2025 – 2026

TAX PLANNING GUIDE

Year-round strategies to make the tax laws work for you

Wertz & Company LLP

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CORE VALUES

Wertz & Company

01 STRIVE TO DO GOOD.

Doing good work is at the heart of Wertz & Company, it's what we do and what we are known for. Taking action and making good happen outside our walls is what we strive for. We always do our best, try our hardest and make the most of what we have.

02 DELIVER ON YOUR WORD.

We do what we say we're going to do, and we accomplish it when we say we're going to. We don't just deliver the expected, we aim to go above and beyond for our clients, continuing to build on the relationship of trust.

03 SAVOR THE MOMENT.

Life is composed of small moments that frame the bigger life moments. Cherish each one and live each day to the fullest. Embrace the good, the bad and the ugly, so that you will continue to grow in joy and wisdom, gain knowledge and build up those around you.

04 ACCEPT LIKE FAMILY.

We strive to welcome every person who walks through our doors or our inbox into our family culture. Embracing, trusting, encouraging and challenging one another to be the best version of who we are. It is important to take care and look out for our fellow colleagues as well as our clients.

05 CREATE A FOUNDATION OF TRUST.

We work hard to make sure each client and colleague feels respected, valued, heard and confident in their partnership with us. We put our clients first, always asking, *is this the best thing for the client*? We build in the equity of trust, engaging in conversation and confidentiality.

06 BALANCE WORK AND PLAY.

We value time here at Wertz & Company. It is of the utmost importance that each person knows how to work hard *and* enjoy the fruits of their labor. We try to live our best life, be grateful for what we have, be present and make time for others.

07 TEACH AND LEARN FROM OTHERS.

We know we do not have all the answers. Yet we believe knowledge is power, so when we don't know the answer, we find out and learn how to fix it. We value the interests and knowledge of others who are experts in their field and we aren't afraid to ask for help.

08 BE GENEROUS.

We strive to be generous with our resources as well as with our time. Our actions speak louder than words and we desire to be known for our generosity towards others and live lives that reflect our joy in giving and serving.

2025 brings more tax planning certainty for higher-income taxpayers

On July 4, the legislation commonly known as the One Big Beautiful Bill Act (OBBBA) was signed into law. It makes permanent many provisions of the Tax Cuts and Jobs Act (TCJA) that help reduce tax liability and had been scheduled to expire Dec. 31, 2025, such as lower individual tax rates and higher gift and estate tax exemptions. But it also makes permanent the reduction or elimination of certain breaks that had been scheduled to resume after 2025.

That's not all: The OBBBA introduces some new tax breaks (though many are subject to income-based phaseouts that will reduce or eliminate the benefit for higher-income taxpayers) and enhances some existing breaks. However, it terminates many tax breaks related to clean energy.

Minimizing taxes is a critical challenge for higher-income taxpayers subject to higher tax rates and certain additional taxes, as well as to tax-break phaseouts. To meet this challenge, you need to know how the OBBBA will affect your specific situation. Then you need to closely monitor your income as the year progresses and be aware of all of the tax breaks for which you are, in fact, eligible. Finally, you have to implement strategies that allow you to take maximum advantage of the tax savings opportunities available to you while staying in compliance with tax law.

This guide provides an overview of some of the key tax provisions higher-income taxpayers need to be aware of. It offers a variety of strategies for minimizing your taxes in the current tax environment. Use it to identify the best ones for your particular situation with your tax advisor, who also can keep you apprised of any new tax law developments that might affect you.

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The latest tax provisions may affect your timing strategies and more

The OBBBA makes permanent certain TCJA changes to tax deductions and the alternative minimum tax (AMT), as well as making other changes to them. Some of these OBBBA provisions will be beneficial to many higher-income taxpayers, while others generally won't be. To maximize your tax savings, familiarize yourself with the OBBBA provisions that affect you as well as tried-and-true strategies for reducing taxes, such as timing income, deductible expenses and more to your tax advantage.

Timing income and expenses

Smart timing of income and expenses can reduce your tax liability, and poor timing can unnecessarily increase it. When you don't expect to be subject to the AMT (see page 4) in the current year or the next year, deferring income to the next year and accelerating deductible expenses into the current year may be a good idea. Why? Because it will defer tax, which usually is beneficial.

But when you expect to be in a higher tax bracket next year — or you believe tax rates may rise — the opposite approach may be beneficial: Accelerating income will allow more income to be taxed at your current year's lower rate. And deferring expenses will make the deductions more valuable because deductions save more tax when you're subject to a higher tax rate.

Whatever the reason behind your desire to time income and expenses, you may be able to control the timing of these income items:

- Bonuses,
- Self-employment income,
- U.S. Treasury bill income, and
- Retirement plan distributions, to the extent they won't be subject to early-withdrawal penalties and aren't required. (See page 21.)

Some *expenses* with potentially controllable timing are property tax (see "Increased deduction for SALT" below), investment interest expense (see Case Study 5 on page 11), mortgage interest (see page 12) and charitable contributions (see page 16).

The OBBBA impact on timing strategies

Timing income and deductions was more challenging under the TCJA because some strategies that taxpayers used to implement no longer made sense. The OBBBA makes most of those changes permanent, but it includes at least one change that might make timing strategies more viable again for certain taxpayers. Here's a look at some significant changes that affect deductions:

Increased deduction for SALT. Property tax used to be a popular expense to time. But with the TCJA's $10,000 limit on the state and local tax deduction, property tax timing has provided little, if any, benefit for higher-income taxpayers in recent years. This might change for some taxpayers beginning this year. (See "What's new!" below.)

If you reside in a state with no, or low, income tax, the SALT limit might be less relevant. But keep in mind that deducting sales tax instead of income tax may be beneficial, especially if you purchased a major item, such as a luxury car or boat.

Elimination of most miscellaneous itemized deductions. The OBBBA makes permanent the TCJA's suspension of miscellaneous itemized deductions that had been subject to the 2% of adjusted gross income (AGI) floor. Examples include certain professional fees, investment expenses and unreimbursed employee business expenses.

WHAT'S NEW!

SALT deduction limit increases four-fold

Under the TCJA, your entire itemized deduction for state and local taxes — including property tax and the greater of income or sales tax — has been limited to $10,000 ($5,000 for married couples filing separately). Beginning in 2025, the OBBBA increases the SALT deduction limit to $40,000 ($20,000 for separate filers).

However, when modified adjusted gross income (MAGI) exceeds $500,000 ($250,000 for separate filers), the cap is reduced by 30% of the amount by which MAGI exceeds the threshold — but not below $10,000 ($5,000 for separate filers).

This boosted SALT cap will be a significant tax saver for many higher-income taxpayers in high-tax states. For example, a single taxpayer with $40,000 in SALT expenses who's in the 35% tax bracket but whose income isn't high enough to be subject to the 30% reduction could save an additional $10,500 in taxes.

Taxpayers with less than $40,000 in SALT expenses and with income below the reduction threshold might be able to further reduce their 2025 tax liability by prepaying their 2026 property tax bill (if the tax has been assessed) in 2025.

Both the SALT cap and the threshold will increase 1% annually through 2029. However, without further legislation, the $10,000 limit will return in 2030.

This effectively eliminates the home office deduction for employees who work from home (even if your employer has required it), because it's considered an unreimbursed employee business expense. But if you're self-employed, you may still be able to deduct home office expenses. (See page 12.)

Permanently restricted personal casualty and theft loss deduction. The TCJA suspended this itemized deduction except if the loss was due to an event declared a federal disaster by the President. The OBBBA permanently eliminates the deduction other than for the disaster exception. But, beginning in 2026, it expands the disasters eligible for the exception to include certain state-declared disasters.

Personal casualty losses not related to a disaster can be deducted to the extent of any personal casualty gains. Such gains occur if you receive more from insurance or other reimbursements than the cost or adjusted basis of the property.

New overall limit on itemized deductions. Beginning in 2026, the OBBBA will limit the benefit of itemized deductions for taxpayers in the top (37%) bracket. Effectively, their maximum tax benefit will be as if they were in the 35% tax bracket. So a $10,000 deduction will save them $3,500 in taxes rather than $3,700. If you'll be affected, you may want to accelerate deductible expenses into 2025 to maximize their tax benefit before the new limit goes into effect.

Permanently increased standard deduction. The OBBBA makes permanent and, for 2025, slightly increases the TCJA's nearly doubled standard deduction. (See Chart 1 for the 2025 standard deduction amounts.) It will continue to be annually adjusted for inflation after 2025.

This means that some higher-income taxpayers — such as those in low-tax states, who don't have mortgages or who aren't as charitably inclined — will continue to save more tax by claiming the standard deduction, as they have since the higher standard deduction went into effect in 2018. But some taxpayers in higher-tax states who hadn't benefited from itemizing while the $10,000 SALT limit was in place might again save more tax by itemizing. And taxpayers who've benefited from itemizing over the last several years, such as those who make large charitable gifts each year, will likely continue to benefit.

Chart 1
2025 standard deduction

Filing status	Standard deduction[1]
Singles and separate filers	$15,750
Heads of households	$23,625
Joint filers	$31,500

[1] Taxpayers who are age 65 or older or blind can claim an additional standard deduction of $2,000 ($1,600 per spouse if married). For taxpayers both over 65 and blind, the additional deduction is doubled.

Tax breaks for health care

If medical expenses not paid via tax-advantaged accounts or reimbursable by insurance exceed 7.5% of your AGI, you can claim an itemized deduction for the amount exceeding that "floor." This floor can be difficult for higher-income taxpayers to surpass.

Eligible expenses may include health insurance premiums, long-term-care insurance premiums (limits apply), medical and dental services, and prescription drugs. Mileage driven for health care purposes also can be deducted (21 cents per mile for 2025).

Consider whether there are any medical services and purchases you could bunch into alternating years (without risking harm to your health, of course). This could save tax if it would help you exceed the applicable floor and you'd have enough total itemized deductions to benefit from itemizing.

If one spouse has high medical expenses and a lower AGI, filing separately may allow that spouse to exceed the AGI floor and deduct some medical expenses that wouldn't be deductible if the couple filed jointly. ***Warning:*** Because the AMT exemption for separate returns is considerably lower than the exemption for joint returns, filing separately to exceed the floor could trigger the AMT. Also, some tax breaks aren't available to separate filers.

You may be able to save taxes without having to worry about the medical expense deduction floor by contributing to one of these accounts:

HSA. If you're covered by a qualified high-deductible health plan, you can contribute pretax income to an employer-sponsored Health Savings Account — or make deductible contributions to an HSA you set up yourself — up to $4,300 for self-only coverage and $8,550 for family coverage (plus $1,000 if you're age 55 or older) for 2025.

HSAs can bear interest or be invested, growing tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year, allowing the account to grow. After age 65, you can take penalty-free distributions to use for nonmedical expenses, but they'll be taxable.

FSA. You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit — not to exceed $3,300 in 2025. The plan pays or reimburses you for qualified medical expenses. (If you have an HSA, your FSA is limited to funding certain permitted expenses.)

What you don't use by the plan year's end, you generally lose — though your plan might give you a 2½-month grace period to incur expenses to use up the previous year's contribution. Or it might allow you to roll over up to $660 to 2026.

Above-the-line deductions

Whether you claim the standard deduction or itemize, you may also be eligible for some "above-the-line" deductions. They're particularly valuable because they reduce your AGI and, depending on the specific deduction, your modified AGI (MAGI). AGI and MAGI are important because they're the triggers for certain additional taxes and the phaseouts of many tax breaks.

But be aware that just because you don't have to itemize to claim a deduction doesn't mean it's an above-the-line deduction. For example, you don't have to itemize to claim the Sec. 199A QBI deduction for pass-through businesses, but it isn't an above-the-line deduction so it doesn't reduce AGI or MAGI. (See "What's new!" on page 14.)

Examples of above-the-line deductions include deductible IRA contributions (see page 20), HSA contributions if they aren't subtracted pretax from your paycheck (see "HSA" on page 3), and certain business and self-employment expenses.

