

Surgent's Individual Income Tax Update

BIT4/26/V1

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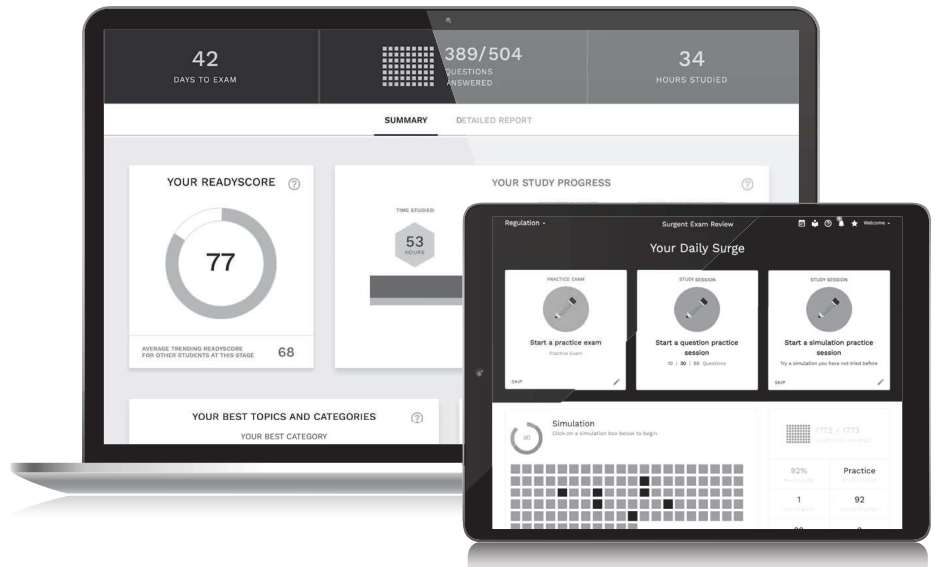
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The One Big Beautiful Bill Act – Individual Provisions

Learning objectives

Upon reviewing this material, the reader will be able to:

- Identify key tax updates applicable to individual taxpayers;
- Evaluate the impact of new OBBBA provisions on individual taxpayers;
- Analyze key provisions extended by the OBBBA; and
- Understand the practical implications of major individual provisions outlined in the OBBBA.

I. Overview

The individual income tax landscape is undergoing a period of significant transition. Recent legislative changes, including the One Big Beautiful Bill Act (OBBBA), remain at the forefront, and when combined with ongoing administrative guidance from the IRS, have introduced new deductions, modified longstanding limitations, and added layers of complexity to compliance and planning. This chapter will focus on the most impactful developments affecting individual taxpayers in 2026.

On December 22, 2017, President Trump signed into law H.R. 1, originally entitled the Tax Cuts & Jobs Act (TCJA). This legislation was the most sweeping, categorical change to the Code in over 30 years. Generally, the TCJA took effect January 1, 2018, although there are exceptions where certain provisions of the TCJA took effect in 2017. Due to complex rules relating to how the TCJA was enacted, most of the provisions of the TCJA are temporary and set to expire after 2025.

On July 4, 2025, President Trump officially signed the "One Big Beautiful Bill Act" (OBBBA) into law. The legislation was narrowly approved by the Senate by a 51–50 vote on July 1, with Vice President JD Vance casting the tie-breaking vote in favor of the bill. The bill was passed under budget reconciliation procedures, requiring only a simple majority vote to advance. The legislation permanently extends, with certain modifications, key provisions that were originally enacted under the 2017 Tax Cuts and Jobs Act (TCJA).

II. Individual Tax Provisions of TCJA Made Permanent

A. Individual Income Tax Rates

The OBBBA permanently extends the lower individual income tax rates and widened brackets originally enacted by the TCJA, effective for tax years beginning after December 31, 2025. For individuals, the permanent rates will remain at 10%, 12%, 22%, 24%, 32%, 35%, and 37%, rather than reverting to the higher pre-TCJA structure that topped out at 39.6%. These brackets will continue to be adjusted annually for inflation.

