiser requirements, it acted with reasonable cause any good faith under the statutory exception. The court held that the appraisal submitted by the partnership were not qualified appraisals within the meaning of the code because they were prepared by individuals who did not meet the definition of a qualified appraiser.

Example: Con't

Specifically, the appraiser's lack verified education experience specific to the property type did not regularly perform appraisals for compensation. Despite the facts, the court determined the partnership satisfied the reasonable cause exception. The court noted the partnership prior to the IRS audit experience its engagement with professionals any good faith conducted efforts to comply with the up appraisal requirements as grounds for relief for the disallowance by the IRS. The court determined the valuation of one painting was overstated and that deduction was reduced.

D. Charitable Contributions: Con't

e. Incorrect Valuation – Leo v. Comm., TC Memo 2025 – 9. A married couple misstated the valuation of a charitable contribution. The Tax Court agreed with the IRS's expert witness' opinion regarding the value of the property. The Tax Court determined that the property's value was even lower than the amount determined by the IRS. The taxpayers argued that the IRS's expert witness failed to use an income approach to valuation. However, the Tax Court noted that an income approach was not the best to value the property. The property was only partly leased at the valuation date. The unleased portion of the property was unrentable, at least without major repairs or renovations.

D. Charitable Contributions: Con't

Accordingly, the deficiencies determined by the IRS in the notice of deficiency were correct. Further, the taxpayers were liable for the 40 percent gross valuation misstatement penalty under Section 6662 (h) (1). The value of the property as reported by the taxpayer exceeded 200 of the value determined by the Tax Court. Accordingly, there was a gross valuation misstatement.

D. Charitable Contributions: Con't

f. Conservation Easements

i. Taxpayers can take a charitable deduction for qualified conservation contributions, which are contributions of a qualified real property interest to a qualified organization exclusively for conservation purposes (See Section 170(h)(1)).

ii. A qualified real property interest for this purpose can be the taxpayer's entire interest in the property, a remainder interest or an easement that restricts the use of the property in perpetuity.

D. Charitable Contributions: Con't

iii. Conservation purposes under IRC Section 170(h)(4)(A) are as follows:

- preserving land for outdoor recreational use by, or education of, the general public;
- protecting relatively natural habitats of fish, wildlife or plants;
- preserving open space (including farmland or forest space) for scenic enjoyment of the general public or under a governmental conservation policy yielding significant public benefit; and
- preserving a historically important land area or a certified historic structure.

iv. Retain Surface Mining Rights in Conservation Easement

Examples

North Donald La Property, LLC v. Comm., TC Memo 2023-50. The LLC filing as a partnership was denied a charitable contribution deduction for the conveyance of a conservation easement to a land Conservancy. The service argued that the limited warranty deed gave the former owners of the land over which the easement was granted a right to my subsurface clay. The owners claim that they intended to transfer all rights to access and exploit the clay reserving rights only to 75% of subsurface liquid and gaseous materials.

Examples: Con't

The taxpayers argued further that even if there was evidence of the retention of rights they had relinquished such in an amended deed in which they relinquished to the LLC any right they had in the minerals located on the land including the clay. However, the amended deed indicated that such relinquishment could be withdrawn at any time.

Examples: Con't

CCA 202236010. The chief counsel advisory indicated that the conservation easement does not satisfy the exclusive purpose of conservation or exclusively for conservation purposes when the terms of the deed allow the donor to use a surface mining method to extract subsurface minerals with the donee's approval. The only way that the easement is exclusively for conservation purposes is that the conservation is protected permanently, the chief counsel advisory found that because the donor had a retained qualified mineral interest the donor will be allowed to extract or remove minerals from the surface thus potentially destroying the conservation.

D. Charitable Contributions: Con't

- **v. Valuation Issues**

- **Overvaluation: Lake Jordan Holdings, LLC v. Comm., TC Memo 2025 – 123.** A TEFRA partnership, classified as a limited liability company for federal tax purposes, was not entitled to the full charitable contribution deduction it claimed for a conservation easement. The Tax Court found that the claimed valuation was substantially overstated and unsupported by a qualified appraisal. The partnership acquired rural property and later donated a conservation easement over it, reporting a valuation exceeding its purchase price. The Court concluded that the appraisal relied on speculative development plans, used unrealistic financial projections, and failed to comply with applicable appraisal standards. It was also prepared by an appraiser who lacked the required license and misrepresented his credentials under oath.
- Further, the Court upheld the imposition of the gross valuation misstatement penalty, concluding that the partnership did not have reasonable cause. The use of an unreliable appraisal and the absence of good faith efforts to comply with appraisal standards justified the penalty.
-

D. Charitable Contributions: Con't

v. Valuation Issues

Overvaluation: Corning Place Ohio, LLC; Corning Place Ohio Investment, LLC; Tax Matters Partner v. Comm., US Court Appeals Sixth Circuit, 25 – 1093, November 5, 2025. The taxpayer was denied it easement donation due to the fact that the value of the easement was 2500 percentage points higher than fair market value. The deduction must be based upon fair market value at the time of the donation. If a sales record of comparable easements exist, the value of the donated easement equals the general market price of those easements.

D. Charitable Contributions: Con't

If a sales record does not exist, the value of the donated easement equals the difference between the fair market value of the property before the easement restrictions and the fair market value after the restrictions. The value of the easement must be grounded in economic realities not pie-in-the-sky. The fair market value must take into account not only current use of the property but an objective assessment of how immediate or remote the likelihood is the property would in fact be developed for conservation purposes. The appraisal in this case and the valuation was based on a hypothetical not related in any way to the use of the property nor the easement.

D. Charitable Contributions: Con't

Overvaluation: Paul Adams Cory Trust, LLC v. Comm., TC Memo 2025 – 112. A limited liability to the company, characterized as a TEFRA partnership for tax purposes was denied a charitable deduction for a conservation easement. The deduction was inflated. The property in question was viewed by the taxpayer as a profitable granite property with the presence of mineral deposits. While mineral deposits were generated, they were not generated at the level that reflected the true value of the property. The profits were overstated and as such the deduction was limited accordingly.

D. Charitable Contributions: Con't

Overvaluation: Ranch Springs, LLC v. Comm., 164 TC No. 6, Dec. 62,636. The Tax Court ruled the value claimed on a taxpayer's return exceeded the value of a conservation easement by 7000%. The taxpayer was an LLC classified as a partnership. The Tax Court used comparable sales method as a backstop by the price actually paid to acquire the property. The taxpayer was entitled to deduction basements fair market value. The easement was granted upon rural land in Alabama and was zoned agricultural which permitted an enlightened residential use only. The transaction did occur in an arms length event.

D. Charitable Contributions: Con't

The taxpayer failed to establish the highest and best use of the property for the granting of the easement. The taxpayer failed to prove the rezoning to permit mining use was a reasonable probability impacting value. The taxpayer's experts equated the value of the raw land with the net present value of a hypothetical limestone business conducted on the land. That is not a proper valuation method per the court.

D. Charitable Contributions: Con't

Overvaluation: Ranch Springs, LLC v. Comm., 164 TC No. 6, Dec. 62,636. The Tax Court ruled the value claimed on a taxpayer's return exceeded the value of a conservation easement by 7000%. The taxpayer was an LLC classified as a partnership. The Tax Court used comparable sales method as a backstop by the price actually paid to acquire the property. The taxpayer was entitled to deduction basements fair market value. The easement was granted upon rural land in Alabama and was zoned agricultural which permitted an enlightened residential use only.

D. Charitable Contributions: Con't

The transaction did occur in an arms length event. The taxpayer failed to establish the highest and best use of the property for the granting of the easement. The taxpayer failed to prove the rezoning to permit mining use was a reasonable probability impacting value. The taxpayer's experts equated the value of the raw land with the net present value of a hypothetical limestone business conducted on the land. That is not a proper valuation method per the court.

D. Charitable Contributions: Con't

Incorrect computation: Green Valley Investors, LLC v. Comm., TC Memo 2025 – 15. The LLC classified as a partnership could not claim a charitable contribution deduction for a conservation easement because the easement valuation was in accurate. The taxpayer asserted the highest and best use of the property was a commercial mining site supporting a valuation higher than its purchase price. The court concluded that the record did not support the assertion the court found the proposed mining use was not financially feasible nor maximum highly productive IRS relies on comparable sales data with the taxpayer's valuation method and was based on the discounted cash flow approach.

D. Charitable Contributions: Con't

Lack of Donative Intent: Seabrook Property, LLC v. Comm., TC Memo 2025 – 6. An LLC classified as a partnership had donative intent when donating a perpetual conservation easement. The fact that the perpetual conservation easement was donated to a charity defeated the IRS's contention as to the donor's subjective intent. The taxpayer obtained an appraisal of the property and attached the appraisal to the return. The Tax Court concluded the appraisal was not deficient in that it failed to comply with generally accepted appraisal standards.

D. Charitable Contributions: Con't

The court noted that the appraiser was a professional appraiser who held himself out to the public and was thus qualified. The parties agree that the easement should be valued by cackling the difference between the property's fair market value before and after the taxpayer granted the easement. The value claimed the taxpayer was more than double that amount this was viewed as a gross misstatement of value subject to additional penalties.

D. Charitable Contributions: Con't

4. Final Regulations on Syndicated Conservation Easement Transactions – TD 10007

a. The IRS issued final regulations that identified certain abusive syndicated conservation easement transactions and substantially similar ones as reportable listed transactions. The regulations released pertain to certain qualified conservation contributions made by partnerships and S corporations. The final regulations clarify that participants and material advisers must report these transactions to the IRS, including any transactions that were completed in tax years that are still open.

D. Charitable Contributions: Con't

b. The final regulations cover three major classes of abusive syndicated conservation easement transactions

- Those that involve contributions occurring before December 30, 2022;
- Those for which a charitable contribution deduction is not automatically disallowed by Section 170(h)(7); and
- Those that substitute the contribution of a fee simple interest in real property for the contribution of a conservation easement.

D. Charitable Contributions: Con't

c. The regulations disallow a federal income tax deduction for a qualified conservation contribution if the amount exceeds 2.5 times the sum of each partner's or S corporation shareholder's relevant basis.

D. Charitable Contributions: Con't

d. Partnerships and S corporations must report the distributive share or pro rata share of any noncash charitable contribution, not just those that are qualified conservation contributions. If the donor is a partnership or an S corporation, the donor must provide a copy of its completed Form 8283, Noncash Charitable Contributions (Section A or Section B) to every partner or shareholder who receives an allocation of a charitable contribution under Section 170 for the property described in Form 8283 (Section A or Section B).

D. Charitable Contributions: Con't

e. The regulations provide reporting requirements for partners and S corporation shareholders that receive a distributive share or pro rata share of any noncash charitable contribution made by a partnership or S corporation, regardless of whether the contribution is a qualified conservation contribution (and regardless of whether the contribution is of real property or other noncash property). Partners and S corporation shareholders must attach Forms 8283 (Section A or Section B) to their return.

D. Charitable Contributions: Con’t

f. The final regulations also modify the definition of "participant" to clarify that the class of participants includes participants in transactions that are the same as, or substantially similar to, syndicated conservation easement transactions.

g. These regulations are effective from June 28, 2024 for contributions after December 29, 2022.

D. Charitable Contributions: Con't

5. New! – Charitable Deductions Modifications

a. Under the Tax Cuts and Jobs Act, no floor applies for individuals' charitable contribution deduction.

b. OBBBA will now provide for a floor of 0.5% of the taxpayer's contribution base. The contribution base would be adjusted gross income on the charitable deductions of individuals.

D. Charitable Contributions: Con't

c. As such, a charitable contribution must be reduced by 0.5% of an individual's contribution base for the tax year. The Act provides rules for the order in which the taxpayer's contributions are taken into account, and for carryforwards of contributions disallowed by the 0.5% floor. (See Act Sec. 70425(a))

d. Prior to OBBBA, individuals could not deduct more than a specified percentage of their contribution based on in any year. An individual may deduct up to 50% of the contribution base. The 60%, limit applies to cash-only contributions by individuals to 50% charities. The rule providing for a 60% ceiling for cash gifts to 50% charities was slated to expire after 2025.

D. Charitable Contributions: Con't

e. The Act makes permanent the 60% ceiling for cash gifts to 50% charities, and provides that a contribution of cash to a 50% charity is deductible to the extent that the total amount of contributions of cash to 50% charities does not exceed the excess of:

- 60% of the taxpayer's contribution base for the tax year, over
- the total amount of contributions to 50% charities for the tax year. (Act Sec. 70425(b))

f. Both the floor provision and the 60%-limit provision are effective for tax years beginning after December 31, 2025. (See Act Sec. 70425(c))

Examples

Bubba, a single taxpayer with $300,000 of AGI donates $5000 of appreciated stock plus $12,000 of cash to public charities. Both gifts are under the respective percentage thresholds of 30% and 60% of AGI. .5% floor equals $1500 (.5% X $300,000) since the statutory ordering requires the property gift to absorb the first floor, only 3500 of stock donations would be deductible while the full 12,000 of cash contributions remains deductible. As such the toll deduction is 15,500 with no carryforward since the percentage limits were not exceeded.

Examples: Con't

Assume a married couple with $200,000 of AGI donates $80,000 of appreciated stock in hundred thousand dollars of cash both facing the percentage limits and the floor limits. Property donation sees the 30% AGI (30%X $200,000 = $60,000) the carryover is $20,000 ($80,000 $-60,000) cash donation is under the 60% AGI limit ($120,000). The .5% floor further reduces the current property deduction to $59,000 and the $1000 gets added to the carryover bringing the total carryover to $21,000. The total deduction is $159,000 consisting of $59,000 of property deduction and the $100,000 cash deduction.

E. Casualty Loss Deductions – Extension and Modification of Limit on Casualty Loss Deduction

1. The TCJA limited itemized deductions for personal casualty losses for tax years 2018 - 2025 to losses attributable to a federally declared disaster.

2. The limitation was set to expire and an itemized deduction for uncompensated personal casualty losses would be available for losses resulting from fire, storm, shipwreck, or other casualty, or from theft after December 31, 2025.

E. Casualty Loss Deductions – Extension and Modification of Limit on Casualty Loss Deduction: Con't

3. The Act permanently limits the deduction to personal casualty losses resulting from federally declared disasters and certain state-declared disasters.

4. The provision applies to tax years beginning after December 31, 2025. (See Act Sec. 70109, amends IRC Section 165 (h) (5))

5. Theft Losses, Section 165 (e).

E. Casualty Loss Deductions – Extension and Modification of Limit on Casualty Loss Deduction: Con't

a. Section 165 (a) permits a deduction for losses sustained during the taxable year and not compensated for by insurance or otherwise.

b. In the case of an individual, a loss is deductible only if the loss:

- is "incurred in a trade or business";
- is incurred in a "transaction entered into for profit"; or
- "arise[s] from fire, storm, shipwreck, or other casualty, or from theft." (See Section 165 (c))

E. Casualty Loss Deductions – Extension and Modification of Limit on Casualty Loss Deduction: Con't

c. To establish a theft loss, taxpayer must prove that the theft occurred under the laws of a relevant jurisdiction. (See Monteleone v. Comm., 34 T.C. 688, 692 (1960)) in addition, the taxpayer must prove by a preponderance of the evidence that an actual theft occurred. (Bruno v. Comm., TC Memo 2020 – 156)

d. Any loss arising from theft shall be treated as sustained during the year in which the taxpayer discovers the loss. That is the general rule. (Section 165 (e)).

Examples

Potts v. Comm., TC Memo 2025 – 108. Married couple was not entitled to a theft loss for investment in a foreign gaming company. The court found no theft occurred under local law and the investors were not the proper parties to claim a loss. The investment involved the purchase of shares in a slot machine operator connected to a proposed casino project. The taxpayer asserted that the company's manager missed used investment funds and that the misuse of the investment created a theft loss. The court determined that the investors received ownership interest in a purchase agreement and that there was no contractual obligation requiring to reinvest any proceeds as such the elements of theft for deduction were not met as there was no actual taking of property. The mere claiming of the loss in value is not a theft loss.

Examples: Con't

Weston v. Comm., TC Memo 2025 – 16. The taxpayers, a married couple were not entitled to a theft loss deduction due to the lack of substantiation. The taxpayers had invested in a business and were passive in nature and were not active in the business. The taxpayers activity did not rise to the level of an active trade or business taxpayers also failed to show there was no reasonable prospect of recovery.

Examples: Con't

Shaut v. Comm., TC Memo 2024 – 103. The taxpayer did not provide reliable evidence indicating when the theft had occurred. According to the taxpayers testimony, his investment in and loans to a company all occurred in 2019. The taxpayer failed to demonstrate that his theft losses were discovered in that year which would have entitled him to a loss deduction. The taxpayer failed to substantiate entitlement to a theft loss. The taxpayer knew prior to 2019 that his investment was failing. And that he would not recover his investment. He had no involvement in the activities or the operation again this was an investment.

E. Casualty Loss Deductions – Extension and Modification of Limit on Casualty Loss Deduction: Con't

e. A forfeiture loss pursuant to a federal seizing of property does not constitute a theft loss for tax purposes.

Example

Hampton v. Comm., TC Memo 2023 – 32. The taxpayer was not entitled to a theft loss deduction from the failure of his S Corporations portions of funds seized by the US marshals service for public policy reasons. The taxpayer had pled guilty to charges of bribery, fraud and money laundering. US marshals service sees money from several banks held in the taxpayer's name and in his S corporation. The S corporation claim the theft loss relating the portion of the assets seized on its return the taxpayer took the flow through on his individual return. The courts have uniformly held that a loss deduction for forfeitures in connection with a criminal conviction frustrate public policy by reducing the sting of the penalty. As such the deduction is denied.

F. Miscellaneous Itemized Deductions

1. Under the Tax Cuts and Jobs Act, for tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for miscellaneous itemized deductions that are subject to the 2% floor were suspended.