For example, if you're self-employed, you can claim an above-the-line deduction for part of your self-employment tax (see "Payroll and self-employment taxes" at right) and 100% of health insurance costs for yourself and, if applicable, your spouse and dependents, up to your net self-employment income. You also can deduct contributions to a retirement plan you set up. (See page 15.) And you might be able to deduct home office expenses. (See page 12.)

The AMT

The top alternative minimum tax rate is 28%, compared to the top regular ordinary-income tax rate of 37%. But the AMT rate typically applies to a higher taxable income base. You must pay the AMT if your AMT liability exceeds your regular tax liability. The OBBBA makes some changes that could increase your AMT liability risk beginning in 2026. (See "What's new!" on page 5.)

So before timing your income and expenses, determine whether you're already likely to be subject to the AMT — or whether the actions you're considering might trigger it. In addition to deduction differences, some income items might trigger or increase AMT liability, such as:

- Long-term capital gains and qualified dividend income,
- Accelerated depreciation adjustments and related gain or loss differences when assets are sold, and
- Tax-exempt interest on certain private-activity municipal bonds. (For an exception, see the second warning on page 11.)

Finally, exercising incentive stock options can trigger AMT liability in certain situations. (See "ISOs" on page 7.)

Avoiding or reducing AMT

With proper planning, you may be able to avoid the AMT, reduce its impact or even take advantage of its lower maximum rate:

If you could be subject to the AMT *this* year … consider accelerating income into this year, which may allow you to benefit from the lower maximum AMT rate. And deferring expenses you can't deduct for AMT purposes may allow you to preserve those deductions. (But watch out for the annual limit on the SALT deduction.) If you also defer expenses you *can* deduct for AMT purposes, the deductions may become more valuable because of the higher maximum regular tax rate. Finally, carefully consider the tax consequences of exercising ISOs.

If you could be subject to the AMT *next* year … consider taking the opposite approach. For instance, defer income to next year, because you'll likely pay a relatively lower AMT rate. And, before year end, consider selling any private-activity municipal bonds whose interest could be subject to the AMT.

Also be aware that, in certain circumstances, you may be entitled to an AMT credit.

Payroll and self-employment taxes

In addition to income tax, you must pay Social Security and Medicare (FICA) taxes on earned income, such as salary and bonuses. The 12.4% Social Security tax applies only up to the Social Security wage base of $176,100 for 2025. All earned income is subject to the 2.9% Medicare tax. Both taxes are split equally between the employee and the employer. Higher-income individuals may also be subject to the additional 0.9% Medicare tax, which is paid only by the employee but in some cases must be *withheld* by the employer.

If you're self-employed, you pay both the employee and employer portions of payroll taxes on your self-employment income. The employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible above the line. (See "Above-the-line deductions" on page 3.)

WHAT'S NEW!

4 new deductions starting this year, but with income-based phaseouts

The OBBBA creates four deductions that go into effect for 2025. You don't have to itemize deductions to claim them. But the new deductions are available only through 2028, unless lawmakers extend them. And, because they phase out, the benefit to higher-income taxpayers will be reduced or eliminated:

1. **Tips income.** Eligible taxpayers can deduct up to $25,000 of qualified tips income, subject to a phaseout that begins when modified adjusted gross income (MAGI) exceeds $150,000 ($300,000 for married couples filing jointly). The deduction is completely phased out when MAGI reaches $400,000 ($500,000 for married couples filing jointly). The taxpayer must be in an occupation that customarily and regularly receives tips. (Payroll taxes and any applicable state taxes still apply to this income.)
2. **Overtime pay.** Eligible taxpayers can deduct up to $12,500 ($25,000 for joint filers) of qualified overtime pay, with a phaseout beginning when MAGI exceeds $150,000 ($300,000 for joint filers). The deduction is completely phased out when MAGI reaches $275,000 ($550,000 for joint filers). Qualified overtime pay is generally compensation required under Section 7 of the Fair Labor Standards Act that's in excess of the employee's regular rate. (Payroll taxes and any applicable state taxes still apply to this income.)
3. **Car loan interest.** Eligible taxpayers can deduct up to $10,000 of qualified passenger vehicle loan interest expense on the purchase of certain American-made vehicles. The deduction begins to phase out when MAGI exceeds $100,000 ($200,000 for joint filers). The deduction is completely phased out when MAGI reaches $150,000 ($250,000 for joint filers).
4. **"Senior" deduction.** For 2025 through 2028, the OBBBA creates a temporary deduction of up to $6,000 for taxpayers age 65 or older. It can be taken *in addition to* the standard deduction *or* itemized deductions. But the deduction begins to phase out at lower income levels than any of the other new deductions: when MAGI exceeds $75,0000 ($150,000 for joint filers). The deduction is completely phased out when MAGI reaches $175,000 ($250,000 for joint filers).

Additional rules apply to these breaks, and IRS guidance is expected.

Additional 0.9% Medicare tax

Another payroll tax that higher-income taxpayers must be aware of is the additional 0.9% Medicare tax. It applies to FICA wages and net self-employment income exceeding $200,000 per year ($250,000 if married filing jointly and $125,000 if married filing separately).

If your wages or self-employment income varies significantly from year to year or you're nearing the threshold for triggering the additional Medicare tax, income-timing strategies may help you avoid or minimize it. For example:

- If you're an employee, perhaps you can time when you receive a bonus or exercise stock options.
- If you're self-employed, you may have flexibility on when you purchase new equipment or invoice customers.
- If you're an S corporation shareholder-employee, you might save tax by adjusting how much you receive as salary vs. distributions.

Also consider the withholding rules. Employers must withhold the additional tax beginning in the pay period when wages exceed $200,000 for the calendar year — without regard to an employee's filing status or income from other sources. So your employer might withhold the tax even if you aren't liable for it — or it might not withhold the tax even though you are liable for it.

If you *don't* owe the tax but your employer *is* withholding it, you can claim a credit on your 2025 income tax return. If you *do* owe the tax but your employer *isn't* withholding it, consider increasing your income tax withholding, which can be used to cover the shortfall and avoid interest and penalties. Or make estimated tax payments.

Payroll tax considerations for owner-employees

There are special payroll tax considerations if you're a business owner who also works in the business, depending on its structure:

Partnerships and limited liability companies. Generally, all trade or business income that flows through to owner-employees for income tax purposes is subject to self-employment taxes — even if it isn't distributed. (Such income may not be subject to self-employment taxes for limited partners or the limited liability company member equivalent.) Whether the additional 0.9% Medicare tax or the 3.8% NIIT (see page 9) will apply depends on the specific circumstances.

S corporations. Only income that owner-employees receive as salary is subject to payroll taxes and, if applicable, the 0.9% Medicare tax. To reduce these taxes, owner-employees may want to keep their salary relatively — but not unreasonably — low and increase the income that is taxed to them through their Schedule K-1 by virtue of their share of the earnings from the business. That income isn't subject to the corporate level tax or the 0.9% Medicare tax and, typically, isn't subject to the 3.8% NIIT.

C corporations. Only income that owner-employees receive as salary is subject to payroll taxes and, if applicable, the 0.9% Medicare tax. Nonetheless, an owner-employee may prefer to take more income as salary (which is deductible at the corporate level) as opposed to dividends (which aren't deductible at the corporate level yet are still taxed at the shareholder level and could be subject to the 3.8% NIIT) if the overall tax paid by both the corporation and the owner-employee would be less.

Warning: The IRS scrutinizes corporate payments to shareholder-employees for possible misclassification, so tread carefully.

WHAT'S NEW!

AMT risk may increase for some taxpayers in 2026

The TCJA substantially increased the alternative minimum tax (AMT) exemptions through 2025. (See Chart 7 on page 24.) This means fewer taxpayers now have to pay the AMT. The OBBBA makes the higher exemptions permanent.

However, it calls for the income thresholds for the exemption phaseout for married couples filing jointly to revert back to their 2018 levels for 2026 (i.e., removing the inflation adjustments that had been made for 2019 – 2025) and then to be annually adjusted for inflation again in subsequent years. It doesn't call for this change for other filers, which might be a drafting error. A technical correction could be released that would also return the phaseout thresholds to 2018 levels for other filers.

For all filers, the OBBBA phases out the exemption more quickly beginning in 2026. Currently, the exemption is reduced $0.25 for each $1.00 by which the taxpayer's AMT income exceeds the applicable threshold. Beginning in 2026, the exemption will be reduced $0.50 for each $1.00 by which the taxpayer's AMT income exceeds the applicable threshold. Effectively, the exemption will phase out twice as fast.

It's also important to consider that deductions used to calculate regular tax that aren't allowed under the AMT can trigger AMT liability. Due to TCJA deduction changes that the OBBBA has made permanent, the SALT deduction generally is now the only major deduction that's deductible for regular tax purposes but not AMT purposes. This reduces AMT risk. However, the OBBBA does increase the SALT deduction for some taxpayers. (See "What's new!" on page 2.) A large SALT deduction could be an AMT trigger.

Estimated tax payments and withholding

You can be subject to penalties if you don't pay enough tax during the year through estimated taxes and withholding. Here are some strategies to help avoid being subject to underpayment penalties for 2025:

Know the minimum payment rules. Your estimated payments and withholding must equal at least 90% of your tax liability for 2025 or 110% of your 2024 tax (100% if your 2024 adjusted gross income was $150,000 or less or, if married filing separately, $75,000 or less).

Use the annualized income installment method. This method often benefits taxpayers who have large variability in income from month to month due to bonuses, investment gains and losses, or seasonal income (at least if it's skewed toward the end of the year). Annualizing computes the tax due based on income, gains, losses and deductions through each estimated tax period.

Estimate your tax liability and increase withholding. If you determine you've underpaid, consider having the tax shortfall withheld from your salary or year-end bonus by Dec. 31. Because withholding is considered to have been paid ratably throughout the year, this is often a better strategy than making up the difference with an increased quarterly tax payment, which may still leave you exposed to penalties for earlier quarters.

Don't let tax surprises reduce the value of your compensation plan

The OBBBA generally doesn't change how executives are taxed on their compensation. But its permanent extension of lower individual tax rates will help you keep more of it. Still, if you receive stock-based compensation such as restricted stock or stock options, the tax treatment can be complex. Or you might have an NQDC plan, which comes with its own unique tax considerations. That's why careful planning for executive compensation is so important.

Restricted stock

Restricted stock is stock your employer grants to you subject to a substantial risk of forfeiture. Income recognition is normally deferred until the stock is no longer subject to that risk (that is, it's vested) or you sell it. When the restriction lapses, you pay taxes on the stock's fair market value (FMV) at your ordinary-income rate. (The FMV will be considered FICA income, so it could trigger or increase your exposure to the additional 0.9% Medicare tax. See page 5.)

But with a Section 83(b) election, you can instead opt to recognize ordinary income when you receive the stock. This election, which you must make within 30 days after receiving the stock, allows you to convert potential future appreciation from ordinary income to long-term capital gains income and defer it until the stock is sold. (See Case Study 1 for an example.)

There are some potential disadvantages of a Sec. 83(b) election, however. First, prepaying tax in the current year could push you into a higher income tax bracket and trigger or increase your exposure to the additional 0.9% Medicare tax. But if your company is in the earlier stages of development, the income recognized may be relatively small. Second, any taxes you pay because of the election can't be refunded if you eventually forfeit the stock or sell it at a decreased value. However, you'd have a capital loss in those situations.

Work with your tax advisor to map out whether the Sec. 83(b) election is appropriate for your situation. You also might be eligible for a tax break under the TCJA that allows for the deferral of tax on stock-based compensation in certain circumstances. But it generally will apply only if at least 80% of full-time employees are covered by the stock-based compensation plan.

RSUs

Restricted stock units are contractual rights to receive stock, or its cash value, after the award has vested. Unlike restricted stock, RSUs aren't eligible for the Sec. 83(b) election. So there's no opportunity to convert ordinary income into capital gains.