The OBBBA also preserves the expanded income thresholds that eliminate the marriage penalty, maintaining joint filer brackets that are generally double those for single filers (except at the top bracket).

For tax year 2025, the marriage penalty typically only applies to taxpayers with combined taxable income in excess of \$751,600.

The TCJA did not alter the tax rates applied to net capital gains and qualified dividends, with the rates remaining at 0%, 15%, and 20%. However, the TCJA adjusted the income thresholds that determine which of these rates apply, effective for tax years 2018 through 2025. This OBBBA provision makes permanent the updated income thresholds for long-term capital gains and qualified dividend tax rates. By preserving these thresholds, the OBBBA provides greater certainty for investment planning. Although the rates are preserved, the impact of the 3.8% Net Investment Income Tax should still be considered for investment income.

B. Standard Deduction

The TCJA temporarily increased the standard deduction amounts for tax years 2018 through 2025. The OBBBA makes permanent the TCJA's expanded standard deduction and further increases the base amounts beginning in 2025. Compared to the inflation-adjusted TCJA levels, the OBBBA provides an additional increase of \$750 for single filers and \$1,500 for married couples filing jointly.

The updated 2025 standard deduction amounts are as follows:

Standard Deduction			
Filing Status	Pre-OBBBA (2025)	Post-OBBBA (2025)	Post-OBBBA (2026)
Married Filing Jointly	30,000	31,500	32,200
Surviving Spouse	30,000	31,500	32,200
Head of Household	22,500	23,625	24,150
Single	15,000	15,750	16,100
Married Filing Separately	15,000	15,750	16,100

The standard deduction will continue to be indexed annually for inflation. The OBBBA updates the cost-of-living adjustment (COLA) methodology for the standard deduction, adopting chained CPI for 2024. The additional standard deduction for individuals aged 65 or older and/or blind remains unchanged.

For 2026, the additional deduction amounts are:

- \$2,050 for single filers and heads of household; and
- \$1,650 per qualifying spouse for joint filers and surviving spouses.

C. Personal Exemptions

Under pre-TCJA law, taxpayers could claim a personal exemption deduction for themselves, their spouse (if filing jointly), and any qualifying dependents. These deductions reduced AGI and were subject to phaseout based on AGI and filing status. The personal exemption amount was indexed annually for inflation, and in many cases provided significant tax savings, particularly for larger families. The TCJA set the personal exemption amount to zero from 2018–2025; however, it left the underlying structure intact for a possible return.

The OBBBA amends §151(d)(5) to permanently set the personal exemption amount to zero, beginning in tax years after December 31, 2024. By codifying a permanent \$0 exemption amount, the OBBBA

prevents the automatic return of personal exemptions in 2026 that would have occurred under the TCJA sunset provisions.

D. Miscellaneous Itemized Deductions

Prior to the TCJA, miscellaneous itemized deductions were allowed if the total exceeded 2% of the taxpayer's adjusted gross income (AGI). Common deductions included unreimbursed employee expenses (like home office or travel costs), investment fees, and certain hobby losses. The TCJA suspended these miscellaneous itemized deductions for tax years 2018 through 2025. Without Congressional action, these deductions would have resumed in 2026.

The OBBBA permanently extends the TCJA's suspension of miscellaneous itemized deductions under §67(g). As a result, it effectively eliminates deductions for items such as unreimbursed employee expenses, tax prep fees, and investment expenses.

The OBBBA creates an exception that allows qualified educators to deduct unreimbursed employee expenses as a permitted itemized deduction under §67(b). Qualified educators include K–12 teachers, instructors, counselors, principals, aides, and interscholastic sports coaches or administrators who work at least 900 hours in a school year. Deductible expenses include amounts paid or incurred for participation in professional development courses, books, supplies, computer equipment (including related software and services), other equipment, and supplementary materials that are used in the classroom. This provision is effective for tax years beginning after December 31, 2025.