2. This would also include miscellaneous itemized deductions subject to the 2% floor on Form 1041 as well.

F. Miscellaneous Itemized Deductions: Con't

3. The deductions that would be subject to the 2% limitation are in three broad categories:

- Unreimbursed Employee Expenses
- Tax Preparation Fees
- Other expenses which are generally on Schedule A, line 23

4. On the IRS website, the service lists the following as unreimbursed employee expenses which would now appear to be non-deductible:

F. Miscellaneous Itemized Deductions: Con't

- Business bad debt of an employee.
- Business liability insurance premiums.
- Damages paid to a former employer for breach of an employment contract.
- Depreciation on a computer your employer requires you to use in your work.
- Dues to a chamber of commerce if membership helps you do your job.
- Dues to professional societies.
- Educator expenses.
- Home office or part of your home used regularly and exclusively in your work.
- Job search expenses in your present occupation.

F. Miscellaneous Itemized Deductions: Con't

- Laboratory breakage fees.
- Legal fees related to your job.
- Licenses and regulatory fees.
- Malpractice insurance premiums.
- Medical examinations required by an employer.
- Occupational taxes.
- Passport for a business trip.
- Repayment of an income aid payment received under an employer's plan.
- Research expenses of a college professor.

F. Miscellaneous Itemized Deductions: Con't

- Rural mail carriers' vehicle expenses.
- Subscriptions to professional journals and trade magazines related to your work.
- Tools and supplies used in your work.
- Travel, transportation, meals, entertainment, gifts, and local lodging related to your work.
- Union dues and expenses.
- Work clothes and uniforms if required and not suitable for everyday use.
- Work-related education.

F. Miscellaneous Itemized Deductions: Con't

5. The certain other expenses that are generally deductible Schedule A, line 23 generally refer to expenses that are ordinary and necessary and are paid to:

- Produce or collect income that is generally included in gross income,
- Manage, conserve or maintain property held for the production of income,
- Determine, contest, pay or claim a refund of any tax

F. Miscellaneous Itemized Deductions: Con't

6. These other expenses generally include the following:

· Appraisal fees for a casualty loss or charitable contribution.

· Casualty and theft losses from property used in performing services as an employee.

· Clerical help and office rent in caring for investments.

· Depreciation on home computers used for investments.

· Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust.

· Fees to collect interest and dividends.

· Hobby expenses, but generally not more than hobby income.

F. Miscellaneous Itemized Deductions: Con't

· Indirect miscellaneous deductions from pass-through entities.

· Investment fees and expenses.

· Legal fees related to producing or collecting taxable income or getting tax advice.

· Loss on deposits in an insolvent or bankrupt financial institution.

· Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed to you.

· Repayments of income.

· Repayments of social security benefits.

· Safe deposit box rental, except for storing jewelry, and other personal effects.

· Service charges on dividend reinvestment plans.

· Tax advice fees.

· Trustee's fees for your IRA, if separately billed, and paid

F. Miscellaneous Itemized Deductions: Con't

7. Miscellaneous Expenses not subject to the 2% limitation.

- Amortizable premium on taxable bonds.
- Casualty and theft losses from income-producing property.
- Federal estate tax on income in respect of a decedent.
- Gambling losses up to the amount of gambling winnings.
- Impairment-related work expenses of persons with disabilities.
- Loss from other activities from Schedule K-1 (Form 1065-B), box 2.
- Losses from Ponzi-type investment schemes.
- Repayments of more than $3,000 under a claim of right.
- Unrecovered investment in an annuity.

F. Miscellaneous Itemized Deductions: Con't

8. **Miscellaneous Itemized Deductions Eliminated**

a. Under the TCJA, individual miscellaneous itemized deductions were not available for tax years 2018 - 2025. Specifically, those subject to the 2% AGI limitation.

b. OBBBA permanently suspends miscellaneous itemized deductions.

c. The Act also adds a deduction for unreimbursed employee expenses for eligible educators to the list of itemized deductions under Section 67 (b).

F. Miscellaneous Itemized Deductions: Con't

d. Eligible educators include K - 12 teachers, instructors, counselors, interscholastic sports administrators and coaches, principals, and aides in a school for at least 900 hours during a school year. The deduction is available for equipment and supplementary materials used by eligible educators as part of an instructional activity.

e. This provision applies to tax years beginning after December 31, 2025. (Act Sec. 70110, amends IRC Section 67 (g))

F. Miscellaneous Itemized Deductions: Con't

9. Limit on Wagering Losses

a. Under the Tax Cuts and Jobs Act, losses from wagering transactions were deductible only to the extent of gains from such transactions.

b. For the 2018 - 2025 tax years, losses from wagering transactions included otherwise allowable deductions incurred in carrying on any wagering transactions.

c. New! – OBBBA provides that for losses from wagering transactions, the deduction amount is 90% of the amount of losses in the tax year, to the extent of the gains from such transactions during the tax year. The provision applies to tax years beginning after December 31, 2025. (See Act Sec. 70114, amends IRC Section 165)

Example

Bubba has $20,000 in gambling winnings but he also has $20,000 in gambling losses. In 2024, the entire winnings would result in no taxable income. With the One Big Beautiful Bill in effect the maximum loss deduction he would get his $18,000 (90%X $20,000). This leaves Bubba with $2000 in taxable income despite no net gain for the taxable year.

Example: Con't

Bubba is a professional gambler who earns $400,000 in the tax year. He has $440,000 in interest fees, lodging and similar expenses associated with the gambling earnings. New acts allowable expense deduction limits his deduction to $396,000 (90% X $440,000) this leaves him with taxes on $4000 of gambling earnings which previously none would have been taxable even though Fred was an overall loser for the year. The limitation on the gambling deduction applies to all of his operational cost. This would include Kermit fees he paid, training expenses, vetting setbacks etc.

F. Miscellaneous Itemized Deductions: Con't

d. The legislation appears to apply also to professional gamblers.

G.– New! – Pease Limitation Repealed

1. Pre-TCJA, taxpayers were subject to an overall limitation on itemized deductions, known as the "overall limitation on itemized deductions," the "3%/80% rule," or the "Pease limitation." (See IRC Section 68).

2. Under the Pease limitation, if an individual's adjusted gross income (AGI) exceeded the inflation-adjusted applicable amount, then the amount of itemized deductions otherwise allowed for the tax year was reduced by the lesser of:

- 3% of the excess of AGI over the applicable amount, or
- 80% of the amount of itemized deductions otherwise allowable for the tax year.

G.– New! – Pease Limitation Repealed: Con't

3. The Pease limitation was set to apply again in tax year 2026 with applicable thresholds of $250,000 for single filers, $275,000 for head of household filers, and $300,000 for married joint filers, all adjusted for inflation.

4. OBBBA permanently repeals the Pease limitation and instead generally applies a 2% reduction.

G.– New! – Pease Limitation Repealed: Con't

5. Under the Act, itemized deductions will be reduced by 2/37 of the lesser of

- the amount of the deductions or
- the taxable income that exceeds the dollar amount at which the 37% rate bracket begins.

6. The Act excludes from the limitation the deduction for qualified business income.

G.– New! – Pease Limitation Repealed: Con't

7. The provision applies to tax years beginning after December 31, 2025. (See Act Sec. 70111, amends IRC Section 68)

8. In essence this provision applies in 2026 for taxpayers in a 37% tax bracket. Under this scenario a portion of their itemized deductions will be disallowed. This limitation also provides a limitation for those in this bracket to their charitable contribution up to the .5% of the taxpayer's modified adjusted gross income.

Examples

Bubba is a single taxpayer with modified AGI of $700,000 in 2026. Bubba has the following itemized deductions:

Taxes –	$65,000
Mortgage Interest Expense –	$50,000
Charitable Contributions –	$150,000
Total	$265,000

based upon the above there will be certain reductions. Regarding taxes the $65,000 exceeds the Under salt and will reduce the amount deductible from $65,000-$10,000. The charitable contribution deduction will be reduced by $3500 representing the floor to $146,500.

Examples: Con't

As a result the net itemized deduction after reductions are as follows:

Taxes – $10,000
Mortgage Interest Expense – $50,000
Charitable Contributions – $146,500
net itemized deduction – $206,500

Examples: Con't

Due to Bubba's income, a portion of his itemized deductions will be disallowed. For 2026, the 37% bracket starts at $626,350. The disallowance of to the disallowance of 2/37 multiplied by the lesser of

$73,650 for the amount of Bubba's income tax at the 37% rate or

$206,500 represents the net itemized deduction.

Examples: Con't

Since $73,650 is the lower number and applying the percentage the additional reduction is $3981 of itemized deductions that will be disallowed. As a result the total itemized deduction allowed to Bubba will be two or $6500 $-3981 = $202,519.

Examples: Con't

Bubbet is single and has modified AGI $400,000 in 2026. Her only itemized deduction is a charitable contribution of $50,000. The haircut rule does not apply because she is not in the 37% tax bracket. The additional limitation does apply. She is allowed to deduct the amount of her trouble contribution that exceeds .5% of her modified AGI. The floor for her is $2000 (400,000 x .5%). As such her $50,000 charitable contribution deduction is reduced by 2000 for a total deductible amount of $48,000.

G.– New! – Pease Limitation Repealed: Con't

9. There are exceptions to this new limitation on the 2/37. One type of charitable contribution not impacted by the floor or the ceiling is a Qualified Charitable Distribution (QCD) from a traditional retirement account by a person over age 70 ½.

a. A QCD provides a unique opportunity to make a charitable donation without taking the funds into income first. In a QCD, the retirement account owner directs the retirement account trustee to make a distribution (up to $108,000 per taxpayer for 2025) to a charitable organization.

G.– New! – Pease Limitation Repealed: Con't

b. The taxpayer does not recognize any income and is not entitled to a charitable deduction, but it reduces the taxpayer's AGI and income taxes by excluding the amount from income. Amounts used for a QCD count towards a taxpayer's required minimum distribution (RMD) for the year, although the taxpayer can direct a QCD at age 70 ½, which is before the RMD requirement would start.

SECTION V: QUALIFIED BUSINESS INCOME DEDUCTION

I. Qualified Business Income Deduction

A. Overview

1. Section 199A was enacted on December 22, 2017 under the Tax Cuts and Jobs Act (P. L. 115 – 97) and was subsequently amended on March 23, 2018 by the Consolidated Appropriations Act of 2018, (P. L.. 115 – 141).

2. This code section provides for a deduction to non-corporate taxpayers based on the concept of Qualified Business Income (QBI) in association with a Qualified Trade or Business.

A. Overview: Con't

3. Noncorporate taxpayers refer to individuals that operate a sole proprietorship or operate through a pass-through entity as well as certain estates and trusts.

4. Hence, the deduction may be taken by individuals and by some estates and trusts.

A. Overview: Con't

5. The deduction is not available for:

- those that only possess wage income (Wages and Salaries),
- those that have business income earned through a C Corporation.
- a taxpayer that is a mere employee and has no ownership interest in a qualified trade or business.

The deduction is available for a taxpayer who has not only wage income but also possesses ownership interest in a sole proprietorship or in a pass-through entity such as a partnership or S Corporation.

A. Overview: Con't

6. Section 199A allows individuals and some estates and trusts a deduction up to 20% of their combined qualified REIT dividends and qualified PTP income, including qualified REIT dividends and qualified PTP income earned through pass-through entities. This component of the deduction is not limited by W – 2 wages or the unadjusted basis in qualified property.

A. Overview: Con't

7. As s a general rule, the Section 199A deduction is the lesser of:

- The *Combined Qualified Business Income Amount* of the taxpayer, or

- 20% of the excess, if any, of the taxable income of the taxpayer for the tax year over the net capital gains (Taxable Income - Net Capital Gains). (See Section 199A(c))

8. *Combined Qualified Business Income Amount* refers to an amount equal to:

The deductible amount for ***each*** *qualified trade or business,* as defined below.

+ 20% of the aggregate amount of qualified REIT dividends and qualified PTP income.

A. Overview: Con't

9. *The deductible amount for **each** qualified trade or business* is defined as the lesser between:

- 20% of the taxpayers Qualified Business Income (QBI) or
- The greater of:
- 50% of W – 2 Wages (This represents W-2 Wages from either a sole proprietorship or allocable share from a pass-through entity, also known as the *Wage Limit*) or
- 25% of the W – 2 Wages +2.5% of the unadjusted basis immediately after acquisition of Qualified Property. (This is also known as the *Wage/Basis Limit*)

+ 20% of the aggregate amount of Qualified REIT Dividends and Qualified PTP Income

A. Overview: Con't

10. The *Wages Limit* and *Wage/Basis Limit* must be provided from each pass-through entity (S Corporation or Partnership) that has or that pays wages and has unadjusted basis of after-acquired depreciable property that is qualified in nature and as defined in this provision.

11. Qualified Property refers to tangible, depreciable property that is:

- held by available for use in the qualified trade or business at the close of the taxable year,
- used at any point during the tax year in the production of qualified business income, and
- the depreciable period for which has not ended before the close of the tax year.

A. Overview: Con't

12. The *Wages Limit* and *Wage/Basis Limit* does not apply in all cases. The Wage Limit and Wage/Basis Limit does not apply if the taxpayer's taxable income before the qualified business income deduction is below a threshold amount.

B. Threshold Amounts

1. The threshold amounts for 2025 are as follows: (Rev. Proc. 2024-40):

Filing Status	Taxable Income Before QBI
Married Filing Joint	$394,600
Single and HOH	$197,300
Married Filing Separately	$197,300

B. Threshold Amounts: Con't

2. The threshold amounts for 2026 are as follows: (Rev. Proc. 2025 – 32):

Filing Status	**Taxable Income Before QBI**
Married Filing Joint	$403,500
Single and HOH	$201,750
Married Filing Separately	$201,775

Note: For 2026, there is a change between married filing separate, versus single and head of household.

C. 2025 Computational

1. Taxable Income Is Below the Threshold Amount

If taxable income is below the threshold amount, the QBI deduction is 20% of each trade or businesses' QBI, subject only to the taxable income limitation.

C. 2025 Computational: Con't

2. Taxable Income is Above the Threshold Minimum, But Not Above the Maximum

If taxable income falls between the threshold and the top of the phase-in range, a limitation on the QBI deduction is phased in. The limitation phase-in reduces the QBI deduction by a percentage calculated with the numerator being the amount of taxable income in excess of threshold for the filing status and the denominator being $50,000 ($100,000 for MFJ).

C. 2025 Computational: Con't

3.Taxable Income is Above the Threshold Maximum

If a taxpayer's taxable income is above the threshold maximum, no QBI deduction is allowed unless the taxpayer has W-2 wages or UBIA allocable to the trade or business.

II. Mineral Interest and QBI Deduction

A. Overview

1. Both the proposed regulations and final regulations did not specifically include or exclude mineral interest or working interest from the Section 199A deduction. As such, taxpayers must look to other areas of the Internal Revenue Code for guidance.

2. In order to classify income from a mineral interest, the taxpayer must know how the income is derived. For federal tax purposes, a mineral interest is known as a bundle of legal rights that may be severed from the surface. Obviously, it is possible for the owner minerals not to own the surface layer. When mineral interests are separated in this way, there are generally two types of rights:

A. Overview: Con't

- Rights to receive lease benefits which include the right to receive bonus payments, delay rentals and royalties. When a mineral interest owner grants a lease, the right to develop is relinquished and vest with the lessee operator. That distinction is critical in the classification of royalties versus a working or operate interest

- Rights to develop the mineral estate often include the right to develop and produce the minerals. This is generally associated with a working or operating interest.

A. Overview: Con't

3. In examining the definition of qualified business income. It appears that portfolio income are generally excluded from qualified business income. However, working interest income are generally viewed as a trade or business activity. The support for this stems from Section 1411 which imposes the 3.8% tax on net investment income of the taxpayer above certain thresholds.

A. Overview: Con't

The definition of net investment income includes royalties *other than those items derived from a non-passive trade or business.* S 469, which is the passive income provisions states that portfolio income can include royalties from a mineral interest unless derived in the ordinary course of a trade or business. This would appear to include all and gas royalties, overriding royalties, but this would not include those that are a dealer in royalties. (See Reg. Sec. 1.469 – 2T(c (3))

A. Overview: Con't

4. In addition Royalties are not burdened with production cost as of the sale or exchange world interest is generally treated as the sale or exchange of a capital asset. (Revenue Ruling 73 – 428)

5. A working interest generally is treated as a trade or business activity because it is burdened with the cost of production, development and operation. The income and losses generally treated as subject to self-employment tax**.** (See . Cokes v. Commissioner, 91 T.C. 222 (1988); and, Methvin v. Commissioner, T.C. Memo. 2015-81, aff'd, 2016 WL 3457623 (10th Cir. 2016) where it small individual working interest owner who is not designated the operator of an oil and gas property was held liable for self-employment tax on trade or business income.)

A. Overview: Con't

a. Likewise, there is nothing in the proposed nor final regulations of Section 199 a that states a working interest in all and gas is excluded from the definition of qualified trade or business. Assuming the working interest is assessing with a domestic trade or business, based upon the above, it appears that the working interest would be qualified business income associate with a qualified trade or business, and thus the deduction would be allowed.

A. Overview: Con't

6. In essence, mineral interest held for investment purposes only, are not likely to qualify for the 20% deduction, but non-investment like a working interest appears to be eligible. If the working interest is considered qualified business income eligible for the deduction, it should be identified as such is either on a K – 1 or Form 1099 – M ISC other than royalty.

III. New! – Extension of Qualified Business Income Deduction

A. Overview

1. Under the TCJA, specified non-corporate taxpayers could deduct 20% of qualified business income (QBI) from a partnership, S corporation, or sole proprietorship. The 20% deduction also applied to certain real estate investment trust dividends and publicly traded partnership income.

B. Changes

1. Under OBBBA, it sets the minimum deduction for active QBI at $400.

2. It also provides that an applicable taxpayer must have a minimum of $1,000 QBI to claim the deduction.

3. An "active qualified trade or business" means any qualified trade or business of the taxpayer in which the taxpayer "materially participates," as defined in IRC Section 469.