Case Study 1

How a Sec. 83(b) election can reduce taxes on restricted stock

Amanda and Samantha are executives at a start-up, and in the same year each receives 10,000 shares of restricted stock with a fair market value of $10 per share. Amanda doesn't make a Section 83(b) election, but Samantha does.

In an initial public offering (IPO) a year later, the stock is offered at $20 per share. More than a year after the IPO, the market price reaches $50 per share and Amanda and Samantha both sell all their shares. By making the Sec. 83(b) election, Samantha has saved $13,200 in federal income taxes!

	Amanda (doesn't make the election)	Samantha (does make the election)
Year the restricted stock is awarded	Recognizes no income related to the stock.	Recognizes $100,000 (10,000 shares at $10 per share) of compensation income, for a federal income tax bill of $37,000.
Year of the IPO (which lifts the substantial risk of forfeiture)	Recognizes compensation income of $200,000 (10,000 shares at the IPO price of $20 per share), for a federal income tax bill of $74,000.	Recognizes no income related to the stock.
Year of the stock sale	Recognizes a long-term capital gain of $300,000 (10,000 shares at $50 per share less basis of $20 per share), for a federal income tax bill of $71,400.	Recognizes a long-term capital gain of $400,000 (10,000 shares at $50 per share less basis of $10 per share), for a federal income tax bill of $95,200.
Total federal income tax paid	$145,400	$132,200

Note: The figures presume that the 37% marginal income tax rate, the 20% long-term capital gains tax rate and the 3.8% NIIT (see page 9) apply. This case study doesn't factor in payroll taxes.

But RSUs do offer a limited ability to defer income taxes: Unlike restricted stock, which becomes taxable immediately upon vesting, RSUs aren't taxable until the employee actually receives the stock. So rather than having the stock delivered immediately upon vesting, you may be able to arrange with your employer to delay delivery.

Such a delay will defer income tax and may allow you to reduce or avoid exposure to the additional 0.9% Medicare tax (because the RSUs are treated as FICA income). However, any income deferral must satisfy the strict requirements of Internal Revenue Code Section 409A. Also keep in mind that it might be better to recognize income now because of the relatively low current tax rates.

ISOs

Incentive stock options allow you to buy company stock in the future (but before a set expiration date) at a fixed price equal to or greater than the stock's FMV at the date of the grant. Thus, ISOs don't provide a benefit until the stock appreciates in value. If it does, you can buy shares at a price below what they're then trading for, provided you're eligible to exercise the options.

ISOs receive tax-favored treatment but must comply with many rules. Here are the key tax consequences:

- You owe no tax when ISOs are granted.
- You owe no regular income tax when you exercise the ISOs.
- If you sell the stock *after* holding the options for at least one year and then holding the shares for at least one year from the exercise date, you pay tax on the sale at your long-term capital gains rate. You also may owe the NIIT. (See page 9.)
- If you sell the stock *before* long-term capital gains treatment applies, a "disqualifying disposition" occurs and any gain is taxed as compensation at ordinary-income rates. (Disqualified dispositions aren't, however, subject to Social Security and Medicare tax, including the additional 0.9% Medicare tax.)

Warning: If you don't sell the stock in the year of exercise, a tax "preference" item is created for the difference between the stock's FMV and the exercise price (the "bargain element") that can trigger the alternative minimum tax (AMT). (See page 4.) A future AMT credit, however, should mitigate this AMT hit.

Case Study 2

When is the best time to exercise ISOs?

Lorenzo was recently awarded a large number of incentive stock options from his employer. He knows holding on to them as long as possible can be beneficial, but he's worried about market risk. He also wants a better understanding of the tax implications. So he consults his tax advisor.

She explains that acting sooner can be advantageous in several situations. For example, Lorenzo can:

- Exercise early to start the holding period so he can sell and receive long-term capital gains treatment sooner,
- Exercise when the bargain element is small or when the market price is close to bottoming out to reduce or eliminate alternative minimum tax (AMT) liability,
- Exercise annually so he can buy only the number of shares that will achieve a breakeven point between the AMT and regular tax and thereby incur no additional tax, or
- Sell in a disqualifying disposition and pay the higher ordinary-income rate to avoid the AMT on potentially disappearing appreciation.

But she points out that, on the negative side, exercising early accelerates the need for funds to buy the stock, exposes Lorenzo to a loss if the shares' value drops below his exercise cost, and may create a tax cost if the exercise generates an AMT liability. She's going to run some numbers for Lorenzo so he can make a fully informed decision to minimize both risk and negative tax consequences.

If you've received ISOs, plan carefully when to exercise them and when to sell the shares received. Waiting to exercise ISOs until just before the expiration date (when the stock value may be the highest, assuming the stock is appreciating) and holding on to the stock long enough to garner long-term capital gains treatment often is beneficial. But sometimes it makes sense to act sooner. (See Case Study 2.)

It's also important to consider that the timing of ISO exercises could positively or negatively affect your liability for higher tax rates and the NIIT. With your tax advisor, evaluate the risks and crunch the numbers to determine the best strategy for you.

NQSOs

The tax treatment of nonqualified stock options is different from the tax treatment of ISOs: NQSOs create compensation income (taxed at ordinary-income rates) on the bargain element when exercised (regardless of whether the stock is held or sold immediately), but they don't create an AMT preference item.

You may need to make estimated tax payments or increase withholding to fully cover the tax on the exercise. Also, an exercise could trigger or increase exposure to top tax rates, the additional 0.9% Medicare tax and the NIIT.

NQDC plans

These plans pay executives in the future for services to be currently performed. They differ from qualified plans, such as 401(k)s, in several ways. For example, NQDC plans can favor highly compensated employees, and plan funding isn't protected from the employer's creditors.

One important NQDC tax issue is that payroll taxes (see page 4) are generally due once services have been performed and there's no longer a substantial risk of forfeiture — even though compensation may not be paid or recognized for income tax purposes until much later. So your employer may withhold your portion of the payroll taxes from your salary or ask you to write a check for the liability. Or it may pay your portion, in which case you'll have additional taxable income. ***Warning:*** The additional 0.9% Medicare tax could also apply.

Tax-aware investing can help you keep more of your returns

Your investment strategy should be guided by your goals, time horizon and risk tolerance. But understanding the potential tax consequences of an investment before buying, holding or selling it is essential to maximizing your after-tax returns.

The OBBBA doesn't include major changes affecting taxes on investments, apart from making permanent the lower ordinary income tax rates that apply in certain situations. What *can* significantly affect the portion of returns you ultimately keep are factors like the type of income an investment generates, how long you hold it, and special tax rules or limitations. Thoughtful planning can help preserve more of your investment income and gains and minimize avoidable tax erosion.

Chart 2
2025 capital gains tax rates

Type of gain	Rate[1]
Short-term (assets held 12 months or less)	Taxpayer's ordinary-income tax rate
Long-term (assets held more than 12 months)	15%
Some key exceptions	
Long-term gain of certain higher-income taxpayers	20%[2]
Most long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate	0%
Long-term gain on collectibles, such as artwork and antiques	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%
Gain on qualified small business (QSB) stock held more than 5 years[3]	
◗ Acquired before Feb. 18, 2009	14%[4]
◗ Acquired on or after Feb. 18, 2009, and before Sept. 28, 2010	7%[5]
◗ Acquired on or after Sept. 28, 2010	0%

[1] In addition, the 3.8% net investment income tax (NIIT) applies to net investment income to the extent that modified adjusted gross income (MAGI) exceeds $200,000 (singles and heads of households), $250,000 (married filing jointly) or $125,000 (married filing separately).

[2] The 20% rate applies only to those with taxable income exceeding $533,400 (singles), $566,700 (heads of households), $600,050 (joint filers), $300,000 (separate filers) or $15,900 (estates and trusts).

[3] Smaller exclusions are available for QSB stock held for shorter periods. (See "What's new!" on page 10.)

[4] Effective rate based on a 50% exclusion from a 28% rate.

[5] Effective rate based on a 75% exclusion from a 28% rate.

Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. Your marginal long-term capital gains rate can be as much as 20 percentage points lower than your ordinary-income tax rate.

The long-term capital gains rate applies to investments held for more than 12 months. The applicable rate depends on your income level and the type of asset you've sold. (See Chart 2.)

It's important to note that the top long-term gains rate of 20% kicks in before the top ordinary-income rate does. (See Chart 7 on page 24.) Also, higher long-term gains rates apply to certain types of assets. (See Chart 2.)

Holding on to an investment until you've owned it more than one year may help substantially cut tax on any gain. Keeping it even longer can also make tax sense. But be sure to look at your specific situation. Finally, be aware that the 3.8% NIIT could apply to both short-term and long-term gains. (See page 9.)

The 0% rate

The 0% long-term capital gains rate generally applies to long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate. If you have adult children in one of these tax brackets, consider transferring appreciated or dividend-producing assets to them.

They can sell the assets or reap the dividends and enjoy the 0% rate, which also applies to qualified dividends. This strategy can be even more powerful if you'd be subject to the 3.8% NIIT or the 20% long-term capital gains rate if you sold the assets.

But the 0% rate applies only to the extent that capital gains "fill up" the gap between your child's taxable income and the top end of the 0% bracket. For 2025, the 0% bracket for singles tops out at $48,350, (just $125 less than the top of the 12% ordinary-income tax bracket).

Warning: If the child will be under age 24 on Dec. 31, first make sure he or she won't be subject to the "kiddie" tax. (See page 18.) Also consider any gift tax consequences. (See page 22.)

3.8% NIIT

Taxpayers with modified adjusted gross income (MAGI) over $200,000 ($250,000 if married filing jointly and $125,000 if married filing separately) may owe the net investment income tax. The NIIT equals 3.8% of the lesser of your net investment income or the amount by which your MAGI exceeds the applicable threshold.

Net investment income can include capital gains, dividends, interest, passive business income, rental income and other investment-related income. (It doesn't include business or self-rental income from an active trade or business).

Many of the strategies that can help you save or defer income tax on your investments can also help you avoid or defer NIIT liability. And because the threshold for the NIIT is based on MAGI, strategies that reduce your MAGI could also help you avoid or reduce NIIT liability.

Being tax-smart with losses

Losses aren't truly losses until they're realized — that is, generally until you sell the investment for less than what you paid for it. So, while it's distressing to see an account statement that shows a large loss, the loss won't affect your current tax situation as long as you still own the investment.

Realized capital losses are netted against realized capital gains to determine capital gains tax liability. If net losses exceed net gains, you can deduct only $3,000 ($1,500 for married taxpayers filing separately) of losses per year against ordinary income (such as wages, self-employment and business income, interest, dividends, and taxable retirement plan distributions). If year-to-date you have a net loss, it could provide an opportunity to divest yourself of appreciated investments in a tax-efficient way. (See Case Study 3.)

If you don't have enough gains to absorb losses, you could be left with losses in excess of the annual ordinary-income deduction limit. So, think twice before selling an investment at a loss. After all, if you hold on to the investment, it may recover the lost value. In fact, a buy-and-hold strategy works well for many long-term investors because it can minimize the effects of market volatility.

Of course, an investment might continue to lose value. That's one reason why tax considerations shouldn't be the primary driver of investment decisions. If you're ready to divest yourself of a poorly performing stock because, for example, you don't think its performance will improve or because your investment objective or risk tolerance has changed, you shouldn't hesitate solely for tax reasons.

Plus, you can carry forward excess losses until death, and building up losses for future use could be beneficial. This may be especially true if you own a closely held business that might generate substantial future gains. Building up losses could also be beneficial if you have a large investment portfolio or real estate holdings — or if tax rates increase.

Because of the tax benefits capital losses can provide, you generally should avoid giving investments that have lost value to loved ones or charity. Instead, sell the investments so you can use the tax loss yourself and then gift or donate the proceeds of the sale. Or gift or donate appreciated investments instead.