A \$350 above-the-line educator expense deduction is available to all eligible taxpayers, regardless of whether they itemize or take the standard deduction in 2026. Under the OBBBA, beginning in the 2026 tax year, the tax treatment of educator expenses shifts from a single capped amount to a dual-benefit structure:

- **Above-the-line Deduction:** Eligible taxpayers can first claim up to \$350 as an above-the-line deduction.
- **Itemized Deduction:** Any qualified expenses exceeding \$350 can be claimed as an itemized deduction on Schedule A.

It is important to note that such unreimbursed expenses claimed as an itemized deduction have no dollar limitation and are not subject to the 2% of AGI floor.

Further, the new itemized deduction for unreimbursed educational expenses is now available to sports administrators and coaches. Additionally, the new itemized deduction for unreimbursed educational expenses is available for nonathletic supplies for courses in physical education or health, expanding eligibility beyond traditional classroom materials. Since the itemized deduction is uncapped, it is crucial to maintain detailed records for all instructional materials, professional development, and other supplies.

Since the enactment of the TCJA in 2017, the nature of work has changed substantially. The COVID-19 pandemic accelerated the adoption of remote work across many industries, and many organizations have since embraced flexible work arrangements as a standard practice rather than a temporary solution.

Further, technological advancements, digital collaboration tools, and changing employer policies have made remote and hybrid work models increasingly common and, in many cases, permanent.

As a result, a growing number of employees now incur significant out-of-pocket expenses to maintain a work environment at their residence, including home office furniture, equipment, utilities, and other costs that were traditionally employer-provided in physical office settings.

Despite this shift, the permanent disallowance of miscellaneous itemized deductions means that employees can no longer deduct these unreimbursed costs, even when incurred directly in connection with their job responsibilities. This change disproportionately impacts employees in roles where remote work is standard but employer reimbursement policies are limited or nonexistent, including educators, knowledge workers, and professionals in tech, finance, marketing, and customer service. Absent a future change in tax law, these employees must either absorb these costs personally or seek reimbursement from their employers, as there is no longer a tax mechanism to recover these expenses through itemized deductions.

E. Pease Limitation

Prior to the TCJA, the Pease limitation applied to high-income taxpayers by reducing the total value of their itemized deductions. The limitation operated by reducing most itemized deductions (excluding medical expenses, investment interest, and casualty, theft, or gambling losses) by the lesser of 3% of AGI above a specified threshold or 80% of the otherwise allowable itemized deductions. The Pease limitation eroded deductions like charitable contributions, state and local taxes, and mortgage interest for high-income taxpayers.

The TCJA suspended the Pease limitation for tax years 2018 through 2025, allowing taxpayers to claim full itemized deductions, subject only to other applicable limits (e.g., the SALT cap, etc.). However, the TCJA included a sunset clause, meaning the Pease limitation was set to return automatically for tax years beginning after December 31, 2025, absent new legislation.

The OBBBA permanently repeals the §68 Pease limitation, preventing its automatic reinstatement after 2025. In its place, the OBBBA introduces a new cap on the value of itemized deductions for higher-income taxpayers. Under the new rule, allowable itemized deductions are reduced by 2/37 of the lesser of:

- The total itemized deductions; or
- The amount by which the taxpayer's taxable income exceeds the threshold for the 37% tax bracket.

This new limitation does not apply to the §199A deduction for qualified business income. This new limitation on total itemized deductions for high-income taxpayers underscores the importance of identifying strategies to reduce taxable income from the 37% marginal rate into the 35% bracket. This change is in effect for tax years beginning after December 31, 2025.

F. Casualty Loss Deduction

The OBBBA permanently extends the TCJA limitation on itemized deductions for personal casualty losses, restricting them to losses that arise from federally declared disasters. In a significant expansion, the OBBBA now also allows itemized deductions for losses attributable to certain state-declared disasters, providing relief to individuals affected by regionally significant events that may not receive federal designation.

Personal casualty losses from events that are not federally or state-declared disasters are no longer deductible, even if uninsured or substantial. This provision applies to tax years beginning after December 31, 2025.