B. Changes: Con't

4. The Act increases the phase-in threshold for single filers from $50,000 to $75,000 and the joint filer threshold increases from $100,000 to $150,000. Inflation adjustments apply to the new minimum amounts for tax years beginning after 2026.

5. This section takes effect for tax years beginning after December 31, 2025. (See Act Sec. 70105, amends IRC Section 199A))

IV. Forms 8995 and 8995-A

A. 2025 Forms

1. Form 8995: Qualified Business Income Deduction.

- This is the simplified computation form will be used if the taxpayer has QBI, qualified REIT dividends and/or qualified PTP income.
- The Taxpayer is not a patron a specified agricultural or horticultural cooperative

a. There is a new worksheet added to provide a reasonable method to track and compute previously disallowed losses or deductions that should be included in the QB I deduction computation for the year allowed. The worksheet is titled *Tracking Losses or Deductions Suspended by Other Provisions*.

A. 2025 Forms: Con't

2. Form 8995 – A: Qualified Business Income Deduction. This form will be used as follows:

- The taxpayer has QBI, qualified REIT dividends and/or qualified PTP income.
- The Taxpayer is not a patron a specified agricultural or horticultural cooperative

A. 2025 Forms: Con't

3**. Schedules Associated with Form 8995 – A:** The Schedules associated with the form include the following:

- Schedule A: Specified Service Trades or Businesses
- Schedule B: Aggregation of Business Operations
- Schedule C: Loss Netting and Carryforward

Schedule D: Special Rules for Patrons of Agricultural or Horticultural cooperative.

SECTION VI: NEW ADDITIONAL DEDUCTIONS

I. Introduction

A. Overview

1. Under the One Big Beautiful Bill Act, there are several new additional deductions available to taxpayers who either itemize or who do not itemize.

2. These deductions are on a temporary basis for the tax years 2025 – through 2028 and pertain to the following transactions:

- Car Loan Interest
- No Tax on Tips
- No Tax on Overtime
- Additional Senior Deduction

A. Overview: Con't

3. There is also a separate form associated with these new temporary deductions. It is known as Schedule 1 – A.

4. These deductions are part of a new computation to determine taxable income.

A. Overview: Con't

5. In essence, taxable income is now subject to the following computation:

Gross Income
Less: Adjustments to Income (Schedule 1)
Adjusted Gross Income
Less: Standard Deduction or Itemized Deduction
Less: Qualified Business Income Deduction
Less: Additional Deductions (Schedule 1 – A)
Taxable Income

6. This section will discuss each of these new additional deductions as well as the new Schedule 1 – A.

B. Car Loan Interest

1. The Act provides individuals (including non-itemizers) with a temporary tax deduction for interest paid on loans used to purchase a new personal-use passenger vehicle.

2. For tax years 2025-2028, individuals can deduct up to $10,000 of car loan interest per year, subject to a phase-out starting at $100,000 modified adjusted gross income (MAGI) for single filers ($200,000 for joint filers).

B. Car Loan Interest: Con’t

3. To qualify for the deduction the following must be evidenced:

a. The debt must be incurred after December 31, 2024, for the purchase of a new personal use vehicle, secured by a first lien on the vehicle, and the vehicle's original use must begin with the taxpayer.

b. The vehicle must be a car, minivan, van, SUV, pickup truck, or motorcycle, with a gross vehicle weight rating under 14,000 pounds, and final assembly of the vehicle must occur in the United States, and

B. Car Loan Interest: Con't

c. The taxpayer must report the vehicle identification number (VIN) on their tax return. In addition, the provision requires lenders to file information returns reporting interest received on qualified personal auto loans with the IRS.

d. The provision applies to qualified indebtedness incurred after **December 31, 2024**. (See Act Sec. 70203(e) amends IRC Sections 613(h) and 6050AA).

4. If a qualifying vehicle loan is later refinanced, interest paid on the refinanced amount is generally eligible for the deduction.

B. Car Loan Interest: Con't

5. The deduction pertains to a qualified vehicle. A qualified vehicle is a car, minivan, van, SUV, pick-up truck or motorcycle, with a gross vehicle weight rating of less than 14,000 pounds, and that has undergone final assembly in the United States. The location of final assembly will be listed on the vehicle information label attached to each vehicle on a dealer's premises. Alternatively, taxpayers may rely on the vehicle's plant of manufacture as reported in the vehicle identification number (VIN) to determine whether a vehicle has undergone final assembly in the United States.

6. The deduction is available for taxpayers who either itemize or take the standard deduction.

Example

Bubba is a single individual with modified AGI of $110,000. Since his modified AGI is $10,000 over the starting threshold, the deduction for his car loan interest will be reduced by $200 for every $1000 over the initial threshold. This is a $2000 reduction so that the maximum car interest loan she could take is $8000.

B. Car Loan Interest: Con't

7. The IRS is expected to issue guidance on verifying US final assembly, likely through dealer confirmation or official IRS resources.

8. There are certain car interest loans that are excluded and would not qualify for interest deduction. These include the following:

- Fleet sales or Commercial Use Vehicle Loans
- Lease financing arrangements
- Loans for vehicles with salvage title, purchase for scrap or parts
- Related Party Car Loans
- Use Vehicle Purchases

B. Car Loan Interest: Con't

9. IRS Notice 2025 – 57. Transition Guidance Announced. The IRS has issued transactional guidance for businesses required to report car loan interest under Section 6050 AA under the One Big Beautiful Bill Act.

a. Businesses that receive individual interest of $600 or more on a qualified passenger vehicle loan must file the information report with the IRS and provide written statements to borrowers showing the amount of interest received.

B. Car Loan Interest: Con't

b. Under the transitional guidance, the IRS will consider that lenders have met their reporting obligations for interest received in 2025 by making a statement available to the buyer on or before 1/31/26, indicating the total amount of interest received.

c. The statement can be made available via an online portal, a regular monthly statement, an annual statement, or by some other similar means.

d. The IRS will not impose penalties under Section 6721 and 6722 if this guidance is followed.

C. No Tax on Tips

1. Section 70201 of OBBBA creates a new, temporary deduction for individuals who receive qualified cash tips in occupations where tipping was customary before January 1, 2025.

2. The deduction is up to $25,000 per year per taxpayer. The deduction phases out by $100 for every $1,000 of modified adjusted gross income (MAGI) above $150,000 (or $300,000 for joint filers).

3. Tips must be properly reported on IRS-approved forms.

C. No Tax on Tips: Con't

4. Tips must be voluntary, not negotiated, and not received in specified service trades or businesses.

5. For individuals receiving tips through a business they operate (other than as employees), the deduction is allowed only if gross income from the business (including tips) exceeds business-related deductions.

6. Married taxpayers must file jointly to claim the deduction. A valid Social Security Number (SSN) must be provided. An omission of a valid SSN is treated as a mathematical or clerical error.

C. No Tax on Tips: Con't

7. The deduction is available to non-itemizers, meaning it can be claimed in addition to the standard deduction

8. Any amount deducted is excluded from the definition of qualified business income for purposes of the Section199A deduction, thus preventing double tax benefits.

C. No Tax on Tips: Con't

9. The FICA tip credit is expanded to include beauty service businesses (barbering, hair care, nail care, esthetics, spa treatments) where tipping is customary, aligning them with food and beverage establishments.

10. Businesses, third-party payers, and platforms must separately report designated cash tips and the recipient's occupation on Forms W-2, 1099, and 1099-K (IRC §6041, §6041A, §6050W, §6051, etc.). Employers must report total employee tips and occupations on wage statements.

C. No Tax on Tips: Con't

11. The IRS is required to publish a list of occupations that customarily receive tips not later than 90 days after the date of the enactment of this Act. The list must cover occupations that customarily and regularly received tips on or before December 31, 2024. IRS must adjust withholding procedures to reflect the new deduction starting in 2026 (See Section 3402).

12. For tips received before January 1, 2026, reporting entities may use reasonable methods to approximate designated tip amounts during the transition period.

C. No Tax on Tips: Con't

13. The new tip deduction and related provisions apply to taxable years beginning **after December 31, 2024**. The deduction is temporary and will expire for taxable years beginning after December 31, 2028 (Act Section 70201, adding new IRC §225).

14. IR 2025 – 92. The IRS provided proposed rules on the no tax on tip provisions. The deduction is available for taxpayers who filed for the standard deduction and who itemize. Those who itemize will be subject to a phaseout. The deduction is not available for married couples filing separately. Tips will still be subject to Medicare, Social Security and payroll taxes on their tipped income. Proposed rules scheduled to be published in the Federal Register on September 22, 2025.

C. No Tax on Tips: Con't

15. NPRM REG – 110032 – 25. The IRS has issued proposed regulations that identified occupations that customarily and regularly receive tips and define Qualified Tips that eligible recipients may claim for the no tax on tips deduction. The provisions under Section 224.

a. Under Section 224, an eligible individual can claim an income tax deduction for qualified tips received in tax years 2025 through 2028. The deduction is limited to $25,000 per tax year, and starts to phase out when modified adjusted gross income is above $150,000 ($300,000 for joint filers).

Example

Bubba, an employee is a single individual and received qualified tips of $26,000 in 2025. This amount is $1000 over the 25,000 limitation. The $26,000 of qualified tips is first reduced to 25,000. If Bubba's modified adjusted gross income is 200,000 qualified tip amount is further reduced by $100 for each thousand dollars by which his modified adjusted gross income exceeds $150,000, the requirement threshold for single filer. Bubba would divide $50,000 by $1000 to get $50. His deduction is further reduced by $5000 ($100 times 50) and this will be reducing the 25,000 down to $20,000.

C. No Tax on Tips: Con't

b. An employer must report qualified tips on an employee's Form W-2, or the employee must report the tips on Form 4137. A service recipient must report qualified tips on an information return furnished to a nonemployee payee (Form 1099-NEC, Form 1099-MISC, Form 1099-K).

c. If an individual tip recipient is "married" (under Section 7703), the deduction applies only if the individual and his or her spouse file a joint return. The deduction is not allowed unless the taxpayer includes his or her social security number (SSN) on their income tax return for the tax year. For this purpose, a SSN is valid only if it is issued to a U.S. citizen or a person authorized to work in the United States, and before the due date of the taxpayer's return.

C. No Tax on Tips: Con't

d. A Qualified Tip is a cash tip received in an occupation that customarily and regularly received tips on or before December 31, 2024. An amount is *not* a qualified tip unless:

- the amount received is paid voluntarily without any consequence for nonpayment, is not the subject of negotiation, and is determined by the payor;
- the trade or business in which the individual receives the amount is not a specified service trade or business under Section 199A(d) (2) and
- other requirements established in regulations or other guidance are satisfied.

C. No Tax on Tips: Con't

e. The proposed regulations define qualified tips—and payments that are not qualified tips— based on several factors, including the following:

- Qualified tips must be paid in cash or an equivalent medium, such as check, credit card, debit card, gift card, tangible or intangible tokens that are readily exchangeable for a fixed amount in cash, or another form of electronic settlement or mobile payment application that is denominated in cash.
- Qualified tips *do not* include items paid in any medium other than cash, such as event tickets, meals, services, or other assets that are not exchangeable for a fixed amount in cash (such as most digital assets).
- Qualified tips must be received from customers. For employees, qualified tips can be received through a mandatory or voluntary tip-sharing arrangement, such as a tip pool

C. No Tax on Tips: Con't

- Qualified tips must be paid voluntarily by the customer, and not be subject to negotiation.
- Qualified tips *do not* include some service charges. For example, if a restaurant imposes an automatic 18-percent service charge for large parties and distributes that amount to waiters, bussers and kitchen staff, the amounts distributed are not qualified tips if the charge is added with no option for the customer to disregard or modify it.
- Qualified tips do not include amounts received for an illegal activity (a service the performance of which is a felony or misdemeanor under applicable law), prostitution services, or pornographic activity.
- Qualified tips do not include tips received by an employee or other service provider who has an ownership interest in or is employed by the tip payor.

C. No Tax on Tips: Con't

f. Cash tips are defined as tips received from customers or, in the case of an employee, through a mandatory or voluntary tip-sharing arrangement, such as a tip pool, that are paid in a cash medium of exchange, including by cash, check, credit card, debit card, gift card, tangible or intangible tokens that are readily exchangeable for a fixed amount in cash (such as casino chips), and any other form of electronic settlement or mobile payment application that is denominated in cash.

C. No Tax on Tips: Con't

Cash tips do not include items paid in any medium other than cash, such as event tickets, meals, services, or other assets that are not exchangeable for a fixed amount in cash (such as most digital assets). For purposes of this paragraph (c)(2), tips are amounts paid by customers for services that are in excess of the amount agreed to, required, charged, or otherwise reasonably expected to have to be paid for the services in an arm's-length transaction.

C. No Tax on Tips: Con't

g. Likewise, amounts are qualified tips only if they are paid voluntarily and without any consequence in the event of nonpayment, are not the subject of negotiation, and are determined by the payor. Qualified tips must be paid without compulsion. Thus, service charges, automatic gratuities and any other mandatory amounts automatically added to a customer's bill by the vendor or establishment are not qualified tips, even if the amounts are subsequently distributed to employees. If a customer is expressly provided an option to disregard or modify amounts added to a bill, such amounts are not mandatory amounts.

Examples: Con't

Restaurant W submenu specifies that an automatic 18% charge will be added to all bills for parties of six or more. Customer Bubba received a bill for food and beverages for the party of six which included the 18% charge on the to plot and the total bill included this amount. The restaurant distributes this amount to the wait staff and bussers. Bubba asked the customer did not determine the amount of the initial charge nor was Bubba expressly provided an option to disregard or modify the amount. Bubba asked the customer did not make the payment free from compulsion. The 18% charge is not a qualified tip under these provisions.

Examples: Con't

Now let's assume the same facts except the bill has a line labeled additional tip amount. Bubba as the customers ads on the additional to applied an amount equal to 2% of the total price for food and beverages provided. The 18% charge is still not a qualified tip. However, the 2% additional amount and did so voluntarily.

Examples: Con't

Let's now assume that the restaurant provides the customer a choice on the POS device between 15%, 18% and 20%. A customer selects a tip amount before paying the bill. The customer selects 15% and pays the total balance via credit card for the POS system is the customer did not voluntarily determine the amount of the additional charge because the customer was forced to select an amount greater then zero. The customer was not expressly provided an option to disregard or modify the amounts. The 15% is not qualified tip.

C. No Tax on Tips: Con't

h. The proposed regulations list the occupations that customarily and regularly received tips on or before December 31, 2024. For each occupation, the list provides a numeric Treasury Tipped Occupation Code (TTOC), an occupation title, a description of the types of services performed in the occupation, illustrative examples of specific occupations, and the related Standard Occupation Classification (SOC) system code(s) published by the Office of Management and Budget (OMB).

The list groups the eligible occupations into eight categories:

C. No Tax on Tips: Con't

- *100s Beverage and Food Service*—includes bartenders; wait staff; food servers outside of a restaurant; dining room and cafeteria attendants and bartender helpers; chefs and cooks; food preparation workers; fast food and counter workers; dishwashers; host staff, restaurant, lounge, and coffee shop; bakers
- *200x Entertainment and Events*—includes gambling dealers; gambling change persons and booth cashiers; gambling cage workers; gambling and sports book writers and runners; dancers; musicians and singers; disc jockeys (but not radio disc jockeys); entertainers and performers; digital content creators; ushers, lobby attendants, and ticket takers; locker room, coatroom, and dressing room attendants

C. No Tax on Tips: Con't

- *300s Hospitality and Guest Services*—includes baggage porters and bellhops; concierges; hotel, motel, and resort desk clerks; maids and housekeeping cleaners
- *400s Home Services*—includes home maintenance and repair workers; home landscaping and grounds keeping workers; home electricians; home plumbers; home heating and air conditioning mechanics and installers; home appliance installers and repairers; home cleaning service workers; locksmiths; roadside assistance workers
- *500s Personal Services*—includes personal care and service workers; private event planners; private event and portrait photographers; private event videographers; event officiants; pet caretakers; tutors; nannies and babysitters

C. No Tax on Tips: Con't

- *600s Personal Appearance and Wellness*—includes skincare specialists; massage therapists; barbers, hairdressers , hairstylists, and cosmetologists; shampooers; manicurists and pedicurists; eyebrow threading and waxing technicians; makeup artists; exercise trainers and group fitness instructors; tattoo artists and piercers; tailors; shoe and leather workers and repairers
- *700s Recreation and Instruction*—includes golf caddies; self-enrichment teachers; recreational and tour pilots; tour guides; travel guides; sports and recreation instructors
- *800s Transportation and Delivery*—includes parking and valet attendants; taxi and rideshare drivers and chauffeurs; shuttle drivers; goods delivery people; personal vehicle and equipment cleaners; private and charter bus drivers; water taxi operators and charter boat workers; rickshaw, pedicab, and carriage drivers; home movers.

C. No Tax on Tips: Con't

i. An amount received by an individual in the course of a specified service trade or business (as defined in Section 199A(d)(2)) is not a qualified tip. If the individual performs services as an employee, the relevant trade or business is the trade or business of the employer in the course of which the employee is performing services.

C. No Tax on Tips: Con't

Thus, an amount received by an employee performing services for the employee's employer in the course of a specified service trade or business operated by the employee's employer is not a qualified tip, regardless of whether the trade or business or an owner of the trade or business is eligible for a deduction under section 199A, and regardless of whether the employee is performing services in an occupation listed in this section or whether that occupation is a specified service trade or business.

Examples

John, a self employed comedian perform stand-up comedy at a comedy venue. The audience gives him cash tips after performance. The cash tips are not qualified tips because the tips are received in the course of the comedian's trade or business in the performing arts. The performing arts is a specified service trade or business. The cash tips are not qualified tips notwithstanding the fact that John's occupation is included in the Treasury Tipped Occupation Code Category of Entertainers and Performers.