Wash sale rule

If you want to achieve a tax loss with minimal change in your portfolio's asset allocation, consider the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or an option to buy such a security) within 30 days before or after you sell the security that created the loss. You can recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid triggering the wash sale rule and still achieve your goals. For example, you can:

- Sell the security and immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold,
- Sell the security and wait 31 days to repurchase the same security, or
- Before selling the security, purchase additional shares of that security equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

Alternatively, you can do a bond swap, where you sell a bond, take a loss and then immediately buy another bond

Case Study 3

Turning portfolio losses into a tax-saving opportunity

Stephanie's year-to-date net realized losses are $53,000. Her portfolio includes $100,000 of stock that she paid only $50,000 for. Stephanie has been thinking about selling it to diversify her portfolio and because year-to-date the stock has dropped from $130,000 to $100,000 in value and she's not confident it will recover.

But she's been concerned about the capital gains tax.

Her tax advisor suggests that now might be a good time to sell the stock because her $50,000 gain would essentially be tax-free: The gain would absorb $50,000 of losses, leaving Stephanie with a $3,000 net loss, the maximum that she could use to offset ordinary income.

of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you can achieve a tax loss with virtually no change in economic position.

Warning: You can't avoid the wash sale rule by selling stock at a loss in a taxable account and purchasing the same stock within 30 days in a tax-advantaged retirement account.

Mutual funds

Investing in mutual funds is an easy way to diversify your portfolio. But beware of the tax pitfalls.

First, mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term gains rates.

Second, earnings on mutual funds are often reinvested. If the resulting increases in your cost basis aren't properly accounted for, you may report too much gain when you sell the fund. For mutual funds acquired after 2011, brokerage firms are required to track (and report to the IRS) your cost basis.

Third, buying equity mutual fund shares late in the year can be costly taxwise. These funds often make capital gains distributions toward year end. If you purchase shares before such a distribution, you could end up with capital gains reportable on your tax return for the year of the distribution. (See Case Study 4.)

On the plus side, capital gains distributions from mutual funds can absorb capital losses. This may be beneficial if your portfolio has a net loss for the year that exceeds the amount that can be deducted from ordinary income. (See "Being tax smart with losses" on page 9.)

Case Study 4

The potentially taxing consequences of purchasing mutual funds late in the year

Dina purchases 500 shares of an equity mutual fund on Dec. 1 at $100 per share, for a total investment of $50,000. The next week, the fund makes a capital gains distribution of $15 per share.

Dina ends up with capital gains of $7,500, reportable on her tax return for the year of the distribution. It doesn't matter whether the actual value of the shares has increased or even decreased since Dina purchased them, or whether she reinvests the proceeds back into the same fund.

Why? The distribution itself is a taxable event. If capital gains distributions from the mutual fund are reinvested in the fund, the distribution itself doesn't change Dina's value in the fund. It simply increases the number of shares she owns, yet now at a lower per-share value.

Small business stock

By purchasing stock in certain small businesses, you can diversify your portfolio. You also may enjoy preferential tax treatment:

Conversion of capital loss to ordinary loss. If you sell qualifying Section 1244 small business stock at a loss, you can treat up to $50,000 ($100,000, if married filing jointly) as an ordinary, rather than a capital, loss — regardless of your holding period. This means you can use it to offset ordinary income, reducing your tax by as much as 37% of this portion of the loss. Sec. 1244 applies only if total capital invested isn't more than $1 million.

Tax-free gain rollovers. If within 60 days of selling qualified small business (QSB) stock you buy other QSB stock with the proceeds, you can defer any tax on your gain until you dispose of the new stock. The rolled-over gain reduces your basis in the new stock. For determining long-term capital gains treatment, the new stock's holding period includes the holding period of the stock you sold. (See "What's new!" below for information on OBBBA enhancements to the tax treatment of QSB stock and the definition of QSB stock.)

Keep in mind that all of these tax benefits are subject to additional requirements and limits. Consult your tax and financial advisors to be sure an investment in small business stock is right for you.

Passive activities

If you've invested in a trade or business in which you don't materially participate and where income or loss flows through to your tax return, remember the passive activity rules. Why? Passive activity income may be subject to the 3.8% NIIT, and passive activity losses generally are deductible only against income from other passive activities. You can carry forward disallowed losses, subject to the same limits each tax year.

To avoid passive activity treatment, you must "materially participate" in the activity, which typically means you must participate in the trade or business more than 500 hours during the year or demonstrate that your involvement constitutes substantially all of the participation in the activity. But there are other ways to meet the material participation test. Plus, there are special rules that apply to investment real estate activities. (See page 13.)

WHAT'S NEW!

The gain exclusion for investing in QSB stock just got even better

Generally, taxpayers selling qualified small business (QSB) stock are allowed to exclude up to 100% of their gain if they've held the stock for more than five years. (The exclusion is less for stock acquired before Sept. 28, 2010. See Chart 2 on page 8.)

The OBBBA provides new but smaller exclusions for QSB stock held for shorter periods. Specifically, it provides a 75% exclusion for QSB stock held for four years and a 50% exclusion for QSB stock held for three years. These exclusions go into effect for QSB stock acquired after July 4, 2025.

To be a QSB, a business must be engaged in an active trade or business and must not have assets that exceed a specific ceiling, among other requirements. The OBBBA increases the asset ceiling from $50 million to $75 million for stock issued after July 4, 2025. The ceiling will be adjusted for inflation after 2026.

If you don't pass the material participation test, consider:

Increasing your involvement. If you can exceed 500 hours, the activity no longer will be subject to passive activity rules.

Grouping activities. You may be able to group certain activities together to be treated as one activity for tax purposes and exceed the 500-hour threshold. But the rules are complex, and there are potential downsides to consider.

Looking at other activities. If you have passive losses, one option is to limit your participation in another activity that's generating net income, so that you don't meet the 500-hour test. Another is to invest in an additional income-producing trade or business that will be passive to you. Under both strategies, you'll have passive income that can absorb some or all of your passive losses.

Disposing of the activity. This generally allows you to deduct all passive losses — including any loss on disposition (subject to basis and capital loss limitations). But, again, the rules are complex.

To help ensure your hours claim will be able to withstand IRS scrutiny, carefully track and document your time. Contemporaneous recordkeeping is better than records that are created after the fact.

Warning: Even if you do pass the material participation test, be aware that your loss deduction might be affected by the rules for deducting business losses. (See page 14.)

Income investments

Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher ordinary-income tax rate. Interest income, however, generally is taxed at ordinary-income rates. So stocks that pay qualified dividends may be more attractive tax-wise than other income investments, such as CDs and taxable bonds.

Some dividends are subject to ordinary-income rates. These include certain dividends from:

- Real estate investment trusts (REITs),
- Regulated investment companies (RICs),
- Money market mutual funds, and
- Certain foreign investments.

Case Study 5

When is investment interest expense deductible?

Evan borrowed to make some investments this year, and he was wondering if the interest would be deductible. So he consulted his tax advisor.

She told him that investment interest expense — interest on debt used to buy assets held for investment, such as margin debt used to buy securities — generally is deductible for both regular tax and alternative minimum tax (AMT) purposes. But special rules apply.

First, Evan's investment interest expense deduction would be limited to his net investment income, which, for the purposes of this deduction, generally includes taxable interest, nonqualified dividends and net short-term capital gains (but not long-term capital gains), reduced by other investment expenses. Any disallowed interest expense is carried forward, and Evan can deduct it in a later year against net investment income.

If his interest expense exceeds his net investment income, Evan may elect to treat all or a portion of his net long-term capital gains or qualified dividends as investment income in order to deduct more of his investment interest expense. But if he does, that portion of the long-term capital gain or dividend will be taxed at ordinary-income rates.

Evan's advisor also explained that payments a short seller makes to the stock lender in lieu of dividends may be deductible as investment interest expense. But interest on debt used to buy securities that pay tax-exempt income, such as municipal bonds, isn't deductible. Finally, she told Evan to keep in mind that passive interest expense — interest on debt incurred to fund a passive activity — becomes part of his overall passive activity income or loss, subject to limitations.

Also note that the tax treatment of bond income varies. For example:

- Bonds (except U.S. savings bonds) with original issue discount (OID) build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.
- Corporate bond interest is taxable for federal and state purposes.
- Interest on U.S. government bonds is taxable on federal returns but exempt on state and local returns.
- Interest on state and local government bonds is excludable on federal returns. If the bonds were issued in your home state, interest also may be excludable on your state return, depending on the state.

State and municipal bonds usually pay a lower interest rate than corporate or U.S. bonds. But their rate of return may be higher than the after-tax rate of return for a taxable investment, depending on your tax rate. To compare apples to apples, calculate the tax-equivalent yield, which incorporates tax savings into the municipal bond's yield. The formula is simple:

Tax-equivalent yield = actual yield / (1 - your marginal tax rate)

Warning: Tax-exempt interest from private-activity municipal bonds can trigger or increase alternative minimum tax (AMT) liability. However, any income from tax-exempt bonds issued in 2009 and 2010 (along with 2009 and 2010 re-fundings of bonds issued after Dec. 31, 2003, and before Jan. 1, 2009) is excluded from the AMT. (See page 4.)

Finally, be aware that interest and dividends can also be subject to the NIIT.

How tax law changes affect tax planning for homes and investment properties

There are many ways you can maximize the tax benefits associated with owning a principal residence, vacation home or investment property. Tax planning is also important if you're planning to sell your home or other real estate in 2025. And the OBBBA may change your tax strategies because it permanently reduces or eliminates some breaks related to real estate and expands others.

Home-related deductions

Consider these itemized deductions in your tax planning:

Property tax deduction. The property tax deduction is subject to an annual limit on combined deductions for state and local taxes (SALT), which the OBBBA temporarily increases beginning in 2025. (See "What's new!" on page 2.)

Mortgage interest deduction. You generally can deduct interest on mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your principal residence also may be deductible. The OBBBA makes permanent the TCJA's reduction of the mortgage debt limit from $1 million to $750,000 for debt incurred after Dec. 15, 2017 (from $500,000 to $375,000 for separate filers), with some limited exceptions.

Home equity debt interest deduction. The OBBBA makes permanent the TCJA's limitation on the home equity interest deduction to debt that would qualify for the home mortgage interest deduction. (Under pre-TCJA law, interest was deductible on up to $100,000 of home equity debt used for any purpose, such as to pay off credit card debt or to buy a car.)

Home office deduction. If you're an employee and work from home, home office expenses aren't deductible. Why? For employees, this used to be a miscellaneous itemized deduction subject to the 2% of adjusted gross income (AGI) floor. But the TCJA suspended such deductions, and the OBBBA permanently eliminates them. (See page 2.)

If you're self-employed, you can still deduct home office expenses as long as your home office is your principal place of business (or used substantially and regularly to conduct business) and that's the space's only use. You can deduct from your self-employment income a portion of your mortgage interest, property taxes, insurance, utilities and certain other expenses, and the depreciation allocable to the space.

Or you can use the simplified method for calculating the deduction — $5 per square foot for up to 300 square feet. Although you won't be able to depreciate the portion of your home that's used as an office, you can claim mortgage interest, property taxes and casualty losses as itemized deductions to the extent otherwise allowable, without needing to apportion them between personal and business use of the home.

Home rental rules

If you rent out all or a portion of your principal residence or second home for *less than 15 days* during the year, you don't have to report the income. But expenses directly associated with the rental, such as advertising and cleaning, won't be deductible.

If you rent out your principal residence or second home for *15 days or more*, you'll have to report the income. But you may be entitled to deduct some or all of your rental expenses — such as utilities, repairs, insurance and depreciation. Exactly what you can deduct depends on whether the home is classified as a rental property for tax purposes (based on the amount of personal vs. rental use):

Rental property. You can deduct rental expenses, including losses, subject to the real estate activity rules discussed on page 13. Property tax attributable to the rental use of the home isn't subject to the SALT limit. You can't deduct any interest that's attributable to your personal use of the home. However, you can take the personal portion of property tax as an itemized deduction (subject to the SALT limit).

WHAT'S NEW!