Examples: Con't

Mary is a pianist employed at a local hotel. The hotel does not operate as a specified service trade or business. The pianist plays the piano in the lobby of the hotel and patrons leave Mary cash tips in a jar on the piano. The cash tips received by Mary R qualified tips even though the tips received for services in the performing arts which is a specified trade or business. Since Mary is performing services as an employee, the employer, the Hotel is not operating a specified service trade or business and Mary's occupation is included in the category of musicians and singers on the list of occupations customarily and readily receiving tips.

C. No Tax on Tips: Con't

j. In the case of qualified tips received by an individual during any taxable year in the course of a trade or business (other than a trade or business of performing services as an employee) of such individual, such qualified tips shall be deducted only to the extent that the gross income for the taxpayer from such trade or business for such taxable year (including such qualified tips) exceeds the sum of the deductions (other than the deduction allowed for qualified tips) allocable to the trade or business in which such qualified tips are received by the individual for the taxable year.

C. No Tax on Tips: Con't

The deduction allowed for qualified tips is not taken into account for this purpose because it is not a trade or business deduction. Thus, generally, for self-employed taxpayers, the deduction under section 224 for a trade or business is limited to the individual's net income (without regard to the section 224 deduction) from that trade or business.

Example

A manicurist who is self-employed owns a nail shop. The manicurist has no other employment. The manicurist receives gross income of $100,000 consisting of $70,000 for services and $30,000 of qualified tips. The manicurist total deductible expenses other than qualified tips are $40,000. The manicurist gross income of $100,000 exceeds the deductions for that trade or business other than the qualified tips by $60,000. ($100,000 $-40,000 = $60,000) since the maximum deduction is $25,000 the manicurist is permitted to deduct $25,000.

C. No Tax on Tips: Con't

k. An employer must report qualified tips on an employee's Form W-2, or the employee must report the tips on Form 4137. A service recipient must report qualified tips on an information return furnished to a nonemployee payee (Form 1099-NEC, Form 1099-MISC, Form 1099-K).

C. No Tax on Tips: Con't

l. If an individual tip recipient is "married" the deduction applies only if the individual and his or her spouse file a joint return. The deduction is not allowed unless the taxpayer includes his or her social security number (SSN) on their income tax return for the tax year. For this purpose, a SSN is valid only if it is issued to a U.S. citizen or a person authorized to work in the United States, and before the due date of the taxpayer's return.

m. Taxpayers may rely on the proposed regulations for those tax years, and on or before the date the final regulations are published in the Federal Register.

D. No Tax on Overtime

1. Section 7202 of OBBBA creates a new, temporary deduction for individuals who receive "qualified overtime compensation." This is codified as new Internal Revenue Code Section 226.

2. Taxpayers may deduct up to $12,500 per year in qualified overtime compensation ($25,000 for joint filers). The deduction phases out by $100 for every $1,000 of modified adjusted gross income (MAGI) above $150,000 (single filers) or $300,000 (joint filers).

D. No Tax on Overtime: Con't

3. "Qualified overtime compensation" is defined as overtime pay required under section 7 of the FLSA that is in excess of the regular rate. The deduction does not apply to any amounts already deducted as qualified tip.

4. Overtime must be properly reported on IRS forms such as W-2s (for employees) or 1099s (for non-employees). The deduction is only available for overtime compensation, not for regular wages or other forms of compensation.

D. No Tax on Overtime: Con't

5. To claim the deduction, taxpayers must include a valid Social Security Number (SSN) on their return. Married individuals must file jointly to be eligible for the deduction.

6. The omission of a required SSN is treated as a mathematical or clerical error under IRC §6213(g)(2), allowing the IRS to correct the return without a formal audit. The IRS is authorized to issue regulations to prevent abuse or misclassification of income.

D. No Tax on Overtime: Con’t

7. The deduction is available to non-itemizers, meaning it can be claimed in addition to the standard deduction.

8. Employers must report the total amount of qualified overtime compensation on employees' W-2 forms. Businesses must also report this information for non-employees on applicable 1099 forms. For overtime compensation earned before January 1, 2026, reporting entities may use reasonable methods to estimate and report qualifying amounts during the transition period.

D. No Tax on Overtime: Con't

9. The IRS must update withholding procedures beginning in 2026 to reflect the new deduction (IRC §3402). The IRS is authorized to issue regulations or guidance to prevent abuse of the deduction.

10. The new overtime deduction and related provisions apply to taxable years beginning after **December 31**, 2024. The deduction is temporary and will expire for taxable years beginning after December 31, 2028 (C Act Section 70202, adding new IRC Section 226).

Examples

Bubba is a single individual and has a base salary of $45,000. He is a non-exempt hourly worker. He works overtime earning an extra $10,000 in 2025. He can deduct the full 10,000 as qualified overtime. He is with in the $12,500 cap. If he is in a 22% tax bracket this will save him $2200 in federal taxes. He reports that deduction on form 1040.

Examples: Con't

Bubbett is an IT manager earning a salary of the hundred $40,000 a year and she is normally exempt from overtime. In 2025, her company reclassified some roles after the passage of the Act now she is nonexempt and eligible for overtime. She earned $15,000 of overtime she also earned $5000 in bonuses. Her total income ends up at $160,000. She is above the hundred and $50,000 threshold. She is a single individual. Since her AGI is over $10,000, the maximum deduction is reduced by $1000 ($100 for each thousand dollars over the limit) in this instance she can deduct $11,500 of her overtime. The remaining 3500 is taxed as ordinary income. If she's in a 24% bracket she saves $2706 (24% x $11,500)

D. No Tax on Overtime: Con't

11. **Notice 2025 – 62; IR 2025 – 110**. The Treasury and the IRS announced Pendley relief provisions for employers and other pay orders for 2025 related to the new tip and overtime information reporting requirement.

a. The IRS notes that employers and payors may not have systems or procedures in place to comply with the new reporting rules for the 2025 tax year. In addition, the agency does not intend to update relevant 2025 forms, such as Form W-2 and Form 1099, to include separate fields for this new information.
For these reasons, the IRS will treat 2025 as a transition period.

D. No Tax on Overtime: Con't

b. For tax year 2025 only, the IRS will not impose penalties under Section 6721 (failure to file correct information returns) or Section 6722 (failure to furnish correct payee statements) for failures to separately report:

- amounts reasonably designated as cash tips.
- the occupation of the person receiving the tips.
- the total amount of qualified overtime compensation.

c. This relief is contingent on the payor otherwise filing a complete and correct return. The amounts for tips and overtime must still be included in the aggregate payment totals reported on the forms.

D. No Tax on Overtime: Con't

d. Despite the penalty relief, the IRS encourages employers and payors to provide the separate tip and overtime information to their employees and payees for tax year 2025. This will ensure individuals have the necessary information to claim the deductions.

e. The notice suggests that employers and payors make this information available through an online portal, an additional written statement, or Box 14 of Form W-2.

E. Additional Senior Deduction (Enhanced Deduction for Seniors)

1. Taxpayers aged 65 or older and their spouses, if filing jointly can claim a $6,000 deduction per qualified individual for tax years beginning before January 1, 2029 (i.e., tax years 2025-2028).

2. This senior deduction is reduced by 6% (but not below zero) for the adjusted gross income that exceeds $75,000 (or $150,000 for joint filers).

E. Additional Senior Deduction (Enhanced Deduction for Seniors): Con't

3. To claim the deduction, the taxpayer must include the qualifying individual's Social Security number (SSN) on the return. The law amends Code Sec. 6213(g)(2) to treat the omission of a correct SSN for the senior deduction as a mathematical or clerical error, allowing the IRS to disallow the deduction without a formal audit.

4. The deduction is available for both taxpayers that itemized and those who do not itemized. However, the deduction is not available for taxpayers who are married filing separate.

E. Additional Senior Deduction (Enhanced Deduction for Seniors): Con't

5. These changes apply to tax years beginning after December 31, 2024 (Act Section 70103 amends Section . 151(d)(5)).

6. The enhanced deduction for seniors when combined with the basic standard deduction and the existing age-related deduction for 65+ taxpayers can result in a significant reduction of taxable income.

Examples

Bubba a single individual age 66 does not itemize. And takes the standard deduction. For 2025 the basic standard deduction is $15,750. He would get an additional $2000 deduction because he is age 65 or older. He would also be in town to the new enhanced senior deduction of $6000 resulting in a combined deduction of $23,750. This assumes that there is no phase out.

Examples: Con't

Now assume Bubba is a single individual with modified AGI of $85,000. He is over the threshold by $10,000. The reduction would be $600 ($10,000 x 6%) so the enhanced senior deduction would be $6000 $-600 = $5400.

Assume Bubba and Bubbett are married with modified AGI of $180,000. Assume both are over the age of 65. There modified AGI is $30,000 above the threshold for married filing joint. The reduction would be $1800 per spouse for total of $3600 ($30,000 x 6%x 2) the deduction allowed will be $12,000 $-3600 = $8400.

F. Draft of 2025 Schedule 1 –A

1. The IRS has published the draft version of a new form that will allow the taxpayers to claim the No Tax on Tips, the No Tax on Overtime and the No Tax on Car Loan Interest.. The form also includes the deduction for Enhanced Deduction for Seniors.

2. Part I on the form is the foundational calculation for each of the deductions. The foundational deduction is based on determining Modified Adjusted Gross Income (M AGI) which is used to apply the income-based limitations for the deduction.

F. Draft of 2025 Schedule 1 –A: Con't

Line 1: Taxpayers begin by entering the "Amount from Form 1040, 1040-SR, or 1040-NR, line 11b". Form 1040, line 11b represents the taxpayer's Adjusted Gross Income (AGI) [11b].

Lines 2a-2d: These lines require the addition of specific excluded income items back into AGI to arrive at MAGI. These include:

- **Line 2a:** Any income from Puerto Rico that was excluded.
- **Line 2b:** The amount from Form 2555, line 45.
- **Line 2c:** The amount from Form 2555, line 50.
- **Line 2d:** The amount from Form 4563, line 15.

F. Draft of 2025 Schedule 1 –A: Con't

Line 2e: This line aggregates the total of the excluded income items from lines 2a through 2d.

Line 3: The final MAGI amount is calculated by adding the AGI from line 1 and the total excluded income from line 2e. This MAGI figure is critical for the phase-out calculations in subsequent parts of the schedule.

F. Draft of 2025 Schedule 1 –A: Con't

3. Part II: No Tax on Tips.

This part calculates a deduction for qualified tips received, subject to specific conditions and income limitations.

- **Conditions:** This deduction is available only if qualified tips were received, and both the taxpayer (and spouse, if filing jointly) must possess a valid social security number. For married individuals, filing a joint return is mandatory to claim this deduction.
- **Line 4a:** Qualified tips received as an employee are entered here. If the amount in Form W-2, box 5, is $176,100 or less, this is typically the qualified tips included in Form W-2, box 7. Special instructions apply for amounts exceeding this threshold.

F. Draft of 2025 Schedule 1 –A: Con't

- **Line 4b:** Qualified tips reported on Form 4137, line 1(c), are entered. If Form 4137 is not filed, -0- is entered.
- **Line 4c:** If qualified tips were received from only one employer, the larger of line 4a or line 4b is entered. Otherwise, taxpayers must refer to specific instructions.
- **Line 5:** This line addresses qualified tips received in the course of a trade or business, as reported on Form 1099-NEC, box 1; Form 1099-MISC, box 3; or Form 1099-K, box 1a. The entered amount cannot exceed the net profit from that trade or business. Specific instructions apply for qualified tips from multiple businesses.

F. Draft of 2025 Schedule 1 –A: Con't

- **Line 6:** The total of all qualified tips, both employee and business, is calculated by adding lines 4c and 5.
- **Line 7:** The initial "Qualified tips deduction" is the smaller of line 6 or $25,000.
- **Lines 8-13 (Phase-out):** This deduction is subject to a phase-out based on MAGI (from Part I, line 3).

F. Draft of 2025 Schedule 1 –A: Con't

- **Line 9:** A threshold of $150,000 ($300,000 if married filing jointly) is established.
- **Line 10:** The amount by which MAGI exceeds the threshold is calculated. If zero or less, the full amount from line 7 is carried to line 13.
- **Line 11:** This excess is divided by $1,000, and the result is decreased to the next lower whole number (e.g., 1.5 becomes 1).
- **Line 12:** The result from line 11 is multiplied by $100, representing the reduction amount.
- **Line 13:** The final "Qualified tips deduction" is determined by subtracting line 12 from line 7. If the result is zero or less, -0- is entered.

F. Draft of 2025 Schedule 1 –A: Con't

4. Part III: No Tax on Overtime

This section computes a deduction for qualified overtime compensation, also subject to specific conditions and MAGI phase-out.

. **Conditions:** This deduction is only applicable if qualified overtime compensation was received, and the taxpayer (and spouse, if filing jointly) must have a valid social security number. Married individuals must file jointly.

F. Draft of 2025 Schedule 1 –A: Con't

- **Line 14a:** Qualified overtime compensation included on Form W-2, box 1, is entered.
- **Line 14b:** Qualified overtime compensation reported on Form 1099-NEC, box 1, or Form 1099-MISC, box 3, is entered.
- **Line 14c:** The sum of lines 14a and 14b constitutes the total qualified overtime compensation.
- **Line 15:** The initial "Qualified overtime compensation deduction" is the smaller of line 14c or $12,500 ($25,000 if married filing jointly).
- **Lines 16-21 (Phase-out):** Similar to the tip deduction, this deduction is subject to a MAGI phase-out.

F. Draft of 2025 Schedule 1 –A: Con't

- **Line 17:** A threshold of $150,000 ($300,000 if married filing jointly) applies.
- **Line 18:** The amount by which MAGI exceeds the threshold is calculated. If zero or less, the full amount from line 15 is carried to line 21.
- **Line 19:** This excess is divided by $1,000, and the result is decreased to the next lower whole number.
- **Line 20:** The result from line 19 is multiplied by $100, representing the reduction amount.
- **Line 21:** The final "Qualified overtime compensation deduction" is determined by subtracting line 20 from line 15. If the result is zero or less, -0- is entered.

F. Draft of 2025 Schedule 1 –A: Con't

5. Part IV: No Tax on Car Loan Interest

This part calculates a deduction for qualified passenger vehicle loan interest, with specific limitations and a MAGI-based phase-out.

. **Conditions:** This deduction is available only if qualified passenger vehicle loan interest was paid or accrued. Taxpayers must consult instructions to define an "applicable passenger vehicle".

F. Draft of 2025 Schedule 1 –A: Con't

- **Line 22:** This section requires Vehicle Identification Numbers (VINs) and the amount of interest for each applicable passenger vehicle. **It also distinguishes if the interest was previously deducted on Schedule C, Schedule E, or Schedule F.**
- **Line 23:** The total qualified car loan interest for Schedule 1-A purposes (column (iii) from line 22) is summed here.
- **Line 24:** The initial "Qualified car loan interest deduction" is the smaller of line 23 or $10,000.
- **Lines 25-30 (Phase-out):** This deduction is also subject to a MAGI phase-out.

F. Draft of 2025 Schedule 1 –A: Con't

- **Line 26:** A threshold of $100,000 ($200,000 if married filing jointly) applies.
- **Line 27:** The amount by which MAGI exceeds the threshold is calculated. If zero or less, the full amount from line 24 is carried to line 30.
- **Line 28:** This excess is divided by $1,000, and the result is **increased to the next higher whole number** (e.g., 1.5 becomes 2). This is a key distinction from the tip and overtime deductions.
- **Line 29:** The result from line 28 is multiplied by $200, representing the reduction amount.
- **Line 30:** The final "Qualified car loan interest deduction" is determined by subtracting line 29 from line 24. If the result is zero or less, -0- is entered.

F. Draft of 2025 Schedule 1 –A: Con't

6. Part V: Enhanced Deduction for Seniors

This part introduces an additional deduction specifically for seniors, also subject to MAGI limitations.

. **Conditions:** This deduction requires the taxpayer (and spouse, if filing jointly) to have a valid social security number. Married individuals must file jointly.
. **Lines 31-35 (Phase-out):** This deduction has its own MAGI-based reduction.

F. Draft of 2025 Schedule 1 –A: Con't

- **Line 32:** A threshold of $75,000 ($150,000 if married filing jointly) applies.
- **Line 33:** The amount by which MAGI exceeds the threshold is calculated. If zero or less, $6,000 is directly entered on line 35.
- **Line 34:** The excess from line 33 is multiplied by 6% (0.06), which is the reduction amount.
- **Line 35:** The reduction from line 34 is subtracted from $6,000. If the result is zero or less, -0- is entered.

F. Draft of 2025 Schedule 1 –A: Con't

- **Lines 36a and 36b:** These lines apply the calculated deduction to eligible individuals.
  - **Line 36a:** The amount from line 35 is entered if the taxpayer has a valid social security number and was born before January 2, 1961.
  - **Line 36b:** The amount from line 35 is entered if the taxpayer is married filing jointly, the spouse has a valid social security number, and the spouse was born before January 2, 1961.
- **Line 37:** The final "Enhanced deduction for seniors" is the sum of lines 36a and 36b.

F. Draft of 2025 Schedule 1 –A: Con't

7. Part VI: Total Additional Deduction

This section aggregates all deductions calculated in the preceding parts.

. **Line 38:** The "Total Additional Deductions" is the sum of the qualified tips deduction (line 13), the qualified overtime compensation deduction (line 21), the qualified car loan interest deduction (line 30), and the enhanced deduction for seniors (line 37). This total is then transferred to the appropriate line on the main tax form.

F. Draft of 2025 Schedule 1 –A: Con't

8. Implications for Adjusted Gross Income

a. The total deductions calculated on Schedule 1-A (Form 1040) are reported on *Form 1040, line 13b*. This placement is highly significant for tax professionals as it explicitly clarifies that these "Additional Deductions" are *not* used in the computation of Adjusted Gross Income (AGI).

b. On Form 1040, line 11b represents the taxpayer's Adjusted Gross Income (AGI.