Act soon to take advantage of repealed clean energy tax credits

The Inflation Reduction Act created two credits for taxpayers who take steps to make their homes more energy efficient, such as installing energy-efficient windows or adding solar panels. The OBBBA repeals these credits for any property placed in service after Dec. 31, 2025. So if you've been considering such improvements, you may want to act soon so you can claim the credits while they're still available:

Energy Efficient Home Improvement Credit. This applies only to improvements to an existing home. The amount of the credit is 30% of the total qualified improvement expenses in the year of installation, generally up to $1,200 annually.

Residential Clean Energy Credit. This is available for both existing and newly constructed homes. The amount of the credit is 30% of the total cost of new, qualified clean energy property, generally with no annual maximum or lifetime limit.

WHAT'S NEW!

Expanded depreciation-related deductions benefit real estate investors

Certain depreciation-related breaks are available to real estate investors, and the OBBBA makes significant enhancements to some of them:

QIP deduction. Qualified retail-improvement, restaurant and leasehold-improvement property are classified as qualified improvement property. QIP has a 15-year Modified Accelerated Cost Recovery System (MACRS) recovery period and qualifies for bonus depreciation and Sec. 179 expensing.

Bonus depreciation. This additional first-year depreciation is available for qualified assets, including QIP. The 100% bonus depreciation that had been available in recent years generally expired Dec. 31, 2022. So bonus depreciation dropped to 80% for 2023 and 60% for 2024. It was scheduled to drop to 40% for 2025, 20% for 2026, and 0% for 2027 and future years. (For certain property with longer production periods, these reductions are delayed by one year.)

But the OBBBA returns bonus depreciation to 100% for assets acquired and placed in service after Jan. 19, 2025, and makes 100% bonus depreciation permanent. (The previous depreciation percentages generally apply to assets acquired on Jan. 19 or earlier even if they're placed in service after that date.)

Section 179 expensing. This election allows you to currently deduct the cost of purchasing eligible assets, including QIP, certain personal property used predominantly to furnish lodging, and the following improvements to nonresidential real property: roofs, HVAC equipment, fire protection and alarm systems, and security systems.

For qualifying assets placed in service in 2025, the OBBBA doubles the expensing limit to $2.5 million. The break begins to phase out dollar-for-dollar when asset acquisitions for the year exceed $4 million (up from $3.13 million before the OBBBA). These amounts will continue to be annually adjusted for inflation after 2025.

You can claim the expensing election only to offset net income, not to reduce it below zero to create an NOL. (See "Loss deductions" on page 14.)

Nonrental property. You can deduct rental expenses only to the extent of your rental or other passive income. Any excess can be carried forward to offset rental income in future years. You also can take an itemized deduction for the personal portion of both mortgage interest and property taxes, subject to the applicable limits. In some instances, it may be beneficial to reduce personal use of a residence so it will be classified as a rental property.

Home sales

When you sell your principal residence, you can exclude up to $250,000 of gain ($500,000 for joint filers) if you meet certain tests. Gain that qualifies for exclusion will also be excluded from the 3.8% NIIT. (See page 9.) To support an accurate tax basis, maintain thorough records, including information on your original cost and subsequent improvements, reduced by any casualty losses and depreciation claimed based on business use. Legislation has been proposed that would exclude from tax more — or perhaps even all — gain on the sale of a principal residence. Check with your tax advisor for the latest information.

Losses on the sale of any personal residence aren't deductible. But if part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

Because a second home is ineligible for the gain exclusion, consider converting it to rental use before selling. It can be considered a business asset, and you may be able to defer tax on any gains. (See "Investment real estate sales," at right.) Or you may be able to deduct a loss, but only to the extent attributable to a decline in value *after* the conversion.

Investment real estate activities

Income and losses from investment real estate, such as a rental property, are passive by definition — unless you're a real estate professional. Why is this important? Passive income and losses have some negative tax consequences. (See "Passive activities" on page 10.)

To qualify as a real estate professional, you must annually perform 1) more than 50% of your personal services in real property trades or businesses in which you materially participate, and 2) more than 750 hours of service in these businesses during the year.

Keep in mind that special rules for spouses may help you meet the material participation test. ***Warning:*** To help withstand IRS scrutiny, be sure to keep adequate records of time spent.

Also be aware that valuable depreciation-related breaks may be available to real estate investors. (See "What's new!" at left.)

Interest expense deduction for real estate businesses

Generally, under the TCJA, interest paid or accrued by a business is deductible only up to 30% of adjusted taxable income (ATI). Under the OBBBA, beginning in 2025, the deduction is increased because ATI is now generally defined as earnings before interest, taxes, depreciation and amortization (EBITDA), rather than earnings before interest and taxes (EBIT). For 2025, taxpayers with average annual gross receipts of $31 million or less for the three previous tax years generally are exempt from the limitation.

Larger real property businesses can elect to continue to deduct 100% of their interest. But then they're required to use the alternative depreciation system for real property used in the business and can't claim bonus depreciation.

Investment real estate sales

It's possible to divest yourself of appreciated investment real estate but defer the tax liability. Such strategies may even help you keep your income low enough to avoid triggering the 3.8% NIIT and the 20% long-term capital gains rate. (See Chart 2 on page 8.) Consider these tax deferral strategies:

1. **Installment sale.** This allows you to defer gains by spreading them over several years as you receive the proceeds. But ordinary gain from certain depreciation recapture is recognized in the year of sale, even if no cash is received.

2. **Section 1031 exchange.** Also known as a "like-kind" exchange, this technique allows you to exchange one real estate investment property for another and defer paying tax on any gain until you sell the replacement property.

But these strategies aren't without risks. For example, if tax rates go up, you could ultimately end up paying more in taxes.

Tax planning is a juggling act for business owners

As a business owner, you must keep your eye on your company's income and expenses and applicable tax breaks, which is particularly challenging this year in light of OBBBA changes. If you operate a pass-through business, you also need to watch out for how your business income and expenses will affect your personal tax situation. And, regardless of your business's structure, you must look out for your own financial future, which requires retirement planning and exit planning. Finally, if you might sell your business (or acquire another), it's critical to consider the tax consequences.

WHAT'S NEW!

The Sec. 199A QBI deduction is extended and improved

The OBBBA has made permanent the TCJA's Section 199A deduction for sole proprietors and owners of pass-through entities, such as partnerships, S corporations and, usually, limited liability companies. The deduction generally equals 20% of qualified business income (QBI), not to exceed 20% of taxable income. QBI is generally defined as the net amount of qualified income, gain, deduction and loss from a qualified U.S. trade or business.

Additional limits begin to apply if your taxable income falls within the 2025 phase-in range of $197,300–$247,300 ($394,600–$494,600 if you're married filing jointly).

For example, if your income falls within the applicable range, the deduction becomes limited to the greater of your share of:

- 50% of the amount of W-2 wages paid to employees by the qualified business during the tax year, or
- The sum of 25% of W-2 wages plus 2.5% of the cost (not reduced by depreciation taken) of qualified property, which is the depreciable tangible property (including real estate) owned by a qualified business as of year end and used by the business at any point during the tax year to produce QBI.

Also, if your income falls within the applicable range and the QBI is from a specified service trade or business (SSTB), the deduction is reduced — and it's eliminated if income exceeds the top of the range. Examples of SSTBs include businesses that provide investment-type services and most professional practices (other than engineering and architecture).

Under the OBBBA, beginning in 2026, the income ranges over which the limits phase in will widen from $50,000 to $75,000 (from $100,000 to $150,000 for joint filers). This will potentially allow larger deductions for some taxpayers. (The bottoms of these ranges will continue to be annually adjusted for inflation.)

Also beginning in 2026, the OBBBA provides a new minimum deduction of $400 for taxpayers who materially participate in an active trade or business if they have at least $1,000 of QBI from it. These amounts will be annually adjusted for inflation after 2026.

The OBBBA makes many other changes affecting businesses, such as increasing depreciation-related breaks (see "What's new!" on page 13) and reviving the immediate deduction for domestic research and experimental expenses. Contact your tax advisor to learn more.

Business structure

Income taxation and owner liability are the main factors that differentiate business structures. Many business owners choose entities that combine pass-through taxation with limited liability, namely limited liability companies (LLCs) and S corporations.

The TCJA significantly changed the tax consequences of business structure. The now-flat corporate rate (21%) is substantially lower than the top individual rate (37%), providing sizable tax benefits to C corporations and mitigating the impact of double taxation for their owners. But the TCJA also introduced the powerful 199A QBI deduction for many owners of pass-through entities, which has been made permanent and enhanced by the OBBBA. (See "What's new!" at left.) The OBBBA also retains the TCJA corporate and individual tax rates.

For tax or other reasons, a structure change may sound like a good idea. But it could have unwelcome tax consequences in certain situations. Consult your tax advisor if you'd like to explore whether a structure change could benefit you.

Loss deductions

A loss occurs when a business's expenses and other deductions for the year exceed its revenue. Losses are common for start-ups, but any business can have a bad year. Fortunately, tax deductions can help ease the pain.

The TCJA applies a limit to deductions for current-year business losses incurred by noncorporate taxpayers: For 2025, such losses generally can't offset more than $313,000 ($626,000 for married couples filing jointly) of income from other sources, such as salary, self-employment income,

interest, dividends and capital gains. In 2022, the Inflation Reduction Act extended this "excess" business losses limit through 2028, and the OBBBA makes the limit permanent.

Excess losses are carried forward to later tax years and can then be deducted under the net operating loss (NOL) rules. The amount of taxable income that can be offset with NOL deductions is generally 80%. NOLs generally can't be carried back to an earlier tax year — but they can be carried forward indefinitely.

Retirement saving

If most of your money is tied up in your business, retirement can be a challenge. So if you haven't already set up a tax-advantaged retirement plan, consider doing so this year. If you might be subject to the 3.8% NIIT (see page 9), this may be particularly beneficial because retirement plan contributions can reduce your modified adjusted gross income (MAGI) and thus help you reduce or avoid the NIIT.

You generally can set up a plan and make deductible 2025 contributions as late as the due date of your 2025 income tax return, including extensions. Keep in mind that, if you have employees, they generally must be allowed to participate in the plan, provided they work enough hours and meet other qualification requirements.

Here are a few options:

Profit-sharing plan. This is a defined contribution plan that allows discretionary employer contributions and flexibility in plan design. If you're age 50 or older, you may be able to contribute more than what you could contribute to a SEP plan. (See Chart 3 for contribution limits.)

SEP plan. A Simplified Employee Pension is a defined contribution plan that provides benefits similar to those of a profit-sharing plan. But a SEP plan is easier to administer. (See Chart 3 for contribution limits.)

Defined benefit plan. This plan sets a future pension benefit and then actuarially calculates the contributions needed to attain that benefit. The maximum compensation for benefit purposes for 2025 is generally $280,000 or 100% of average earned income for the highest three consecutive years, if less. Because it's actuarially driven, the 2025 contribution needed to attain the future benefit may exceed the maximum contributions allowed by other plans, depending on your age and the desired benefit. ***Warning:*** Employer contributions generally are mandatory.

Chart 3
Profit-sharing plan vs. SEP: How much can you contribute?

Profit-sharing plan	SEP
2025 maximum contribution: $70,000, $77,500 or $81,250	**2025 maximum contribution:** $70,000
Additional limits: You can't contribute more than 25% of your compensation generally. But you can contribute 100% up to the 401(k) limits if the plan includes a 401(k) arrangement. To qualify for the higher limits, your plan must include a 401(k) arrangement and you must be eligible to make catch-up contributions (that is, be age 50 or older, or for the $81,250 limit, be age 60, 61, 62 or 63).	**Additional limits:** You can't contribute more than 25% of your eligible compensation. (Special rules apply if you're self-employed.) To make the maximum contribution, your eligible compensation must be at least $280,000 ($350,000 before the deduction if you're self-employed).

Note: Other factors may further limit your maximum contribution.

Exit planning

An exit strategy is a plan for passing on responsibility for running the company, transferring ownership and extracting your money from the business. This requires planning well in advance of the transition. Here are the most common exit options:

Buy-sell agreement. When a business has more than one owner, a buy-sell agreement can control what happens to the business when a specified event occurs, such as an owner's retirement, disability or death. It's critical to factor in tax and funding issues when drafting a buy-sell agreement.

Succession within the family. You can pass your business on to family members by giving them interests, selling them interests or doing some of each. The OBBBA provides more certainty when it comes to gift and estate tax considerations. (See page 22.)

ESOP. An employee stock ownership plan is a qualified retirement plan created primarily to own your company's stock. It can provide liquidity and various tax benefits.

Sale to an outsider. If you can find the right buyer, you may be able to sell the business at a premium.

Business sale or acquisition

Whether you're selling your business as part of your exit strategy or acquiring another company to help grow it, the tax consequences can have a major impact on the transaction's success or failure. Consider installment sales, for example.

A taxable sale might be structured as an installment sale if the buyer lacks sufficient cash or pays a contingent amount based on the business's performance. An installment sale also may make sense if the seller wishes to spread the gain over a number of years. This could be especially beneficial if it would allow the seller to stay under the thresholds for triggering the 3.8% NIIT or the 20% long-term capital gains rate. (See Chart 2 on page 8.)

But an installment sale can backfire on the seller. For example, depreciation recapture must be reported as gain in the year of sale, no matter how much (or how little) cash the seller receives. Also, if tax rates increase, the overall tax could wind up being more.

With a corporation, a key consideration is whether the deal should be structured as an asset sale or a stock sale. If a stock sale is chosen, another important question is whether it should be a tax-deferred transfer or a taxable sale.

Regardless of the type of business entity or the potential deal structure, tax consequences are only one of many important considerations when planning a sale (or acquisition).

Do well by doing good

The OBBBA makes some notable changes to tax breaks for charitable giving in 2026 (see "What's new!" on page 17) but generally doesn't affect the tax treatment of 2025 donations. By giving to charity, you not only can enjoy the satisfaction of doing good but also can reap valuable tax savings (as long as you itemize deductions). The more generous you are, the more you can save. You just need to remember the various rules and limits.

Cash donations

Outright gifts of cash are the easiest to make. Examples include donations made via check, credit card and payroll deduction. The substantiation requirements depend on the gift's value:

- Gifts under $250 can be supported by a canceled check, credit card receipt or written communication from the charity.
- Gifts of $250 or more must be substantiated by the charity.

Deductions for cash gifts to public charities normally can't exceed 60% of your adjusted gross income (AGI). But the AGI limit is only 30% for cash donations to nonoperating private foundations. Contributions exceeding the applicable AGI limit can be carried forward for up to five years.

Warning: Charitable contribution deductions are allowed for alternative minimum tax (AMT) purposes (see page 4), but your tax savings may be less if you're subject to the AMT. For example, if you're in the 37% tax bracket for regular income tax purposes, but the 28% tax bracket for AMT purposes, your deduction may be worth only 28% instead of 37%.

Chart 4

How much can itemizers deduct for their donations?

Cash. This includes not just actual cash but gifts made by check, credit card or payroll deduction. You may deduct 100%.
Ordinary-income property. Examples include stocks and bonds held one year or less, inventory, and property subject to depreciation recapture. You generally may deduct only the lesser of fair market value or your tax basis.
Long-term capital gains property. You may deduct the current fair market value of appreciated securities and real estate held more than one year.
Tangible personal property. Your deduction depends on the situation: ◗ If the property *isn't* related to the charity's tax-exempt function (such as an antique donated for a charity auction), your deduction is limited to your basis. ◗ If the property *is* related to the charity's tax-exempt function (such as an antique donated to a museum for its collection), you can deduct the fair market value.
Vehicle. Unless it's being used by the charity, you generally may deduct only the amount the charity receives when it sells the vehicle.
Use of property. Examples include use of a vacation home and a loan of artwork. Generally, you receive no deduction because it isn't considered a completed gift. There may, however, be ways to structure the gift to enable you to get a deduction.
Services. You may deduct only your out-of-pocket expenses, not the fair market value of your services. You can deduct 14 cents per charitable mile driven.
Note: Your annual charitable deductions may be reduced if they exceed certain limits based on your adjusted gross income, the type of donation and the type of charity receiving the donation. If you receive some benefit from the charity relating to your donation, such as services or products, your deduction must be reduced by the value of the benefit you receive. Various substantiation requirements also apply. Consult your tax advisor for additional details.

Stock donations

Appreciated publicly traded securities you've held more than one year are long-term capital gains property, which often makes one of the wisest charitable gifts. Why? You can deduct the current fair market value and avoid any capital gains tax you would have owed had you sold the property. This will be especially beneficial to taxpayers facing the 3.8% NIIT (see page 9) or the top 20% long-term capital gains rate (see Chart 2 on page 8) this year.

Donations of long-term capital gains property are subject to tighter deduction limits, however: 30% of AGI for gifts to public charities and 20% for gifts to nonoperating private foundations.

Don't donate stock that's worth less than your basis. Instead, sell the stock so you can deduct the loss and then donate the cash proceeds to charity.

IRA QCDs

Taxpayers age 70½ or older are allowed to make direct qualified charitable distributions from their IRA to qualified charitable organizations, up to $108,000 in 2025. In addition, eligible taxpayers can make a one-time QCD of up to $54,000 (for 2025) through a charitable gift annuity or CRT. (See page 17.)

A charitable deduction can't be claimed for QCDs, but these amounts aren't included in taxable income and can be used to satisfy an IRA owner's required minimum distributions (RMDs). Note that the age for QCDs hasn't changed even though the age after which RMDs generally must begin is now higher. (See page 21.)

A QCD might be especially tax-smart if you won't benefit from the charitable deduction or you face AGI-based limits. To be a QCD, the transfer must be made by the IRA trustee directly to an eligible charity.

Making gifts over time

If you don't know which charities you want to support but you'd like to start making large contributions now, consider a private foundation. It offers you significant control over how your donations ultimately will be used. You must comply with complex rules, however, which can make foundations expensive to run. Also, the AGI limits for deductibility of contributions to nonoperating foundations are lower. (See "Cash donations" and "Stock donations.")

If you'd like to influence how your donations are spent but avoid a foundation's downsides, consider a donor-advised fund (DAF). Many larger public charities and investment firms offer them. ***Warning:*** To deduct your DAF contribution, obtain a written acknowledgment from the sponsoring organization that it has exclusive legal control over the assets contributed.

CRTs

To benefit a charity while helping ensure your own financial future, consider a charitable remainder trust. Here's how it works:

- For a given term, the CRT pays an amount to you annually (some of which generally is taxable).
- At the term's end, the CRT's remaining assets pass to one or more charities.
- When you fund the CRT, you can claim an income tax deduction for the present value of the amount that will go to charity.
- The property is removed from your taxable estate.

You may owe capital gains tax when you receive the payments. However, because the payments are spread over time, much of the liability will be deferred. Plus, a portion of each payment might be considered tax-free return of principal. This may help you reduce or avoid exposure to the 3.8% NIIT and the 20% top long-term capital gains rate.

A CRT can be especially wise if you hold highly appreciated stock and you'd like to diversify your portfolio. You can contribute the stock to the CRT, which can sell it without paying any current capital gains tax on the gain — avoiding the tax you would have owed had you sold the stock yourself. The trust can use the sale proceeds for other investments, which in turn helps diversify your portfolio because of your income interest in the trust. You can also use trust payouts to make investments to further diversify your portfolio.

You can name someone other than yourself as income beneficiary or fund the CRT at your death, but the tax consequences will be different.

CLTs

To benefit charity while transferring assets to loved ones at a reduced tax cost, consider a charitable lead trust. It works as follows:

- For a given term, the CLT pays an amount to one or more charities.
- At the term's end, the CLT's remaining assets pass to one or more loved ones you name as remainder beneficiaries.
- When you fund the CLT, you make a taxable gift equal to the present value of the amount that will go to the remainder beneficiaries.
- The property is removed from your taxable estate.

For gift tax purposes, the amount of the remainder interest is determined using the assumption that the trust assets will grow at the current Section 7520 rate. The lower the Sec. 7520 rate, the smaller the remainder interest and the lower the gift tax — or the less of your lifetime gift tax exemption you'll have to use up. If the trust's earnings outperform the Sec. 7520 rate, the excess earnings will be transferred to the remainder beneficiaries gift- and estate-tax-free.

As interest rates have risen overall, the Sec. 7520 rate has also risen. So, a CLT may not be as attractive as it had been a few years ago. But interest rate reductions could make CLTs more appealing again. If you might be interested, keep in mind that the increased gift and estate tax exemption may reduce the tax benefits of a CLT, depending on your specific situation. (For more on estate and gift taxes, see page 22.)

You can name yourself as the remainder beneficiary or fund the CLT at your death, but the tax consequences will be different.

Qualified charities

Before you donate, it's critical to make sure the charity you're considering is indeed a qualified charity — that it's eligible to receive tax-deductible contributions.

The IRS's online search tool, Tax Exempt Organization Search, can help you more easily find out whether an organization is eligible to receive tax-deductible charitable contributions. You can access the tool at IRS.gov. According to the IRS, you may rely on this list in determining deductibility of your contributions.

Also, don't forget that political donations aren't deductible.

WHAT'S NEW!

Changes to charitable deductions for 2026 and beyond

The OBBBA brings some bad news to taxpayers who itemize deductions and donate to charity. Beginning in 2026, a 0.5% of adjusted gross income (AGI) floor will apply to itemized charitable deductions. This generally means that only charitable donations in excess of 0.5% of your AGI will be deductible if you itemize. So, if your AGI is $500,000, your first $2,500 of charitable donations for the year won't be deductible. Also, if you're in the top (37%) tax bracket, your tax benefit will be further reduced. (See "New overall limit on itemized deductions" on page 3.)

But if you typically claim the standard deduction, the OBBBA brings some good news. Currently, nonitemizers can't deduct charitable donations. Beginning in 2026, the OBBBA creates a charitable deduction for nonitemizers of up to $1,000, or $2,000 for married couples filing jointly. Only cash donations qualify.

Tax-smart planning for children and education

Helping your children — or grandchildren — build long-term financial security involves more than just paying for their education. Strategic tax planning can enhance your ability to help fund their future while reducing your own tax burden. Changes under the OBBBA have modified several tax breaks tied to children and education. For higher-income families, income-based phaseouts can have an impact. But plenty of powerful opportunities are still available.

Child, dependent and adoption credits

You may be eligible for one or both of these two tax credits for families:

1. **CTC.** The OBBBA makes permanent the TCJA's higher Child Tax Credit, plus for 2025 increases it to $2,200. It also adjusts the CTC annually for inflation starting in 2026. You may be able to claim the CTC for each qualifying child under age 17 at the end of the tax year.

2. **COD.** The OBBBA makes the TCJA-created $500 Credit for Other Dependents permanent but doesn't annually adjust it for inflation. You may be able to claim the credit for each qualifying dependent other than a qualifying child (such as a dependent child over the age limit or a dependent elderly parent).

Some higher-income taxpayers who couldn't benefit from the CTC before the TCJA went into effect are now finding that they do. The TCJA significantly raised the modified adjusted gross income (MAGI) phaseout thresholds for the CTC — which also apply to the COD — and the OBBBA makes these higher ranges permanent. The credits begin to phase out when MAGI exceeds $200,000, or $400,000 for married couples filing jointly.

If you adopt in 2025, you might be eligible for the adoption credit. It's $17,280 for 2025, but it begins to phase out when MAGI exceeds $259,190 for all taxpayers and is eliminated when MAGI reaches $299,190.

Care-related breaks

A couple of tax breaks can offset the costs of dependent care:

Child and dependent care tax credit. For children under age 13 or other qualifying dependents, the credit generally equals 20% of the first $3,000 of qualified expenses for one child or dependent or 20% of up to $6,000 of such expenses for two or more. So, the maximum credit is usually $600 for one child or $1,200 for two or more children.