F. Draft of 2025 Schedule 1 –A: Con't

c. The form proceeds to calculate taxable income by subtracting various deductions from AGI. Specifically:

- Line 12e reports the Standard deduction or itemized deductions (from Schedule A).
- Line 13a reports the Qualified business income deduction (from Form 8995 or Form 8995-A).
- Line 13b explicitly states "Additional deductions from Schedule 1-A, line 38".
- Line 14 sums lines 12e, 13a, and 13b.
- Line 15 then subtracts this total (line 14) from AGI (line 11b) to arrive at taxable income.

F. Draft of 2025 Schedule 1 –A: Con't

This sequential structure on Form 1040 demonstrates that the deductions from Schedule 1-A are below-the-line deductions. Unlike "Adjustments to income" found on Schedule 1, which are reported on Form 1040, line 10, and are subtracted from gross income to arrive at AGI, the Schedule 1-A deductions are subtracted *after* AGI has been computed. This distinction is crucial for various tax calculations that rely on AGI, such as limitations on other deductions, credits, or income thresholds. The inclusion of Schedule 1-A deductions alongside standard/itemized deductions and the QBI deduction confirms their role in reducing taxable income, not AGI.

SECTION VIII: AMT AND OTHER TAXES

I. AMT and Other Taxes

A. AMT for 2025 (Rev. Proc. 2024 – 40)

1. For 2025, the AMT exemption amount will be as follows:

Married filing joint and surviving spouse	$137,000
Single individuals and HOH	$88,100
Married Filing Separately	$68,500

2. For 2025, the amount used to determine the phase-out of the AMT exemption will be as follows**:**

Married filing joint and surviving spouse	$1,252,700
Single individuals and HOH	$626,350

B. AMT for 2026 (Rev. Proc. 2025 – 32)

1. For 2026, the AMT exemption amount will be as follows:

Married filing joint and surviving spouse	$140,200
Single individuals and HOH	$90,100
Married Filing Separately	$70,100

2. For 2026, the amount used to determine the phaseout of the AMT exemption will be as follows:

Married filing joint and surviving spouse	$1,280,400
Single individuals and HOH	$680,200
Married Filing his separately	$640,200

C. Excess Taxable Income and AMT

1. For 2025, the excess taxable income above which the 28% tax rate applies will be: (Rev. Proc. 2024 – 40)
Married filing joint and surviving spouse
$239,100
Single, HOH and married persons filing separately
$119,550

2. For 2026, The xx taxable income above which the 28% tax rate applies will be (Rev. Proc. 2025 – 32)

Married filing joint and surviving spouse
$244.500
Single, HOH and married persons filing separately
$122,250

D. Alternative Minimum Tax Exemption for a Child Subject to the Kiddie Tax

1. For 2025, a child for whom the kiddie tax applies the exemption for purposes of the alternative minimum tax may not exceed the sum of the child's earned income for the taxable year plus $9,550.

2. For 2026, a child of whom the kiddie tax applies the exemption purpose of the alternative minimum tax may not exceed the sum of the child's earned income for the taxable year plus $9,750. (Rev. Proc. 2025 – 32).

E. AMT Exemption Amounts Permanently Increased

1. An individual's alternative minimum tax (AMT) liability is calculated by subtracting an exemption amount from the individual's alternative minimum taxable income (AMTI). The exemption amounts are phased out above certain income thresholds.

2. The TCJA increased individual AMT exemption amounts and exemption phaseout thresholds through December 31, 2025. The statutory AMT exemption dollar amounts for 2017 to 2025 as follows:

- $109,400 for married filing joint
- $70,300 for all other filers, adjusted for inflation.

E. AMT Exemption Amounts Permanently Increased: Con't

3. The amount is reduced by 25% of the amount by which AMTI exceeds $1,000,000, adjusted for inflation or 25% of the amount by which AMTI exceeds 50% of the married-filing-jointly phaseout threshold amount for individuals or marrieds filing separately.

4. Under OBBBA, the exemption amounts are increased permanently.

E. AMT Exemption Amounts Permanently Increased: Con't

5. The exemption phaseout threshold is set at $500,000 (or $1,000,000 for joint returns) in 2026 and indexed for inflation. The Act also increases the phase-out rate for higher-income taxpayers from 25% to 50%.

6. This provision applies to tax years beginning after December 31, 2025. (Act Sec. 70107, amends IRC Section 55 (d) (4)))

E. AMT Exemption Amounts Permanently Increased: Con't

7. For taxable years beginning in 2026 (Rev. Proc. Section 4.10):

The AMT exemption amounts (Code Section 55(d)(1)) are:

- Joint Returns or Surviving Spouses: $140,200.
- Unmarried Individuals (other than Surviving Spouses): $90,100.
- Married Individuals Filing Separate Returns: $70,100.
- Estates and Trusts: $31,400.

E. AMT Exemption Amounts Permanently Increased: Con't

8. The amounts used to determine the phaseout of the exemption amounts (Code Section 55(d)(2)) are:

Filing Status	Threshold Phaseout Amount	Complete Phaseout Amount
Joint Returns or Surviving Spouses	$1,000,000	$1,280,400
Unmarried Individuals	$500,000	$680,200
Married Individuals Filing Separate Returns	$500,000	$640,200
Estates and Trusts	$104,800	$167,600

9.For a child subject to the "kiddie tax" (Code Sections 55(d) and 59(j)), the AMT exemption amount may not exceed the sum of (1) the child's earned income, plus (2) **$9,750**.

F. AMT Credit Carryforward

1. The AMT credit carryforward can be used to the extent that the regular tax exceeds AMT. Since many taxpayers will avoid AMT in 2021, the credits may be usable sooner than later. However, the credits are not assignable.

Example

Vichich v. Comm., 146 TC 12. Husband before his marriage to Wife exercised incentive stock options resulting in AMT liability which he reported on his tax return filed jointly with his first wife. The payment of the AMT liability generated an AMT credit carryforward. Husband's first wife died and he remarried (Wife 2). Husband subsequently died. On Wife 2's tax return she reported AMT credits derived from the deceased husband's AMT credit carryforward that she used to offset her income tax liability. The court agreed with the IRS the 2nd wife is not entitled to premarital credit carryforwards.

II. Kiddie Tax

A. Overview

1. The kiddie tax applies to a child if the child is:

- Under the age of 18, regardless of whether earned income equals more than one half of the child support, or
- That the child turned age 18, or
- If the child was a full-time student between the ages of 19 and 23 before the end of the applicable tax year and the child's earned income for the year does not exceed one half of his or her support.
- The child has at least one living parent at the close of the tax year;
- The child possessed unearned income of more than $2,600; and
- The child did not file a joint return.

A. Overview: Con't

2. Unearned income for these purposes is income other than wages, salaries, professional fees, other amounts received as compensation for personal services actually rendered. It also includes distributions from qualified disability trusts. In general, a child is eligible to use the preferential tax rates for qualified dividends and capital gains.

A. Overview: Con't

3. SECURE Act. The changes under the TCJA created a degree of unfairness causing increase in tax on certain children, including those who are receiving government payments which were characterized under income because they were survivors of deceased military personnel, first responders and emergency workers.

a. As such, the SECURE Act changed the rules under the TCJA on December 20, 2019 by repealing the prior measures. Beginning in 2020, with an option to start retroactively in 2018 and 2019, the income of children is taxed under the pre- TCJA rules. In other words, the old rule now prevails.

B. Unearned Income of Minor Children Subject to Kiddie Tax Exemption

1. For 2025, the exemption from the kiddie tax for 2025 will be $2,600. A parent will be able to elect to include a child's income on the parent's return for 2025 if the child's income is more than $1,350 and less than $13,500. (Rev. Proc. 2024 – 40)

2. For 2026, the exemption for the kiddie tax for 2026 will be the same as 2025.. (Rev. Proc. 2025 – 32)

III. Tax On Net Investment Income

A. Tax for 2025

1. The 3.8% Net Investment Income (NII) Tax Is Imposed On The Lesser Of:

- An Individual's NII For The Tax Year, Or
- MAGI In Excess Of A Floor:
  - $200,000 For Single And Head Of Household;
  - $250,000 For Joint Filers And Surviving Spouses; Or
  - $125,000 For A Married Taxpayer Filing Separately

(See Reg. Section 1411(A)(1) & (B); §1.1411- 2(B)(1); §1.1411-2(D)(1)).

2. The Act did not change the threshold requirements for the imposition of the net investment income tax. In other words, the above amounts will be applicable in 2021.

B. Credit Claims Against Net Investment Income

1. The foreign tax credit does not reduce the net investment income tax. (Toulouse v. Comm., 157 TC 49)

2. Application of Tax Treaties

IV. Additional Medicare Tax

A. General Rule

1. The 0.9% Additional Medicare Tax applies to your Medicare wages, Railroad Retirement Tax Act (RRTA) compensation, and self-employment income above a threshold amount.

2. Medicare wages and self-employment income are combined to determine if the taxpayer exceeds the thresholds shown below. A self-employment loss cannot be considered for purposes of this tax. RRTA compensation should be separately compared to the thresholds.

A. General Rule: Con't

3. The employer of the taxpayer is responsible for withholding the .9 additional Medicare tax on the taxpayers Medicare wages or RRTA compensation in excess of the thresholds in a calendar year.

4. The form to file his Form 8959.

B. Threshold Amounts

1. The threshold amounts are as follows:

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household	$200,000
Qualifying surviving spouse	$200,000

2. The threshold amounts are not adjusted for inflation.

V. Excess Advance Premium Tax Credit Repayment – Form 8962

A. Advanced Premium Tax Credits required Form 8962 to be attached to the return

1. Presently there is a limit on the amount of excess premium tax credit certain individuals must repay if they misestimated or under estimated their projected income and benefit from a more generous advance payment of the tax credit that they qualify for. For taxpayers whose household income exceeds 400% no limitation applies.

A. Advanced Premium Tax Credits required Form 8962 to be attached to the return: Con't

2. The proposed bill removes the repayment limitations and requires taxpayers to reimburse the IRS for the full amount of any excess tax credit received. This is in your respective of the household income in association the federal poverty level. This provision will go into effect after December 31, 2025. (See Section 112203)

3. Advanced Premium Tax Credits required Form 8962 to be attached to the return

Example

Sneed v. Comm., TC Summary 2023 – 11. Taxpayer enrolled in health insurance for herself and to dependents through the marketplace. The taxpayer received advance premium tax credits on the basis of information in the application. Taxpayer did not attach a copy of Form 8962: Premium Tax Credit to her return but later mailed it separately. The notice of deficiency determine the taxpayer was not eligible for the tax credit because her modified AGI exceeds 400% of the federal poverty level line in association with her family size. The form according to the court is required to reconcile the events payments in relation to the eligibility for the credit and income of the taxpayer with respect to the federal poverty level and family size.

A. Advanced Premium Tax Credits required Form 8962 to be attached to the return: Con't

Taxpayers must file Form 8962 if any family member was enrolled in Marketplace health insurance and IRS records show that APTC was paid to their Marketplace insurance company. The IRS has seen an increase in the number of taxpayers who are not including the required form when using tax software to file their returns. If a taxpayer's e-filed return is rejected due to a missing Form 8962, they may refile their complete return by completing and attaching Form 8962 or a written explanation of the reason for its absence.

New! – Elimination of Repayment on Excess Advance PTC Payments

A. Overview

1. Taxpayers can elect to have advance payments of their estimated premium tax credit (PTC) made directly by IRS to the insurer. Taxpayers who choose this option must reconcile the advance payments with the actual credit (on Form 8962) when they file their returns.

2. If the advance payments exceed the PTC to which the taxpayer is entitled for the tax year, the taxpayer owes the excess amount as an additional income tax.

A. Overview: Con't

3. Under pre-Act law, a "repayment cap" limits the additional tax to an applicable dollar amount, for taxpayers whose household income was less than 400% of the federal poverty line (FPL) for a family of the size involved.

4. For tax years beginning in 2025, the applicable dollar amounts are as follows:

- $750 if household income is less than 200% of the FPL
- $1,950 if household income is at least 200% but less than 300% of the FPL, and
- $3,250 if household income is at least 300% but less than 400% of the FPL.

A. Overview: Con't

5. For unmarried individuals other than surviving spouses or heads of household, the applicable dollar amounts are one-half of the above amounts.

6. The Act strikes Code Section 36 B which provides for the repayment cap. (See Act Sec. 71305(a))

7. As a result, all taxpayers will have to repay their excess advance PTC payments in their entirety. This change is effective for tax years beginning after December 31, 2025. (See Act Sec. 71305(c))

SECTION IX: PERSONAL TAX CREDITS

I. Child Tax Credit

A. Qualifications

1. To be a qualifying child of the tax year the defendant must be:

- Be under age 17 at the end of the year
- Be your son, daughter, stepchild, eligible foster child, brother, sister, stepbrother, stepsister, half-brother, half-sister, or a descendant of one of these (for example, a grandchild, niece or nephew)
- Provide no more than half of their own financial support during the year
- Have lived with you for more than half the year
- Be properly claimed as your dependent on your tax return
- Not file a joint return with their spouse for the tax year **or** file it only to claim a refund of withheld income tax or estimated tax paid
- Have been a U.S. citizen, U.S. national or U.S. resident alien

B. Current Amounts

1. 2025. For taxable years beginning in 2025, the amount used to determine the amount of credit that may be refundable is $1,700. (Rev. Proc. 2024-40).

2. 2026. For taxable years ending in 2026, the amount used to determine the amount of the credit that may be refundable is the same as 2025. (Rev. Proc. 2025 – 32.).

C. Denial of Credit

1. No identifying number prior to filing a ritual turn cannot be amended by the taxpayer.

Example

Sowards v. Comm., TC Memo 2023 – 99. The taxpayers filed a joint return for the years at issue. The taxpayers claimed the child tax credit and the additional child tax credit. The IRS notify the taxpayers that the credits were being disallowed as mathematical or clerical errors. At the time of filing, the returns did not have Social Security numbers for the children nor his spouse. After the taxpayer was notified of the disallowance, he received the Social Security numbers.

Example: Con't

The taxpayer amended his return accordingly. The taxpayer was not allowed to make the amendment as the tax identification numbers had not been issued before the due date for the filing of the return. The dependents were deemed undocumented immigrants and under Section 32 (m) and Section 6428 they were denied. It appears the court left the door open that if the identification numbers were received during the extension. The credits would've been allowed.

D. Extension and Enhancement of Increased Child Tax Credit; Credit for Other Dependents Extended – New!

1. Under the Tax Cuts and Jobs Act, for tax years 2018 through 2025, the TCJA temporarily modified the child tax credit (CTC) to: increase the credit amount to $2,000 per qualifying child without adjustment for inflation.

2. The Tax Cuts Jobs Act also increased the refundable portion of the credit (the "additional child tax credit") to $1,400, adjusted annually for inflation using chained CPI computed using 2017 as the base year)

D. Extension and Enhancement of Increased Child Tax Credit; Credit for Other Dependents Extended – New!: Con't

3. It is presently set to be $1,700 for 2025 and the Act decrease the earned income threshold at which taxpayers may qualify to claim the credit, to $2,500 without adjustment for inflation and increase the modified adjusted gross income (MAGI) threshold amounts at which the credit begins to phase out to $400,000 for joint filers, and $200,000 for all other filers (without adjustment for inflation).

4. In addition, for 2018 through 2025, to claim the credit, the TCJA requires that the taxpayer include the qualifying child's Social Security Number (SSN), issued on or before the due date of the return, on the return.

D. Extension and Enhancement of Increased Child Tax Credit; Credit for Other Dependents Extended – New!: Con't

5. For tax years after 2025, the CTC rules were scheduled to revert to pre-TCJA levels which would have been a $1,000 per qualifying child CTC amount, a maximum $1,000 refundable credit amount; an earned income threshold of $3,000; and MAGI phase-out thresholds of $110,000 for joint filers, $75,000 for singles or heads of household, and $55,000 for marrieds filing separately with no indexing for inflation.

6. The qualifying child's name and taxpayer identification number, either an SSN or an Individual Taxpayer Identification Number (ITIN) issued on or before the due date of the return, would have to be included on the tax return.

D. Extension and Enhancement of Increased Child Tax Credit; Credit for Other Dependents Extended – New!: Con't

7. Under OBBBA, for tax years after 2025, makes all of the TCJA changes to the CTC permanent with the following modifications:

a. The nonrefundable CTC amount is increased to $2,200 per qualifying child (Act Sec. 70104(a)(2) amends and is indexed for inflation for tax years after 2025, using chained CPI computed using 2024 as the base year (See Act Sec. 70104(c) amends IRC Section 24 (i))

D. Extension and Enhancement of Increased Child Tax Credit; Credit for Other Dependents Extended – New!: Con't

b. To claim the credit, the taxpayer is required to include on the tax return both the taxpayer's SSN (or for a joint return the SSN of at least one spouse) and the qualifying child's SSN. A qualifying SSN for these purposes is an SSN issued by the Social Security Administration to a U.S. citizen or national or pursuant to a provision of the Social Security Act relating to lawful admission for employment in the U. S. (See Act Sec. 70104(b) amends Section 24 (h) (7))

II. Beyond Child Tax Credit

A. Other Dependent Credit – New!

1. Under current law, for tax years 2018 through 2025, the TCJA provides a temporary $500 nonrefundable credit (not adjusted for inflation) for dependents who do not qualify for the CTC--including children aged 17 or over, children with no SSN, and qualified dependents who are not children (e.g., parents or siblings).

2. The credit is available for dependents who are U.S. citizens, U.S. nationals, or U.S. resident aliens who have either an SSN or an ITIN.

A. Other Dependent Credit – New!: Con't

3. The credit for other dependents phases out at MAGI of $400,000 for married joint filers, and $200,000 for all other filers (without adjustment for inflation). For tax years after 2025, the $500 credit would have expired.

4. OBBBA makes the credit for other dependents permanent. The credit continues not to be adjusted for inflation. (See Act Sec. 70104(a) amends IRC Section 24 (h) (1))

A. Other Dependent Credit – New!: Con't

5. The omission of a correct SSN on a return regarding either child tax credit or the other dependent credit rules will be treated as a mathematical or clerical error that IRS can summarily assess. (See Act Sec. 70104(e) amends IRC Section 6213 (g) (2) (I))

6. The section is effective for tax years beginning after **December 31, 2024**. (See Act Sec. 70104(f))

III. Dependent Care Credit

A. Enhancement of Child and a Dependent Care Credit – New!

1. Under TCJA, a taxpayer with one or more qualifying individuals, such as a child or other dependent, is eligible to claim a credit for employment-related expenses for child and dependent care.

2. The employment-related expenses are expenses for household services and expenses for the care of a qualifying individual.

A. Enhancement of Child and a Dependent Care Credit – New!: Con't

3. This credit is calculated by multiplying the amount of qualifying expenses - a maximum of $3,000 if the taxpayer has one qualifying individual, and up to $6,000 if the taxpayer has two or more qualifying individuals - by the appropriate credit rate. The credit rate varies by the taxpayer's adjusted gross income, with a maximum credit rate of 35% that declines, as AGI increases, to 20% for taxpayers with AGI above $43,000.

4. OBBBA increases the maximum credit rate to 50%, reduced by one percentage point, but not below 35%, for each $2,000 or fraction thereof by which the taxpayer's AGI exceeds $15,000.

A. Enhancement of Child and a Dependent Care Credit – New!: Con't

5. Under OBBBA4 for AGIs between $43,001 and $75,000 ($86,001 and $150,000, respectively, in the case of a joint return), the credit rate is 35%.

6. This credit rate is further phased down to 20% for AGI between $75,001 and $105,000 ($150,001 and $210,000, respectively, in the case of a joint return).

7. This provision is effective for tax years after December 31, 2025. (See Act Sec. 70405 amends IRC 21)

IV. Adoption Credit

A. Current deductible amounts for 2025 and 2026

1. 2025. Currently, the adoption credit is capped at $17,280 for qualified adoption expenses when adopting an eligible child. The credit begins to phase out for adjusted gross income over $252,150 and completely phases out AGI's over $292,150. The credit is nonrefundable any unused credit may be carried over up to five years.

2. 2026. The adoption credit is capped at $17,670 for qualified expenses when adopting an eligible child. The credit begins to phase out for adjusted gross income over $265,080 and is completely phased out over AGI in excess of $305,080.

B. Enhancement of Adoption Credit – New

1. IRC Section 23 allowed taxpayers to claim a nonrefundable income tax credit for qualified adoption expenses incurred, up to a maximum of $17,280 per child.

2. Effective 2025, the adoption credit is enhanced to include a refundable portion of up to $5,000. (See Act Sec. 70402(a))

B. Enhancement of Adoption Credit – New: Con't

3. This refundable amount will be adjusted for inflation annually, with the adjustments beginning in 2025 using a base year of 2024 for cost-of-living calculations. (See Act Sec. 70402(b))

4. The provision clarifies that the refundable portion of the adoption credit will not be eligible for carryforward to subsequent years. (See Act Sec 70402(c))

5. This provision is effective for tax years beginning after **December 31, 2024**. (Act Sec. 70402(d))

V. Credit of up to $1,700 For Contributions to Scholarship-Granting Organizations

A. Overview

1. The Act allows an individual taxpayer who is a U.S. citizen or resident an income tax credit for each tax year equal to the aggregate amount of qualified contributions of cash made by the taxpayer during the tax year to a scholarship-granting organization. (See IRC Section 25F(a), as added by Act Sec. 70411(a)(1))

2. A scholarship-granting organization must be a public charity and must maintain separate accounts for qualified contributions. (See IRC Section 25F(c)(5), as added by Act Sec. 70411(a))

A. Overview: Con't

3. Qualified contributions must be used to fund scholarships to eligible students solely within the state in which the organization is listed as a qualifying scholarship-granting organization. (See IRC Section 25F(c)(3), as added by Act Sec. 70411(a))

4. The credit is only allowed for organizations in states that elect to participate in this program and that provide IRS with a list of scholarship-granting organizations within the state. (See Section 25F(g), as added by Act Sec. 70411(a))

A. Overview: Con't

5. The credit cannot exceed $1,700 per taxpayer per tax year and is reduced by the amount allowed as a credit on any state tax return of the taxpayer for qualified contributions made by the taxpayer during the tax year.

6. An amount taken as a credit under this provision cannot be counted as a charitable contribution for purposes of the charitable contribution deduction. (See IRC Section 25F(e), as added by Act Sec. 70411(a))

A. Overview: Con't

7. Credits in excess of the limit on combined amount of nonrefundable personal credits can be carried forward for five years. (See IRC Section 25F(f), as added by Act Sec. 70411(a))

8. An eligible student for these purposes is an individual who is a member of a household with an income which, for the calendar year before the date of the application for a scholarship, is not greater than 300% of the area median gross income and is eligible to enroll in a public elementary or secondary school. (See IRC Section 25F(c)(2), as added by Act Sec. 70411(a))

A. Overview: Con't

9. An individual's gross income will not include any amounts provided to that individual or any dependent of that individual under a scholarship for qualified elementary or secondary education expenses of an eligible student which is provided by a scholarship-granting organization. (See Section 139K, as added by Act Sec. 70411(b))

A. Overview: Con't

10. The credit is available in tax years ending after December 31, 2026. (See Act Sec. 70411(c)(1))

11. The exclusion for scholarship amounts described above will apply to amounts received after December 31, 2026, in tax years ending after that date. (See Act Sec. 70411(c)(2))

VI. American Opportunity and Lifetime Learning Credits

A. Overview

1. Under the Tax Cuts and Jobs Act a taxpayer in order to qualify for the American Opportunity Tax Credit (AOTC) and the Lifelong Learning credit for the education of an individual only if the taxpayer includes on their tax return the taxpayer identification number ("TIN") of that individual.

2. A taxpayer is allowed the AOTC only if the taxpayer includes the employer identification number ("EIN") of any institution to which qualified tuition and related expenses were paid.

A. Overview: Con't

3. Under OBBBA a taxpayer must include on the taxpayer's tax return their (or their spouse's) social security number ("SSN") or, for an individual other than the taxpayer or the taxpayer's spouse, that individual's name and social security number. (Act Sec. 70606(a)(1)(A))

4. The present-law EIN requirement is clarified to provide that a taxpayer must include on their tax return for that year, the EIN of any institution to which the taxpayer paid qualified tuition and related expenses taken into account in computing the credit. (See Act Sec. 70606(a)(1)(B))

A. Overview: Con't

5. A taxpayer's omission of a required correct SSN or EIN is treated as a mathematical or clerical error (See Act Sec. 70606(b))

6. This provision is effective for tax years beginning after December 31, 2025. (See Act Sec. 70606(c))

B. American Opportunity Tax Credit – Current 2025 Provision

1. The amount of the credit available is capped at $2,500 associate with the cost of tuition and related expenses paid during the tax year. The taxpayer can receive a tax credit based on 100% of the first $2,000 of tuition and related expenses. This does include course material paid during the tax year and 25% of the next $2,000 of tuition and related expenses paid during the tax year. 40% of the credit is refundable.

B. American Opportunity Tax Credit – Current 2025 Provision: Con't

2. Taxpayers will not be allowed to claim the credit or the lifetime learning credit or the tuition deduction unless the taxpayer receives a Form 1098 – T from the educational institution. No American opportunity tax credit will be allowed unless the taxpayer includes the employer identification number of any educational institution to which the qualified tuition and related expenses were paid for education furnished in academic education.

B. American Opportunity Tax Credit – Current 2025 Provision: Con't

3. Verification similar to the earned income credit will be required each year that taxpayers must include in the return prior to taking the credit.

4. The taxpayer has the burden to show that the dependent student was enrolled at least half-time and eligible education institution in order to receive the education credit. The fact that the student receives a Form 1098 – T is not enough evidence that they are entitled to the deduction. (Lee and Martin v Comm. TCM 2017 – 73).

B. American Opportunity Tax Credit – Current 2025 Provision: Con't

5. If this credit was denied or reduced for any reason other than a math or clerical error, Form 8862: Information to Claim Certain Credits at the Disallowance is still required to be attached to the return.

6. No credit will be allowed if the identifying number of the tax periods issued after the due date of the tax return. (Section 32 (m), Section 24 (e), Section 25A (I))

7. The credit includes tuition and related expenses and only applies to the first four years of college. Related expenses are those expenses required for the enrollment or attendance and eligible education institution.

Example

Bravo v. Comm., Tax Court Docket No. 26566 – 22 (January 14, 2024). The taxpayer claimed the American Opportunity Tax Credit for her and her dependent son. The qualified related expenses for purposes of this credit included books, two computers, an office chair, a laptop messenger bag and ink cartridge for a printer. The book was viewed as the only qualified related expense eligible to be included in the computation of the credit. The rest fell outside the definition of qualified intuition related as they were not a requirement for attendance or coursework.

C. Lifetime Learning Credit

1. The Credit Is Nonrefundable. The Maximum Benefit Is $2,000 (20% Of First $10,000 In Qualified Expenses) Per Return. The student must be enrolled particular class is an eligible educational institution, take higher education courses to get the degree or other recognized educational credit or to get or improve job skills and be enrolled for at least one academic timeframe beginning in the tax year.

2. The academic timeframe can be a trimester, semester or quarterly basis and can include summer school.

D. Income Limitations for both Credits

1. For both credits an, there is a phaseout or reduction in the amount of the credit. Based upon the taxpayer's modified AGI. That is between $80,000 and $90,000 or $160,000 and $180,000 if the taxpayer is married filing jointly.

2. Both credits remain to be claimed on Form 8863.

D. Income Limitations for both Credits: Con't

3. Presently, a student, taxpayer, or spouse must have a valid taxpayer identification number issued or applied for on or before the due date of the return, including extensions. In order to claim the American Opportunity Tax Credit or the Lifetime Learning Credit a taxpayer identification number (TIN) is a Social Security number, an individual taxpayer identification number or an adoption taxpayer identification number neither of these credits can be claimed without that identifying number issued. The proposed bill under Section 112106 adds the requirement for the student and taxpayer, if filing on behalf of the student, to include their Social Security number on the return in order to receive either credits. This would be effective for the upcoming tax season.

VII. Premium Tax Credit

A. Overview

1. Under Section 36 B, an applicable taxpayer who enrolls in a qualified health plan (QHP) through an Affordable Insurance Exchange is allowed a refundable premium tax credit (PTC).

2. The PTC allowed to a taxpayer is based, in part, on the monthly premiums for one or more QHPs covering the taxpayer, the taxpayer's spouse, or the taxpayer's dependent(s) that were enrolled in through an Exchange.

A. Overview: Con't

3. Premiums attributable to individuals who are not lawfully present in the U.S. are not taken into account in computing the PTC. However, under current law, premiums attributable to individuals who are lawfully present in the U.S. are taken into account.

4. OBBBA amends this rule by introducing a new category of "eligible aliens." Under the Act, premiums attributable to individuals who are lawfully present in the U.S. but are not eligible aliens are not taken into account in computing the PTC. (Act Sec. 71301(a), amending IRC Section 36 B (c) (1)))

A. Overview: Con't

5. The Act defines an "eligible alien" as an alien who is lawfully present in the U.S. and who, for the entire enrollment period for which the PTC is claimed and is reasonably expected to be:

- an alien lawfully admitted for permanent residence under the Immigration and Nationality Act (8 U.S.C. 110120 et seq.), i.e., a green card holder;

A. Overview: Con't

- an alien who has been granted the status of Cuban and Haitian entrant, as defined in section 501(e) of the Refugee Education Assistance Act of 1980 (Public Law 96-422), i.e., an individual granted parole as a Cuban-Haitian entrant; or

- an individual who lawfully resides in the U.S. in accordance with a Compact of Free Association (COFA) referred to in section 402(b)(2)(G) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (8 U.S.C. 1612(b)(2)(G)), i.e., an individual from Federated States of Micronesia, Republic of the Marshall Islands, and Republic of Palau who lives and works in the U.S. under a COFA.

A. Overview: Con't

6. Under the provisions, the PTC will not be available for premiums paid for individuals who are lawfully present in the U.S. but do not fall into one of the above three categories.

7. These ineligible aliens include Deferred Action for Childhood Arrivals (DACA) recipients, temporary protected status (TPS) holders, and nonimmigrant visa holders.

8. The provision is effective for tax years beginning after December 31, 2026. (See Act Sec. 71301(e))

A. Overview: Con't

9. OBBBA imposes a new verification requirement on the exchange. Specifically, the Act provides that the term "coverage month" does not include, for any individual covered by a QHP enrolled in through an Exchange, any month beginning before the Exchange verifies the individual's eligibility to enroll in the plan through the Exchange and for advance PTC payments.

A. Overview: Con't

10. If a month is not a coverage month, the taxpayer will not be eligible for the premium tax credit for that month.

11. The verification will be made using applicable enrollment information that the applicant will provide or verify. "Applicable enrollment information" includes affirmation of at least the following information, to the extent relevant in determining eligibility for plan enrollment and advance PTC payments:

A. Overview: Con't

- household income and family size.
- whether the individual is an eligible alien (i.e., a lawfully present alien who is eligible for the PTC, see Act Sec. 71301).
- any health coverage status or eligibility for coverage.
- place of residence.
- other information that the Treasury Secretary, in consultation with the Secretary of Health and Human Services (HHS), determines to be necessary for the verification.

A. Overview: Con't

12. The Act allows for verification of past months. Hence, a month that begins before the required verification will be treated as a coverage month if the Exchange verifies for that month, using applicable enrollment information provided or verified by the applicant, the individual's eligibility to have enrolled and for any advance payment.

13. An individual who fails to meet the verification requirements for a month will not, solely for that reason, be treated as ineligible to enroll in a QHP through an Exchange for that month.

A. Overview: Con't

14. The Treasury Secretary may waive application of the verification requirement in the case of an individual who enrolls in a QHP through an Exchange for one or more months of the tax year during a special enrollment period (SEP) provided by the Exchange based on a change in the individual's family size.

15. An Exchange may use any available data and any reliable third-party sources in collecting information for verification by the applicant.

A. Overview: Con’t

16. In addition, the term "coverage month" will not include, for any individual covered by a QHP enrolled in through an Exchange, any month for which the Exchange does not meet, with respect to the individual, the requirements of 45 CFR 155.305(f)(4)(iii), as published in the Federal Register on June 25, 2025.

A. Overview: Con't

17. The regulation contains a failure to file and reconcile (FTR) process under which Exchanges must determine a tax filer is ineligible for advance PTC payments. This would occur if HHS notifies the Exchange that the tax filer (or their spouse if the tax filer is a married couple) received advance payments for a prior year for which tax data will be utilized for verification of income, and the tax filer or tax filer's spouse didn't comply with the requirement to file a federal income tax return and reconcile advance PTC payments for that year. While 45 CFR 155.305(f)(4)(iii) by its terms applies only for plan year 2026, the Act provision treats it as applying for all post-2025 plan years.

A. Overview: Con’t

18. The Act provides that the term "qualified health plan" will not include any plan enrolled in through an Exchange, unless the Exchange provides a pre-enrollment verification process through which any applicant may, beginning not later than August 1, verify with the Exchange the applicant's household income and eligibility for enrollment in the plan for plan years beginning in the following year.

19. These changes are effective for tax years beginning after Dec. 31, 2027. (See Act Sec. 71303(c))

A. Overview: Con't

20. Presently, to be eligible for the Premium tax credit the taxpayer must have household income of at least 100% of the federal poverty level line for a family of the size involved. (I.e., household income). Likewise, under current law, this income threshold did not apply to an alien who is lawfully present in the United States if the taxpayer was not eligible for Medicaid because of their status as an alien.

a. OBBBA eliminates the ability of lawful present aliens with income below the applicable federal poverty level to be eligible for the premium tax credit, even if the alien cannot receive Medicaid coverage due to alien status. This change will be effective for tax years beginning after December 31, 2025. (See Act. Sec. 771302 (a))

A. Overview: Con't

21. Under Section 38, taxpayers who enroll in a qualified health plan (QHP) through an Affordable Insurance Exchange are allowed a refundable premium tax credit. A QHP for purposes of the premium tax credit is a "qualified health plan" as defined by Section 1301(a) of the Patient Protection and Affordable Care Act (PPACA) except that it does not include a catastrophic plan described in affordable care act. Likewise, an QHP does not have any plan enrolled in during a special enrollment period provided for by an Exchange based on the relationship of the individual's expected household income to a percentage that the Secretary of Health and Human Services prescribes for purposes of the SEP, and not in connection with the occurrence of an event or change in circumstances that the Secretary of Health and Human Services specifies for those purposes.

A. Overview: Con't

a. The federal marketplace and many state marketplaces currently provide a year-round SEP for taxpayers whose household income does not exceed 150% of the federal poverty line. This low-income SEP is available even if the taxpayer has not experienced a life event or change of circumstances, such as marriage, divorce, birth, etc.

22. OBBBA The Act eliminates this type of SEP by making such coverage ineligible for the premium tax credit and the change is effective for plan years beginning after December 31, 2025. (See Act Sec. 71304(b))

B. Final Regulations Adopting New Definition of "Coverage Month" – TD 10019 (12/17/2024)

1. The IRS issued final regulations amending the definition of a "coverage month" for the purposes of calculating the Premium Tax Credit (PTC) and plans to revise a related form submitted by health care exchanges.

2. The IRS has issued proposed regulations to modify what a coverage month is in certain instances when the full premium balance remains unpaid by the unextended due date of the taxpayer's return for the applicable coverage year, but enough payments were made (including by using APTCs) to avoid coverage termination. In coordination with the Department of Health and Human Services, the IRS issued the regs to promote reporting consistency among exchanges regarding the reporting of enrollment premiums for non-payment months.

B. Final Regulations Adopting New Definition of "Coverage Month" – TD 10019 (12/17/2024): Con't

3. Under the proposed regs, the modified coverage month definition applies to the first month of a grace period under 45 CFR 156.270(d). The definition also applies to months in which an individual meets the 45 CFR 155.400(g) premium payment threshold. Finally, a coverage month includes months when state insurance departments declare an emergency and prohibit QHP providers from terminating coverage.