Child and dependent care FSA. For 2025, you can contribute up to $5,000 pretax to an employer-sponsored child and dependent care Flexible Spending Account. The OBBBA increases the limit to $7,500 beginning in 2026. The plan pays or reimburses you for these expenses. Your contributions will reduce your qualified expenses for purposes of the tax credit.

Kiddie tax

The "kiddie tax" generally applies to unearned income beyond $2,700 (for 2025) of children under age 19 and of full-time students under age 24 (unless the students provide more than half of their own support from earned income). Such income is generally taxed at the parents' tax rate.

The purpose of the kiddie tax is to minimize the ability of parents to significantly reduce their family's taxes by transferring income-producing assets to their children in lower tax brackets. Keep the kiddie tax in mind before transferring income-producing assets to children (or grandchildren) who'd be subject to it.

IRAs for teens

One of the best ways to get children on the right financial track is to set up IRAs for them. IRAs can be ideal for teenagers because they likely will have many decades to let their accounts grow tax-deferred or tax-free.

If your children or grandchildren don't want to invest too much of their hard-earned money, you could *give* them money to contribute. For example, if your daughter earns $7,000 for the year but only wants to contribute $1,000 of it to an IRA, you could give her $6,000 so she could contribute the full $7,000 she's eligible to contribute but still have $6,000 to spend as she wishes (or save for a shorter-term goal). But you should first consider any potential gift tax consequences.

If your children or grandchildren don't have earned income and you own a business, consider hiring them. As the business owner, you can deduct their pay, and other tax benefits may apply. ***Warning:*** The children must be paid in line with what you'd pay nonfamily employees for the same work.

Beginning in 2026, the OBBBA introduces an IRA-like account for children that doesn't require the child to have earned income for contributions to be made. (See "What's new!" on page 19.)

529 plans

Section 529 plans provide another tax-advantaged savings opportunity. You can choose a prepaid tuition plan to secure current tuition rates or a savings plan to fund education expenses. Here are some of the possible benefits of such plans:

- Although contributions aren't deductible for federal purposes, any growth is tax-deferred. (Some states offer tax breaks for contributing.)

- The plans usually offer high contribution limits, and there are no income limits for contributing.
- A special break for 529 plans allows you to front-load five years' worth of gift tax annual exclusions and make up to a $95,000 contribution (or $190,000 if you split the gift with your spouse) per beneficiary in 2025.
- There's generally no beneficiary age limit for contributions or distributions.
- You can control the account, even after the beneficiary is of legal age.
- You can make tax-free rollovers to a 529 plan for another qualifying family member.
- Unused 529 plan funds can be rolled into a Roth IRA for the beneficiary, subject to various rules and limits.

Prepaid tuition vs. savings plan

With a *529 prepaid tuition plan*, if your contract is for four years of tuition, tuition is guaranteed regardless of its cost at the time the beneficiary actually attends the school. One downside is that there's uncertainty in how benefits will be applied if the beneficiary attends a different school. Another is that the plan doesn't cover costs other than tuition, such as room and board.

A *529 savings plan*, on the other hand, can be used to pay the beneficiary's expenses at most postsecondary educational institutions, as well as to pay certain other education-related expenses. Distributions used to pay the following expenses are income-tax-free for federal purposes and potentially also for state purposes, making the tax deferral a permanent savings:

- Qualified postsecondary school expenses, such as tuition, mandatory fees, books, supplies, computer equipment, software, internet service, generally room and board, and, under the OBBBA, after July 4, 2025, certain credentialing expenses,
- Qualified elementary and secondary school expenses of up to $10,000 per year per beneficiary (increasing to $20,000 in 2026 under the OBBBA), which, through July 4, 2025, include only tuition but, under the OBBBA, after July 4, also include various additional expenses such as books, instructional materials and certain fees, and
- Up to $10,000 of student loan debt per beneficiary.

One downside is that you're limited to the investment options the plan offers. Additionally, for funds already in the plan, you can make changes to your investment options only twice during the year or when you change beneficiaries. But each time you make a new contribution to a 529 savings plan, you can select a different option for that contribution, regardless of how many times you contribute throughout the year. And every 12 months you can make a tax-free rollover to a different 529 plan for the same beneficiary.

WHAT'S NEW!

A new tax-advantaged savings account for children

Beginning in 2026, Trump Accounts will provide families with a new way to build savings for children. An account can be set up for anyone under age 18 at the end of the tax year who has a Social Security number.

Annual contributions of up to $5,000 can be made until the year the beneficiary turns 18. In addition, U.S. citizen children born between Jan. 1, 2025, and Dec. 31, 2028, can potentially qualify for an initial $1,000 government-funded deposit.

Contributions aren't deductible, but earnings grow tax-deferred as long as they're in the account. The account generally must be invested in exchange-traded funds or mutual funds that track the return of a qualified index and meet certain other requirements. Funds generally can't be withdrawn until the child turns age 18.

Talk with your tax advisor about how you might use these new accounts along with other accounts like 529 plans to best achieve your planning goals.

ESAs

Coverdell Education Savings Accounts are similar to 529 savings plans in that contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free. ESAs are worth considering if you'd like to have direct control over how your contributions are invested or you want to fund elementary or secondary education expenses beyond what a 529 plan allows.

But the $2,000 contribution limit is low, and the amount a taxpayer is allowed to contribute is fully phased out when MAGI reaches $220,000 for married couples filing jointly and $110,000 for other filers. Also, contributions can generally be made only for beneficiaries under age 18. When the beneficiary turns age 30, the ESA generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

Education credits

The income phaseout ranges for education credits are fairly low, but your child might qualify:

AOTC. The American Opportunity Tax Credit covers 100% of the first $2,000 of tuition and related expenses and 25% of the next $2,000 of expenses. The maximum AOTC, *per student*, is $2,500 per year for the first four years of postsecondary education in pursuit of a degree or recognized credential.

LLC. The Lifetime Learning Credit — up to $2,000 *per tax return* — is available for postsecondary education expenses beyond the first four years.

ABLE accounts

Achieving a Better Life Experience accounts offer a tax-advantaged way to fund qualified disability expenses for a beneficiary who became blind or disabled before age 26 (increasing to age 46 in 2026). For federal purposes, tax treatment is similar to that of 529 savings plans.

The OBBBA makes permanent the ability to roll over 529 plan funds to an ABLE account without penalty if the ABLE account is owned by the beneficiary of the 529 plan or a member of the beneficiary's family. Such rolled-over amounts count toward the ABLE account annual rollover and contribution limit ($19,000 for 2025).

Tax-advantaged retirement plans can be powerful wealth-building tools

Retirement plans offer more than just a place to set aside funds for the future — they provide an opportunity to reduce your current or future tax burden while potentially growing your money faster through tax-deferred or tax-free compounding. But the tax advantages that make these plans so powerful can also lead to costly surprises if distributions aren't planned carefully. Understanding contribution limits, income thresholds and withdrawal rules is essential to getting the full benefit without triggering unintended tax consequences.

Retirement plan contributions

Contributing the maximum you're allowed (see Chart 5) to an employer-sponsored defined contribution plan, such as a 401(k), is often a smart move:

- Contributions are typically pretax, reducing your modified adjusted gross income (MAGI). This in turn can help you reduce or avoid exposure to the 3.8% NIIT. (See page 9.)
- Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions, hopefully in retirement when your tax rate may be lower.
- Your employer may match some or all of your contributions.

If you participate in a 401(k), 403(b) or 457 plan, it may allow you to designate some or all of your contributions as Roth contributions. While Roth contributions don't reduce your current MAGI, qualified distributions will be tax-free. An added benefit is that Roth plans don't require you to take distributions during your lifetime, so you can let the entire balance grow tax-free for the benefit of your heirs.

The opportunity to make such Roth contributions may be beneficial for higher-income earners because they're ineligible to contribute to a Roth IRA. Roth contributions may soon be your only option for catch-up contributions. (See "What's new!" on page 21.)

Chart 5
Retirement plan contribution limits for 2025

	Regular contribution	Catch-up contribution
Traditional and Roth IRAs	$ 7,000	$ 1,000[1]
401(k)s, 403(b)s, 457s and SARSEPs[2]	$23,500	$ 7,500[1] $11,250[3]
SIMPLEs[4]	$16,500	$ 3,500[1] $ 5,250[3]

[1] For taxpayers age 50 or older by the end of the tax year.

[2] Includes Roth versions where applicable.

[3] For taxpayers age 60, 61, 62 or 63 by the end of the tax year.

[4] The limit for Savings Incentive Match Plans for Employees can be 10% higher in certain circumstances. Check with your employer.

Note: Other factors may further limit your maximum contribution. If you're a business owner or self-employed, you may be able to set up a plan that allows you to make much larger contributions. (See Chart 3 on page 15.)

Roth IRA conversions

If you have a traditional IRA, a partial or full conversion to a Roth IRA can allow you to turn tax-*deferred* future growth into tax-*free* growth and take advantage of a Roth's estate planning benefits. The converted amount is taxable in the year of the conversion. Whether a conversion makes sense for you depends on factors such as:

- Your age,
- Whether the conversion would push you into a higher income tax bracket or trigger the 3.8% NIIT,
- Whether you can afford to pay the tax on the conversion,
- Your tax bracket now and expected tax bracket in retirement, and
- Whether you'll need the IRA funds in retirement.

With tax rates relatively low now because the OBBBA made the TCJA rates permanent, it may be a good time for a Roth conversion. Remember, "permanent" only means that the rates have no expiration date. Lawmakers could still pass legislation in the future increasing tax rates. So today's relatively low rates might mean there's a better chance that your rate in retirement will be higher. Your tax advisor can run the numbers and help you decide if a conversion is right for you this year.

If you (and your spouse, if you're married) don't have funds in a traditional IRA, consider "back door" Roth IRA contributions. You set up a traditional account and make a nondeductible contribution to it. After the transaction clears, you convert the traditional account to a Roth account. The only tax due will be on any growth in the account between the time you made the contribution and the date of conversion.

Early withdrawals

With a few exceptions, retirement plan distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. This means that, if you're in the top tax bracket of 37%, you can lose almost half of your withdrawal to taxes and penalties — and perhaps more than half if you're also subject to state income taxes and/or penalties. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

If you have a Roth account, you can withdraw up to your contribution amount without incurring taxes or penalties. But you'll be losing the potential tax-free growth on the withdrawn amount.

So if you're in need of cash, consider tapping your taxable investment accounts rather than dipping into your retirement plan. (See page 8 for information on the tax treatment of investments.)

Leaving a job

When you change jobs or retire, avoid taking a lump-sum distribution from your employer's retirement plan because it generally will be taxable, plus potentially subject to the 10% early-withdrawal penalty. These options help avoid current income tax and penalties:

Staying put. You may be allowed to leave your money in your old plan. But if you'll be participating in a new employer's plan or you already have an IRA, keeping track of multiple plans can make managing your retirement assets more difficult.

A rollover to your new employer's plan. If you're changing jobs and this will leave you with only one retirement plan to keep track of, it may be a good solution. But evaluate how well the new plan's investment options meet your needs.

A rollover to an IRA. If you participate in a new employer's plan, this will require keeping track of two plans. But it may be the best alternative because IRAs offer nearly unlimited investment choices.

If you choose a rollover, request a direct rollover from your old plan to your new plan or IRA. Otherwise, you'll need to make an indirect rollover within 60 days to avoid tax and potential penalties.

WHAT'S NEW!