4. The final regulations adopt the proposed rules without revision.

B. Final Regulations Adopting New Definition of "Coverage Month" – TD 10019 (12/17/2024): Con't

5. The IRS intends to revise Form 1095-A, *Health Insurance Marketplace Statement*, to reflect the final regs. The instructions will continue to provide that Exchanges must report $0 in column A for any other months for which the full enrollment premium for the month is not paid, and that the amount reported in column A should be reduced by any enrollment premium refunds or credits.

6. In column B of Form 1095-A, exchanges will be instructed to report the second lowest cost silver plan, or SLCSP, premium that would apply if the enrollment premium had been paid in full.

VIII. Earned Income Credit

A. Eligibility Requirements

1. The taxpayers investment income must be less than $11,600 in 2024. (Rev Proc. 2023 – 34)

a. For 2025, the investment income must be less than $11,950. (Rev. Proc. 2024 – 40)

2. The taxpayer must not have filed a Form 2555: Foreign Earned Income or claim any foreign earned income exclusion.

A. Eligibility Requirements: Con't

3. The taxpayer claiming the credit without any qualifying children must be between the ages of 25 and 65. If the taxpayer is claiming jointly without a child, only one spouse needs to meet the age requirement.

4. The taxpayer can still qualify for the credit if they are separated but still married. The taxpayers must not file a joint return and the child must meet the definition of a qualifying child including living with the taxpayer for more than half the year and the taxpayer and your spouse must not have live together during the last 6 months of the year or are subject to a written separation agreement or decree.

B. 2025 EIC Credit

1. For the 2025 tax year (taxes filed in 2065), the earned income credit will range from $649 to $8,046, depending on your filing status and how many children you have. Below are the maximum 2025 earned income tax credit amounts, plus the most you can earn before losing the benefit altogether.

Number of children	Maximum earned income tax credit	Max AGI, single or head of household filers	Max AGI, married joint filers
0	$648	$19,104	$26,214
1	$4,328	$50,434	$57,554
2	$7,152	$57,310	$64,430
3 or more	$8,490	$61,555	$68,675

C. 2026 EIC Credit

Number of children	Maximum earned income tax credit	Max AGI, single or head of household filers	Max AGI, married joint filers
0	$664	$19,540	$26,820
1	$4,427	$51,459	$58,863
2	$7,316	$58,629	$65,899
3 or more	$8,231	$62,974	$70,224

D. Documentation

- 1. Part of the requirement to clean the earned income credit is provide documentary evidence of residency status and if necessary permanent disability status. Qualified relative status also comes into play.
    - **Example**
- **Graham v. Comm., TC Memo 2025 – 116**. Married couple claim the earned income tax credit for disabled relative. The relative was the spouse's sister. The taxpayers testified that the sister had suffered a stroke leaving her unable to care for herself. The sister did not file a tax return for the year in question. The IRS rejected the claim indicating that the sister was not a qualified relative for purposes of the credit. Under the code for the credit an individual meets the age requirement if he or she has not reached the age of 19 at the end of the year or is a student under age 24. Section 152 (c) (3) (B) exempts permanent and total disability from the age limitation. Individual is deemed permanently and totally disabled if they are unable to engage in any substantial gainful activity by reason of any medically determined physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. There was no substantiation to support the relationship and the disability. There was no medical evidence submitted as far as the disability. As such the credit was denied

IX. Energy Efficient Home Improvement Credit

A. New! – Elimination of Energy Efficient Home Improvement Credit

1. Prior to the One Big Beautiful Bill, taxpayers were eligible for a credit equal to 30% of expenditures on energy efficient home improvements.

2. Energy efficient home improvement expenditures include qualified energy efficiency improvements, residential energy property expenditures, and home energy audits. The credit was limited to $1,200 and was available for property placed in service through December 31, 2032.

3. The Act amends IRC Section 25 C (h) to eliminate this credit for property placed in service after December 31, 2025. (See Act Sec. 70505(a))

X. Energy Efficient Home Improvement Credit

A. New! – Elimination of Energy Efficient Home Improvement Credit

1. Prior to the One Big Beautiful Bill, taxpayers were eligible for a credit equal to 30% of expenditures on energy efficient home improvements.

2. Energy efficient home improvement expenditures include qualified energy efficiency improvements, residential energy property expenditures, and home energy audits. The credit was limited to $1,200 and was available for property placed in service through December 31, 2032.

3. The Act amends IRC Section 25 C (h) to eliminate this credit for property placed in service after December 31, 2025. (See Act Sec. 70505(a))

XI. Residential Clean Home Improvement Expenditures Credit

A. New! – Elimination of Residential Clean Home Improvement Expenditures Credit

1. Prior to the One Big Beautiful Bill Act, taxpayers were eligible for a credit for residential clean energy credit for expenditures.

2. Residential clean energy expenditures included expenditures for qualified solar electric property, qualified solar water heating property, qualified fuel cell property, qualified small wind energy property, qualified geothermal heat pump property, and qualified battery storage technology.

A. New! – Elimination of Residential Clean Home Improvement Expenditures Credit: Con't

3. For property placed in service after December 31, 2021, and before January 1, 2033, the credit was for 30 percent of the expenditures.

4. The Act amends IRC Section 25 D (h) to terminate the residential clean energy expenditures credit for any expenditures after December 31, 2025. (See Act Sec. 70506(a))

XII. Clean Vehicle Credit

A. New! – Elimination of Previously Owned Clean Vehicles Credit

1. IRC Section 25 E provides a credit for a "qualified buyer" of a used clean vehicle. The credit amount is the lesser of $4,000 or 30% of the vehicle sale price.

2. The credit is subject to an income cap and a number of other limits and requirements, including that the vehicle model year be at least two years earlier than the calendar year in which the taxpayer acquires the vehicle, the sale price must not exceed $25,000, the seller must be a dealer, a "first transfer" rule must be met, and the taxpayer must purchase the vehicle for use, not resale.

A. New! – Elimination of Previously Owned Clean Vehicles Credit: Con't

3. Previously, the credit was set to terminate for vehicles acquired after 2032.

4. The Act significantly changes this and accelerates the termination date to vehicles acquired after September 30, 2025. This provision is effective as of the date of enactment of The Act. (See Act Sec. 70501 amends IRC Section 25 E (g)).

B. New! – Elimination of the Clean Vehicle Credit

1. Section 30 D, as modified by the Inflation Reduction Act of 2022, provides a credit for each new clean vehicle a taxpayer places in service in a tax year. The credit is subject to a host of requirements and limits, including the critical mineral and battery component requirements for vehicles placed in service after April 17, 2023.

2. The critical mineral and battery component requirements are aimed at incentivizing domestic manufacturing and the use of supply chains in the U.S., or with countries with which the U.S. has trusted trade agreements.

B. New! – Elimination of the Clean Vehicle Credit: Con't

3. An "applicable percentage" of the value of the critical minerals of the vehicle's battery must be extracted or processed in the U.S. or in any country with which the U.S. has a free trade agreement or recycled in North America. And an applicable percentage of the battery's components must be manufactured or assembled in North America. The applicable percentages were set at annually increasing percentages.

4. The credit was to terminate for vehicles placed in service after 2032.

B. New! – Elimination of the Clean Vehicle Credit: Con't

5. The Act significantly accelerates and changes the parameter for termination, such that **the credit now terminates for vehicles acquired after September 30, 2025**

6. Placed in service for purposes of this means the date the taxpayer takes delivery of the vehicle delivery.

B. New! – Elimination of the Clean Vehicle Credit: Con't

7. The outstanding issue is whether a client acquires the vehicle before September 30, 2025, but does not take possession of the vehicle, meaning it is not placed in service until 2026. It is uncertain as to whether the taxpayer will be able to claim the credit for 2025.

8. This provision is effective as of the date of the enactment of The Act. (See Act Sec. 70502 amends IRC Section 30 D (h), 30D(e)).

XIII. Foreign Tax Credit

A. Qualifying Foreign Taxes

1. A taxpayer can claim a foreign tax credit in association with foreign taxes imposed by a foreign country or US possession. Generally only income, war profits and excess profits qualify for the credit.

2. Taken as a deduction, for income taxes reduces US taxable income. Foreign taxes that are deducted or on Schedule A.

3. Any foreign earned income or foreign housing cost exclusion does not allow the taxpayer to take a foreign tax credit on the income so excluded.

A. Qualifying Foreign Taxes: Con't

4. The credit is claimed on Form 1116: Foreign Tax Credit. Likewise, corporations can claim the credit on Form 1118.

5. There is a special 10 year statute of limitations that applies to foreign taxes paid or accrued to any country or any possession of the US in which the credit is allowed against the tax. The 10 year timeframe begins from the date for the filing of the return for the year in which the taxes were actually paid or accrued. (Section 6511 (a)). The 10 year statute of limitations also applies to refund claims.

Example

Polk v US , US Fed Court of Claims No. 1:22 – CB – 00896 (8/18/2023). The taxpayers had not filed their 2008 tax return. In 2010 the IRS filed a substituted return resulting in an assessment of taxes in the amount of $156,796. The IRS took payments from refunds to the taxpayer subsequently filed returns. The taxpayers filed a claim for refund but the claim was made more than three years after the due date of the return and more than two years after the payment of taxes.

Example: Con't

Part of the amount due was from a foreign tax credit that was previously disallowed by the IRS under the general statute of limitations. The IRS erred in because there is a special period of limitation regarding foreign taxes paid or accrued. If the claim for credit or refund relates to an overpayment attributable to foreign taxes paid or accrued the statute of limitations is 10 years from the due date for the filing of the return for the tax year in which the four taxes were in fact paid or accrued.

SECTION X: ESTATES, GIFTS AND TRUSTS

I. Estate Tax Update

A. New! – One Big Beautiful Bill Act

1. Prior to the One Big Beautiful Bill, the basic exclusion amount was to revert to $5 million adjusted for inflation after December 31, 2025. Presently, the exclusion is 13.9 million per person for 2025. (

2. Effective 2026, the basic exclusion amount will increase to $15 million per person

3. The basic exclusion amount is adjusted for inflation after 2025.

4. This provision is effective for estates of decedents dying and gifts made after December 31, 2025. (See Act Sec. 70106(b))

B. Estate Tax Exclusion Amount

1. For 2025, the estate exclusion will be $13,990,000. (Rev. Proc. 2024 – 40)

2. For 2026, the estate exclusion will be $15 million (Rev. Proc. 2025 – 32)

C. Interest on Certain Portion of the Estate Tax Payable in Installments

1. For 2025, the dollar amount used to determine the portion will be $1,900,000. (Rev. Proc. 2024-40)

2. For 2026, the dollar amount used to determine the portion will be $1.95 million (Rev. Proc. 2025 – 32)

D. Valuation of Qualified Real Property in Decedent's Gross Estate – Section 2032 A

1. For an estate of a decedent dying in 2025, the executor can elect to use special use valuation method under Section 2032A for qualified real property. The aggregate decrease in the value of said real property resulting from the election cannot exceed $1,420,000. (Rev. Proc. 2024-40)

2. For an estate of a decedent dying in 2024, the executor can elect to use special use valuation method under Section 2032A for qualified real property. The aggregate decrease in the value of said real property resulting from the election cannot exceed $1,460,000. (Rev. Proc. 2025 – 32)

E. Deceased Spouse Unused Exemption (DSUE)

1. The surviving spouse may utilize the DSUE in addition to their own exemption amount. The deceased spouse's estate must make an election to have the portability provisions apply. Executors intending to make the election must timely file a complete and properly prepared Form 706, including extensions, irrespective of whether or not the gross estate has a value in excess of the exclusion amount or is otherwise not obligated to file Form 706.

2. A complete and properly prepared Form 706 includes filling out the section designated to determine whether or not the portability feature has been elected as well as the calculation of the DSUE.

E. Deceased Spouse Unused Exemption (DSUE): Con't

3. For purposes of electing the portability, Form 706 is considered complete and properly prepared if the return is prepared in accordance with the instructions for the Estate Tax Return.

4. It should be noted the value of the marital deduction property and show reduction property is not required to be reported. However, executors must include the description, ownership, and the beneficiary of marital or charitable deduction property along with all other information necessary to establish the right of the state to such deductions.

E. Deceased Spouse Unused Exemption (DSUE): Con't

5. The value of marital deduction property or charitable deduction property is required if:

- The value of such property relates to, is affected by, or is needed to determine the value passing from the decedent to another recipient;
- The value of such property is needed to determine the estate's eligibility for the provisions of Sections 2032,2032A or another provision;
- Less than the entire value of an interest in property includible in the decedent's gross estate is marital deduction property charitable deduction property; or
- A partial disclaimer or partial qualified terminable interest property election is made with respect to a bequest, devise, or transfer of property includible in the gross estate, part of which is marital deduction property or charitable deduction property.

F. IRS Provides Simplified Method for Extending Portability Election - Rev Proc 2022-32, 2022-30 IRB

1. The IRS has released a procedure that provides a new, simplified method for obtaining an extension of time to make a "portability" election. A portability election allows a surviving spouse to apply a deceased spouse's unused exclusion (DSUE) amount to their own transfers during life or at death.

2. The new procedure provides a new simplified method for certain estates to use to obtain an extension of time to elect portability of a DSUE amount. The procedure applies to estates that are not normally required to file an estate tax return because the value of the gross estate and adjusted taxable gifts is under the filing threshold and the decedent has a surviving spouse.

F. IRS Provides Simplified Method for Extending Portability Election - Rev Proc 2022-32, 2022-30 IRB: Con't

3. Under the new procedure, an extension request must be made on or before the fifth anniversary of the decedent's death. This simplified method, which doesn't require a user fee, should be used in lieu of the letter ruling process.

4. In 2017, the IRS published Rev Proc 2017-34, 2017-26 IRB 1282, which provided a simplified method for obtaining an extension of time to make a portability election for an estate wasn't required to file an estate tax return and the decedent had a surviving spouse. This procedure was to be used in lieu of the letter ruling process and was available up to the second anniversary of the decedent's date of death.

F. IRS Provides Simplified Method for Extending Portability Election - Rev Proc 2022-32, 2022-30 IRB: Con't

5. Since the publication of Rev Proc 2017-34, the IRS issued numerous letter rulings granting an extension of time to elect portability in situations in which the decedent's estate was not required to file an estate tax return and the time for obtaining relief under the simplified method had expired. According to the IRS, these requests place a significant burden on the IRS's resources. Therefore, the new procedure supersedes Rev Proc 2017-34.

6. Rev Proc 2022-32 is effective July 8, 2022, and it is the exclusive method for obtaining an extension of time for estates.

G. IRS Provides Simplified Method for Extending Portability Election - Rev Proc 2022-32, 2022-30 IRB

a. The IRS has released a procedure that provides a new, simplified method for obtaining an extension of time to make a "portability" election. A portability election allows a surviving spouse to apply a deceased spouse's unused exclusion (DSUE) amount to their own transfers during life or at death.

b. The new procedure provides a new simplified method for certain estates to use to obtain an extension of time to elect portability of a DSUE amount. The procedure applies to estates that are not normally required to file an estate tax return because the value of the gross estate and adjusted taxable gifts is under the filing threshold and the decedent has a surviving spouse.

G. IRS Provides Simplified Method for Extending Portability Election - Rev Proc 2022-32, 2022-30 IRB : Con't

c. Under the new procedure, an extension request must be made on or before the fifth anniversary of the decedent's death. This simplified method, which doesn't require a user fee, should be used in lieu of the letter ruling process.

4. In 2017, the IRS published Rev Proc 2017-34, 2017-26 IRB 1282, which provided a simplified method for obtaining an extension of time to make a portability election for an estate wasn't required to file an estate tax return and the decedent had a surviving spouse. This procedure was to be used in lieu of the letter ruling process and was available up to the second anniversary of the decedent's date of death.

G. IRS Provides Simplified Method for Extending Portability Election - Rev Proc 2022-32, 2022-30 IRB : Con't

5. Since the publication of Rev Proc 2017-34, the IRS issued numerous letter rulings granting an extension of time to elect portability in situations in which the decedent's estate was not required to file an estate tax return and the time for obtaining relief under the simplified method had expired. According to the IRS, these requests place a significant burden on the IRS's resources. Therefore, the new procedure supersedes Rev Proc 2017-34.

G. IRS Provides Simplified Method for Extending Portability Election - Rev Proc 2022-32, 2022-30 IRB : Con't

6. Rev Proc 2022-32 is effective July 8, 2022, and it is the exclusive method for obtaining an extension of time for estates.

7. The IRS has issued interim and final proposed regulations lowering the user fee to issue an estate tax closing letter from $67.02 $56. (TD 10031 and Reg – 107459 – 24). The service reiterates that estate tax closing letter is not a formal closing arrangement.

H. Consistent Basis Reporting Final Regulations Issued -TD 9991

1. The final regulations adopt most of the provisions from the proposed regulations, with two important changes. First, the proposed regulations provided that if no estate tax return is filed, or if a decedent's property is not reported on a filed return before the period of limitations on assessment expires, the final value of that property is zero, the so-called "zero basis rule".

H. Consistent Basis Reporting Final Regulations Issued -TD 9991: Con't

2. The IRS recognized that such a rule primarily impacts the recipients of unreported property, who may have had no knowledge of or involvement in the failure to report the property for Federal estate tax purposes, but, nevertheless, have an increased tax burden under the rule. As such, the final regulations do not include the zero basis rule. Instead, the final regulations clarify that the consistent basis requirement applies only to included property, a term that is defined to refer to property, the value of which is included in the value of the decedent's gross estate.

H. Consistent Basis Reporting Final Regulations Issued -TD 9991: Con't

3. The second change from the proposed regulations is the removal of the obligation of most transferees of property subject to the consistent basis rule to file additional Forms 8971 if they, in turn, transfer the property subject to this rule. This subsequent filing rule will now apply only to trustees who transfer property subject to the consistent basis rule.

H. Consistent Basis Reporting Final Regulations Issued -TD 9991: Con't

4. The final regulations clarify the definition of "Final Value." "Final value" is defined as:

- the value reported on the federal estate tax return once the period of limitations on assessment has expired without that value being adjusted by the IRS;
- the value determined by the IRS once that value can no longer be contested by the estate;
- the value determined in an agreement binding on all parties; or
- the value determined by a court once the court's determination is final.

H. Consistent Basis Reporting Final Regulations Issued -TD 9991: Con't

4. An executor is required to file Form 8971 (the Information Return) and all required Statements. In general, the Information Return and Statements are due to the IRS and beneficiaries on or before the earlier of 30 days after the due date of the estate tax return or the date that is 30 days after the date on which the estate tax return is filed with the IRS.

H. Consistent Basis Reporting Final Regulations Issued -TD 9991: Con't

5. If a beneficiary acquires property after the due date of the estate tax return, the Statement must be furnished to the beneficiary by January 31 of the year following the acquisition of that property. Also, by January 31, the executor must attach a copy of the Statement to a supplement to the Information Return. An executor has the option of furnishing a Statement before the acquisition of property by a beneficiary.

6. Executors have a duty to supplement the Information Return or Statements upon the receipt, discovery, or acquisition of information that causes the information to be incorrect or incomplete.

H. Consistent Basis Reporting Final Regulations Issued -TD 9991: Con't

7. Penalties may be imposed for filing an incorrect Information Return, and for filing incorrect Statements. In addition, an accuracy-related penalty can be imposed on the portion of the underpayment of tax relating to property subject to the consistent basis requirement that is attributable to an inconsistent basis.

H. Consistent Basis Reporting Final Regulations Issued -TD 9991: Con't

8. The final regulations apply to estate tax return is filed after September 17, 2024 and must file must file Form 8971, *Information Regarding Beneficiaries Acquiring Property From a Decedent.*

9. The final regulations eliminated the requirement that beneficiaries take zero basis in assets not reported on a Form 706, *United States Estate (and Generation–Skipping Transfer) Tax Return*, prior to the expiration of the statute of limitation.

H. Consistent Basis Reporting Final Regulations Issued -TD 9991: Con't

10. The final regulations clarified that executors are required to report assets on Schedule A only when such assets are "acquired" by the beneficiary. Assets acquired on or before the Form 706 is filed must be reported by the 30–day deadline, whereas assets acquired after the Form 706 is filed should be reported by Jan. 31 following the year of acquisition. Importantly, the final regulations define an asset as being "acquired" by a beneficiary when title vests in the beneficiary or when the beneficiary otherwise has sufficient control over the asset, thus removing the executor's need to report all assets the beneficiary "may" receive.

11. Individual beneficiaries are not required to report subsequent transfers of inherited assets.

I. Final Regulations on GST Exemption

1. The service has issued final regulations provide guidance on when and how taxpayers contain an extension of time to make certain GST exempt allocations and elections under Section 2642 (g) (1).

2. As a result of the final regulations relief under this code section will no longer be granted on or after May 6, 2024. However, private letter ruling relief will still be granted.

3. The final regulation removed a proposal that would prohibit relief to revoke a prior GST election.. The final regulation would allow relief to revoke a GST election if it was erroneous in nature.

I. Final Regulations on GST Exemption: Con't

4. The final relations provide additional details relate to affidavits when requesting Private Letter Ruling for GST purposes.

5. To receive relief the taxpayer must show that acted reasonably and in good faith and that they are not attempting to benefit from hindsight and that it would not prejudice the interest the government if relief were granted.

J. Life Insurance Proceeds

1. Section 2031 (Definition of Gross Estate) and 2033 (Property in which the Decedent Had An Interest) are often examined with respect to the inclusion or exclusion of life insurance proceeds from a decedent's Gross estate.

2. Generally, insurance proceeds from a life insurance policy are not included in the gross estate because the step up transaction doctrine does not apply.

Example

Estate of Becker V. Comm., TC Memo 2024 – 89. The Decedent created an irrevocable life insurance trust (ILIT) that held two policies on his life. The trust was both the owner and the beneficiaries of the policies. At no point did the decedent possess any incidents of ownership in either policies. The trust paid the premium by borrowing money from the decedent. The decedent then borrowed from an insurance broker and the broker in turn borrowed from a third party. That third-party was repaid by the broker. For 30 months the trust pay premiums on the life insurance policy using the loan proceeds.

Example: Con't

The decedent assigned the trust repayment obligation to the broker which satisfied the loan. The broker transferred the promissory notes from the trust to an LLC which the broker owns 100% of the LLC. The broker had the LLC transfer the notes to a second LLC the trust later entered to the agreement with a third LLC under which that LLC agreed to pay future premium payments on the policies owned by the trust in exchange for 75% of the total death benefit. The decedent died and the insurer paid the full death benefit on the policies to the trust.

Example: Con't

The IRS argued that the policy should be included in Becker's estate because the step transaction doctrine applied to the payment structure and all the transaction should collapse because the estate had a cause of action to recover the proceeds under state law. The Tax Court disagreed and held the transaction should not be collapsed for determining whether the step transaction doctrine should apply. The court found that the step transaction doctrine did not apply because the transaction was not a series of formally separate steps that were parts of a single transaction intended from the outset to reach the ultimate result.

K. Transfers with Retained Life Estate – Section 2036

1. The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death:

- the possession or enjoyment of, or the right to the income from, the property, or
- the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Example

Estate of Fields v. Comm., TC Memo 2024 – 90. Property transferred to a family limited partnership caused the estate tax exclusion under Section 2036 (a) (1) and (2) at the date of death fair market value of assets transferred to the partnership because the decedent retained rights and interests in the assets until her death and the transfers were not made via bona fide sales. The decedent contributed $17 million of assets into a limited partnership of which she held a 99.99% limited partnership interest.

Example: Con't

The transfer was completed by her great-nephew who held the general partnership interest through his LLC shortly before the decedent's death. The nephew used a power of attorney to transfer the assets to the limited partnership. Upon the decedent's death, the nephew reported a discounted value of the partnership of $10.8 million. The discounts were for lack of marketability and control with respect to her 99.99% limited partnership interest that she held at the time of her death.

Example: Con't

The IRS disputed the discount. The tax Court indicated that the decedent retained economic benefits at the time of her death. The nephew acting under the power the attorney had authority to distribute income from the partnership for her benefit. The Tax Court also noted that the decedent had retained the same control enjoyment of the assets both before and after the transfer to the partnership as such the full value of the transferred asset should be included in her estate under Section 2036 (a).

J. Claims Against the Estate – Section 2053

1. Payments a decedent makes to relatives where the payments are required also to be made under a prenuptial agreement are not deductible claims against the estate.

Example

Estate of Spizzirri v. Comm., No. 23 – 14049 (11th Cir. May 16, 2025). The 11th circuit Court of Appeals affirmed the Tax Court decision that payments by a Decedent's estate made pursuant to a premarital agreement to the surviving spouse's children from a prior marriage were not deductible as claims against the estate. The Decedent entered into a prenuptial agreement with his fourth wife whereby the agreement required the Decedent's estate to pay $6 million to the wife and $3 million to her three children from a prior marriage upon his death.

Example: Con't

Upon the Decedent's death, his estate paid the stepchildren and claimed a deduction against the estate under Section 2053. The IRS disallowed the deduction. The appellate court indicated that the payment to the stepchildren were not deductible they were not contracted for and there was no bona fide adequate and full consideration in money or money's worth for the agreement. This is a requirement under Section 2053.

K. Q-tip Election

1. What happens when the Q-tip election is missed?

Example

Estate of Griffin v. Comm., TC Memo 2025 – 47. The Decedent created a revocable trust and had subsequently created an irrevocable trust for the benefit of his wife. The revocable trust provided for a distribution of $2 million to the irrevocable trust and the trustee was required to pay the wife a monthly distribution to be determined between the wife and the trustee with an amount not to exceed $9000 monthly. The revocable trust provided a second distribution of $300,000 to the irrevocable trust to be held as living expenses reserve for the wife and for the trustee to distribute $60,000 a year up to 60 months.

Example: Con't

Any undistributed amounts would go into the wife's estate. The $300,000 bequest was to be paid out of the irrevocable trust at a rate of $5000 per month until the wife's death in the remainder will pass to her estate. The irrevocable trust stated that no beneficiary should be able to appoint any part of the trust to the beneficiary, the beneficiary's estate, beneficiary creditors or to the creditors of the beneficiaries the estate. The husband (Decedent) died the executor filed a timely Form 706 but did not list any property of the estate as Q-tip.

Example: Con't

Schedule and indicated that all other property included in the specific bequest of 2.3 million was to go to the surviving wife. The IRS maintained that the bequests were not eligible for the marital deduction. The Tax Court determined that the $2 million bequest was a terminal interest and therefore includable in the decedent's estate the estate did not make a valid Q-tip Election. The Tax Court noted that a terminal interest does not qualify for the marital deduction exception unless the Q-tip Election is made.

Example: Con't

The Court Determined $ 300,000 are bequest was not a terminal interest under state law because the decedent intended the bequest to create a separate trust. The language of the trust reference living expense reserve and the distribution provision to the wife's estate upon her death conflicted with the terms of the irrevocable trust allows the Court to hold that the decedent's intent was to create a legally distinct trust and that that distribution did not contain a terminal interest.

II. Gift Tax Update

A. Exclusion Amounts

1. For 2025, the gift tax exclusion will be $19,000. (See Rev. Proc. 2024 – 40)

2. For gifts made in 2025, exclusion for gifts to non-citizen spouses will be $190,000. (See Rev. Proc. 2024 – 40)

3. Update! – OBBBA references an increase in the gift tax exclusion but does not provide a base amount. It does reference the estate exclusion going to $15 million in 2026. A previous proposal had an increase to $50,000 that does not appear to be in the bill at the house past.

B. IRS Releases Final Regulations Regarding Imposition of Tax on Certain Gifts and Bequests from Covered Ex-patriots under Section 2801

1. The IRS issued final regulations on the Sec. 2801 inheritance tax on a U.S. person's receipt of a covered gift or bequest from a covered expatriate. Section 2801 inheritance tax acts as a backstop to the estate tax, gift, and GST taxes where they could be avoided through expatriation.

2. The final regulations provide that the tax is imposed on U.S. citizens, U.S. residents, domestic trusts, and electing foreign trusts that directly or indirectly receive gifts or bequests from covered expatriates on or after January 1, 2025. The rate of the inheritance tax is a flat tax equal to the highest estate tax rate in effect at the time of receipt, currently 40%, of the total value of the gift or bequest. The recipient of the gift, not the donor, is required to pay the tax.

B. IRS Releases Final Regulations Regarding Imposition of Tax on Certain Gifts and Bequests from Covered Ex-patriots under Section 2801: Con't

3. As a result, the Section 2801 inheritance tax could surpass the transfer tax the donor would have owed as a U.S. resident, since there is no lifetime exemption.

4. Under the final regulations, a "covered expatriate" has the same meaning as it does for purposes of the exit tax under Section 877A. The regulations create a rebuttable presumption that every gift or bequest received by a U.S. recipient from a foreign person is subject to the Section 2801 inheritance tax unless the living donor of the gift or the decedent's estate authorizes the IRS to disclose the donor's relevant information to the U.S. recipient.

B. IRS Releases Final Regulations Regarding Imposition of Tax on Certain Gifts and Bequests from Covered Ex-patriots under Section 2801: Con't

5. The IRS will provide further guidance on how to request information on the donor's covered expatriate status and how to authorize such disclosure to the U.S. recipient. It is important for individuals who receive gifts or bequests from foreign persons to understand the donor's past status as a U.S. citizen or long–term permanent resident.

6. A "covered gift or bequest" is defined in the final regulations as any property acquired from a covered expatriate, regardless of the situs of the property or whether the property was acquired by the covered expatriate before or after expatriation. However, several types of gifts and bequests are not covered by the inheritance tax:

B. IRS Releases Final Regulations Regarding Imposition of Tax on Certain Gifts and Bequests from Covered Ex-patriots under Section 2801: Con't

- Prior reported gifts on Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, or Form 709-NA, United States Gift (and Generation-Skipping Transfer) Tax Return of Nonresident Not a Citizen of the United States;

- Property subject to estate tax reported on a timely filed Form 706; Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of Nonresident Not a Citizen of the United States; or Form 706-QDT, U.S. Estate Tax Return for Qualified Domestic Trusts;

B. IRS Releases Final Regulations Regarding Imposition of Tax on Certain Gifts and Bequests from Covered Ex-patriots under Section 2801: Con't

- Covered bequest previously subject to the Section 2801 tax as a covered gift;
- Qualified disclaimers;
- Transfers eligible for a charitable deduction under Section 2522 or 2055;
- Transfers to a spouse that qualify for the marital deduction under Section 2523 or 2056, these gifts are only available to transfers to U.S. citizen spouses, but certain transfers to a qualified domestic trust may qualify for the marital deduction and be exempt from the Sec. 2801 inheritance tax.

B. IRS Releases Final Regulations Regarding Imposition of Tax on Certain Gifts and Bequests from Covered Ex-patriots under Section 2801: Con't

7. U.S. recipients will report gifts and inheritances from a covered expatriate on Form 708, United States Return of Tax for Gifts and Bequests Received From Covered Expatriates. As of this writing, the IRS had not yet published the final Form 708. The final regulations permit taxpayers who reasonably conclude that a gift or bequest is not subject to Sec. 2801 to file a protective Form 708 to start the period of limitation for the assessment of any inheritance tax.

B. IRS Releases Final Regulations Regarding Imposition of Tax on Certain Gifts and Bequests from Covered Ex-patriots under Section 2801: Con't

8. The final regulations are not retroactive, as they specifically apply to covered gifts and bequests from a covered expatriate received by the U.S. person on or after Jan. 1, 2025. Importantly, planners should be cautious of transfers initiated before Jan. 1, 2025, that eventually become completed gifts on or after this date or remain included in a covered expatriate's estate, as these transfers may result in a Sec. 2801 inheritance tax.

C. Intra-Family Notes – Gift or Loan Example

Estate of Galli v. Comm., TC Nos. 7003 – 20 and 7005 – 20 (March 5, 2025). The Decedent loaned $2.3 million to her son. The terms of the loan provided for a nine year loan term with interest at the applicable federal rate of 1.01% payable annually and with repayment of the principal due at the end of nine years. The sun made annual payments of interest for three years until the decedent died. The decedent did not file a gift tax return relating to the no and left a taxable estate that include the repayment obligation under the note. The IRS argued the fair market value the note was higher than the estate had reported at the time of her death and that the excess was a gift not a loan.

C. Intra-Family Notes – Gift or Loan Example: Con't

The IRS argued the note did not create a legally enforceable right in the Decedent to seek repayment from the sun and that the Decedent had failed to show that her son had the ability to repay the loan or whether there was an intent to repay. The Tax Court determine the estate had provided sufficient evidence to classify the note as a loan and not a gift. The note was signed by both parties and it included adequate interest at the applicable federal rate, it specified a repayment date and the sun had actually made annual interest payments for several years.

III. Trust Update

A. Proposed Regulations Updating QDOT – Reg 119683 – 22

1. The proposed regulations primarily affect estates of decedents that pass property to or for the benefit of a non-US citizen.

2. Currently the regulations contain a requirement that the fair market value of the assets passing to the trust are *finally determined* for federal tax purposes. The definition of *finally determined* depends on the IRS issuing an estate closing letter. Since the IRS no longer routinely issues estate closing letters proposed regulation updates the definition of *finally determined* to conform with the current IRS procedures.

A. Proposed Regulations Updating QDOT – Reg 119683 – 22: Con't

3. In addition, the regulations require the trust with assets of more than $2 million to satisfy one of three alternative security arrangements for paying the estate tax. The regulation previously directed the trust to specify offices and addresses for submitting notifications to the IRS if the security arrangement was not replaced or renewed. The regulations require taxpayers to file an agreement to pay Section 2056 A estate tax with the district director and a Agreement to rollover annuity payments as possibly required. Since these offices no longer exist the proposed reg removes the reference to those offices and directs taxpayers to follow IRS publication 4235: Collection Advisory Office Contact information. The proposed reg would also removed the requirement to attach the security instrument to the federal estate tax return.

B. Income Tax Considerations when Terminating Trust Early – LTR 202509010

1. In Letter Ruling 202509010, the Service has determined that while the termination of a trust did not have any negative gift or generation-skipping transfer tax consequences, there are unfavorable income tax consequences. Specifically, taxable gain to the holder of a lifetime beneficial interest in a trust.

2. The trust paid out an annual annuity to the settlers grandchild and that was the only current distribution permitted during the taxpayer's lifetime. Upon the death of the taxpayer, the annuity was to be divided per stirpes among the grandchildren's descendants, the grandchild's two adult children and four great-grandchildren received the division. The trust would terminate upon the last of the 10 individuals specified in the trust to die.

B. Income Tax Considerations when Terminating Trust Early – LTR 202509010: Con't

3. An agreement among the parties was entered to terminate the trust contingent upon receiving a favorable letter ruling from the IRS and upon termination, the remaining trust property would be distributed according to the actuarial value of each individual's beneficial interest.

B. Income Tax Considerations when Terminating Trust Early – LTR 202509010: Con't

4. The Service found the termination proposed distribution did not cause beneficial interest to be shifted to another beneficiary in a lower generation than the beneficiaries who held the interest part of the transaction. The Service also found that assuming the actuarial value was an accurate representation of each beneficiary's beneficial interest in the trust, the beneficial interest, rights and expectancies of the beneficiaries will be substantially the same both before and after the proposed termination and distribution. As such no beneficiaries were to have made a taxable gift.

B. Income Tax Considerations when Terminating Trust Early – LTR 202509010: Con't

5. However, the service applied the substance over form doctrine and found that the actuarial values were used to determine the distributions of the trust upon termination and that in essence was a sale to the beneficiaries in exchange for other beneficial interest. There was no step up in basis allowed.