Catch-up contributions are changing for some taxpayers

While the OBBBA generally doesn't make changes to retirement plans, the SECURE 2.0 Act, signed into law at the end of 2022, includes some provisions affecting catch-up contributions that have just gone into effect or will go into effect soon:

1. **Beginning in 2025, the act allows certain taxpayers to make larger catch-up contributions.** Taxpayers ages 60 to 63 can make catch-up contributions to most employer-sponsored plans up to 150% of the amount allowed for those age 50 and over. (See Chart 5 on page 20 for the 2025 amounts.)
2. **Beginning in 2026, the act will require the catch-up contributions of higher-income taxpayers to be treated as post-tax Roth contributions.** The requirement will apply to taxpayers who earned more than $145,000 (annually indexed for inflation) during the prior year. If you'll be affected by this limit and are age 50 or older, you may want to max out your catch-up contributions this year to take full advantage of your last chance to enjoy the upfront tax savings of pretax catch-up contributions.

Warning: If you don't do a direct rollover, the check you receive from your old plan may be net of 20% federal income tax withholding. Your subsequent indirect rollover must be of the gross amount (making up for the withheld amount with other funds) or you'll be subject to income tax — and potentially the 10% penalty — on the difference.

RMDs

Generally, you must begin taking required minimum distributions annually from your traditional IRAs and defined contribution plans (but not Roth accounts) once you reach a certain age. If you don't comply, you can owe a 25% penalty on the amount you should have withdrawn but didn't. If the failure is corrected in a "timely" manner, the penalty drops to 10%.

At what age must RMDs begin? Historically, taxpayers had to start taking their annual RMDs after reaching age 70½. A few years ago, the age was raised to 72. Last year, the age was raised again, to 73. It's currently scheduled to rise one more time, to 75 on Jan. 1, 2033.

Waiting as long as possible to take *nonrequired* distributions generally is advantageous because of tax-deferred compounding. But a distribution (or larger-than-required one) in a year your tax rate is lower than usual may save tax in the long run.

Be sure, however, to consider the lost future tax-deferred growth and, if applicable, whether the distribution could 1) cause Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect other tax breaks with income-based limits.

Also keep in mind that, while retirement plan distributions aren't subject to the additional 0.9% Medicare tax (see page 5) or 3.8% NIIT, they are included in your MAGI. That means they could trigger or increase the NIIT, because the thresholds for that tax are based on MAGI. If your IRA RMD could boost your MAGI enough to trigger the NIIT (or the phaseout of a valuable tax break), consider making a QCD to your favorite charity to meet your RMD requirement. (See page 16.)

If you've inherited a retirement plan, consult your tax advisor about the distribution rules that apply to you. ***Warning:*** The time period for distributions is only 10 years for beneficiaries — other than surviving spouses and certain others — inheriting plans after Dec. 31, 2019.

Higher exemptions will continue, but planning is still critical

Estate planning is about much more than reducing taxes; it's about ensuring your loved ones are provided for after you're gone and that your assets are passed on according to your wishes. So even though the OBBBA makes record-high estate, gift and generation-skipping transfer (GST) tax exemptions permanent and far fewer taxpayers are worrying about these taxes, estate planning is still critical.

Estate tax

Several years ago, the TCJA doubled the estate tax exemption base amount from $5 million to $10 million. The inflation-adjusted amount for 2025 is $13.99 million.

The exemption had been scheduled to return to an inflation-adjusted $5 million in 2026 (which likely would have been a little over $7 million). But the OBBBA permanently increases the exemption. It will be $15 million for 2026 and annually indexed for inflation after that.

This provides more certainty to taxpayers with large estates, but not complete certainty: "Permanently" increases just means there's no expiration date for the higher exemption; lawmakers could still reduce the exemption in the future. The estate tax rate remains at 40%, so the tax is costly when it does apply.

Gift tax

The gift tax continues to follow the estate tax, so the gift tax exemption also will permanently increase under the OBBBA. (See Chart 6.) Any gift tax exemption used during your lifetime reduces the estate tax exemption available at death.

Under the gift tax annual exclusion, you can exclude from taxation certain gifts of up to $19,000 per recipient in 2025 (up from $18,000 in 2024) — twice that if your spouse elects to split the gift with you or you're giving joint or community property — without depleting any of your gift and estate tax exemption. This can save significant taxes.

Warning: Each year you need to use your annual exclusion by Dec. 31. The exclusion doesn't carry over from year to year. For example, if you didn't make an annual exclusion gift to your child last year, you can't add $18,000 to your 2025 exclusion of $19,000 to make a $37,000 tax-free gift to that child this year.

GST tax

The GST tax generally applies to transfers (both during your lifetime and at death) made to people more than one generation below you, such as your grandchildren. The GST tax exemption and rate are the same as those for the gift and estate tax, but the GST tax is applied *in addition to* any gift or estate tax due. The GST tax exemption will also permanently increase under the OBBBA to continue to match the gift and estate tax exemption. (See Chart 6.)

The GST tax exemption can be a valuable tax-saving tool for taxpayers with large estates whose children also have — or may eventually have — large estates. With proper planning, they can use the exemption to make transfers to grandchildren and avoid tax at their children's generation.

For example, by allocating your GST tax exemption to contributions to a dynasty trust, you can ensure that any future distributions or other transfers of trust assets to your grandchildren or subsequent generations will avoid GST taxes. This is true even if the value of the assets grows well beyond the exemption amount or the exemption is reduced in the future.

State taxes

Even before the TCJA and the OBBBA, some states imposed estate tax at a lower threshold than the federal government did. Now the differences in some states are even more dramatic. To avoid unexpected tax liability or other unintended consequences, consult a tax advisor familiar with the law of your particular state.

Exemption portability

If part (or all) of one spouse's estate tax exemption is unused at that spouse's death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining exemption. This exemption "portability" provides flexibility at the first spouse's death, but it has some limits. Portability is available only from the most recently deceased spouse, doesn't apply to the GST tax exemption and isn't recognized by many states.

And portability doesn't protect future growth on assets from estate tax like

Chart 6
Estate, gift and GST tax exemptions and rates

	2025	2026
Exemption	$13.99 million	$15 million
Rate	40%	40%

applying the exemption to a credit shelter (or bypass) trust does. Such a trust also offers creditor and remarriage protection, GST tax planning, and possible state estate tax benefits.

So married couples should still consider these trusts — and transferring assets to each other as necessary to fully fund them at the first death. Such transfers aren't subject to gift or estate tax as long as the recipient spouse is a U.S. citizen.

Tax-smart giving

Giving away assets now will help reduce the size of your taxable estate. Because lawmakers could reduce the estate tax exemption in the future, making gifts during your lifetime may be tax-smart even if you expect your estate to stay below the inflation-adjusted $15 million exemption. Here are some strategies for tax-smart giving:

Choose gifts wisely. Consider both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- To minimize *estate tax*, gift property with the greatest future appreciation potential.
- To minimize *your beneficiary's income tax*, gift property that hasn't appreciated significantly while you've owned it.
- To minimize *your own income tax*, don't gift property that's declined in value. Instead, consider selling the property so you can take the tax loss and then gifting the sale proceeds.

Plan gifts to grandchildren carefully. Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts to a grandchild that don't qualify for the exclusion to be tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

Gift interests in your business or an FLP. If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts for lack of control and marketability. For example, assuming a combined discount of 25%, you could gift an ownership interest worth up to $25,333 (on a controlling basis) gift-tax-free. That's because the discounted value of the gift wouldn't exceed the $19,000 annual exclusion.

Case Study 6

Save income taxes for your family with the step-up in basis

Tim and Maureen want to give some of their wealth to their children so that they can see them enjoy it. But they're not sure which assets to give now and which to hold on to and bequeath at their deaths. They ask their tax advisor about the tax considerations.

He explains that, for taxpayers who don't need to worry too much about federal gift and estate taxes, income taxes are typically more important to consider. For example, gifted assets don't receive the "step-up" in basis that bequeathed assets do. This means that, if Tim and Maureen's kids sell assets that the couple gifts to them, the kids' taxable capital gains will be determined based on *their parents'* basis in the assets. Whereas, if the kids inherit the assets, the basis will be stepped up to the fair market value at death. So their capital gains tax could be significantly lower if they inherit the assets.

Therefore, the advisor suggests that Tim and Maureen hold on to highly appreciated assets that will benefit from the step-up in basis later, especially if their children are in one of the upper income tax brackets. But if the couple has some highly appreciated assets that they think the family should divest itself of now and their children are in *lower* tax brackets, gifting those assets to their kids might save tax for the family as a whole. Why? The children can sell them at a lower tax cost — perhaps even $0. (See "The 0% rate" on page 8.)

Another way to benefit from valuation discounts is to set up a family limited partnership. You fund the FLP with assets such as public or private stock and real estate, and then gift limited partnership interests.

Warning: The IRS may challenge valuation discounts; a professional, independent valuation is recommended. The IRS also scrutinizes FLPs, so be sure to set up and operate yours properly.

Pay tuition and medical expenses. You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider.

Make gifts to charity. Donations to qualified charities aren't subject to gift tax. They may also be eligible for an income tax deduction. (See page 16.)

Consider "taxable" gifts. Making some gifts beyond annual exclusion gifts and using some or all of your lifetime exemption can make sense if you have a large estate. These "taxable" gifts can protect transfers from gift and estate tax, even if the exemption drops in the future. They also remove the future appreciation from your estate. You do, however, need to keep in mind your beneficiaries' income tax. (See Case Study 6.)

Trusts

Trusts can provide a way to transfer assets and potentially enjoy tax savings while preserving some control over what happens to the transferred assets. For those with large estates, funding trusts now, while the gift tax exemption is high, may be particularly tax-smart. Here are some types of trusts to consider:

QPRT. A qualified personal residence trust allows you to give your home to your children today — removing it from your taxable estate at a reduced gift tax cost (provided you survive the trust's term) — while you retain the right to live in it for a specified period.

GRAT. A grantor-retained annuity trust works on the same principle as a QPRT but allows you to transfer other assets; you receive payments back from the trust for a specified period.

Crummey trust. This allows you to enjoy both the control of a trust that will transfer assets to loved ones at a later date and the tax savings of an outright current gift of up to the annual exclusion.

Chart 7
2025 individual income tax rates

Regular tax brackets				
Tax rate	**Single**	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
10%	$ 0–$ 11,925	$ 0–$ 17,000	$ 0–$ 23,850	$ 0–$ 11,925
12%	$ 11,926–$ 48,475	$ 17,001–$ 64,850	$ 23,851–$ 96,950	$ 11,926–$ 48,475
22%	$ 48,476–$ 103,350	$ 64,851–$ 103,350	$ 96,951–$ 206,700	$ 48,476–$ 103,350
24%	$ 103,351–$ 197,300	$ 103,351–$ 197,300	$ 206,701–$ 394,600	$ 103,351–$ 197,300
32%	$ 197,301–$ 250,525	$ 197,301–$ 250,500	$ 394,601–$ 501,050	$ 197,301–$ 250,525
35%	$ 250,526–$ 626,350	$ 250,501–$ 626,350	$ 501,051–$ 751,600	$ 250,526–$ 375,800
37%	Over $ 626,350	Over $ 626,350	Over $ 751,600	Over $ 375,800

Alternative minimum tax (AMT) brackets				
Tax rate	**Single**	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
26%	$ 0–$ 239,100	$ 0–$ 239,100	$ 0–$ 239,100	$ 0–$ 119,550
28%	Over $ 239,100	Over $ 239,100	Over $ 239,100	Over $ 119,550

AMT exemptions				
	Single	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
Amount	$ 88,100	$ 88,100	$ 137,000	$ 68,500
Phaseout[1]	$ 626,350–$ 978,750	$ 626,350–$ 978,750	$ 1,252,700–$ 1,800,700	$ 626,350–$ 900,350

[1] These are the AMT income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

Note: Consult your tax advisor for AMT rates and exemptions for children subject to the "kiddie tax."

Chart 8
2025 corporate income tax rates

Tax rate	Type of corporation
21%	C corporation
21%	Personal service corporation

Chart 9
2025 estate and trust income tax rates

Tax rate	Tax brackets
10%	$ 0–$ 3,150
24%	$ 3,151–$ 11,450
35%	$ 11,451–$ 15,650
37%	Over $ 15,650

Note: Consult your tax advisor for AMT rates and exemptions.

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