G. Disaster-Related Personal Casualty Losses

The OBBBA also extends and modifies disaster relief rules under the Taxpayer Certainty and Disaster Tax Relief Act of 2020, offering expanded relief for individuals in qualified disaster areas. Such taxpayers in qualified disaster areas can claim personal casualty losses without itemizing deductions.

Instead of claiming the loss as an itemized deduction, affected taxpayers may increase their standard deduction by the amount of the net disaster loss, calculated as the excess of qualified disaster-related personal casualty losses over any casualty gains. The per-casualty floor for losses has been raised from \$100 to \$500 under these disaster provisions. To qualify, the loss must arise on or after the first day of the incident period in a qualified disaster area.

H. Alternative Minimum Tax (AMT)

The Alternative Minimum Tax (AMT) is a parallel tax system designed to ensure that higher-income individuals pay at least a minimum level of tax, regardless of deductions, exemptions, or credits claimed under the regular income tax system. The OBBBA permanently extends the increased individual AMT exemption amounts originally enacted by the TCJA, which were previously set to expire after 2025. The OBBBA also resets the phase-out thresholds to their lower 2018 levels. As such, beginning in 2026, the phase-out thresholds are:

- \$500,000 for single filers; and
- \$1,000,000 for joint filers.
- *Note:* Both thresholds are indexed for inflation.

The AMT exemption phaseout rate doubles from 25% to 50%, causing higher-income taxpayers to lose the exemption twice as quickly as income exceeds the applicable threshold. This change results in higher effective AMT liabilities for high-income taxpayers whose incomes fall well above the threshold, despite the increased exemption amounts. The AMT still applies only if it results in more tax than under the regular system, ensuring high-income taxpayers pay a minimum amount of tax, regardless of deductions or credits claimed under the regular system.

I. Moving Expenses

Prior to 2018, taxpayers who met specific distance and employment criteria could deduct qualified moving expenses regardless of whether they itemized, and employer reimbursements for qualified moving expenses were excluded from gross income and wages for tax and employment purposes. Originally enacted as a temporary measure, the TCJA suspended both the deduction and exclusion for most individuals from 2018-2025, retaining the benefit only for active-duty military moves under official orders.

The OBBBA makes permanent the suspension of the moving expense deduction under §217 and the employer-paid moving expense exclusion under §132(g) for most taxpayers. As a result, for tax years beginning after December 31, 2025, most taxpayers can no longer deduct moving expenses or exclude employer reimbursements from gross income.

For employers, moving expense reimbursements are taxable compensation for most employees, and must be included on Form W-2. For most employees, relocating for a new job is fully out-of-pocket unless they fall under one of the narrow exemptions, with no federal tax relief for qualifying expenses.

Limited exceptions remain in place:

- The deduction and exclusion continues to apply to active-duty members of the U.S. Armed Forces who move pursuant to a military order and permanent change of station.
- Further, the OBBBA expands the exception to include employees and appointees of the U.S. intelligence community who relocate due to an official change in assignment.

These changes apply to tax years beginning after December 31, 2025, with expanded eligibility for the intelligence community beginning in tax year 2026.

J. Mortgage Interest Deduction

Prior to the TCJA, taxpayers could deduct interest on up to \$1,000,000 of acquisition mortgage debt (\$500,000 for married filing separately), as well as interest on up to \$100,000 of home equity debt (\$50,000 for married filing separately).

Under the TCJA, the deduction became temporarily limited for tax years 2018 through 2025 to the first \$750,000 of acquisition debt (\$375,000 married filing separately), while home equity interest was disallowed unless used to buy, build, or substantially improve the home. Loans dated before December 15, 2017, were grandfathered, permitting continued deduction under old the limit.

The OBBBA permanently extends the limitation on the deduction for qualified residence interest to apply only to the first \$750,000 of home acquisition mortgage debt (\$375,000 for married individuals filing separately). This provision applies to acquisition indebtedness used to purchase, build, or substantially improve a qualified residence, which includes a taxpayer's principal residence and one other residence. This change makes permanent the temporary cap introduced by the TCJA, which was originally set to revert to a \$1 million limit beginning in 2026.

The OBBBA also permanently excludes interest on home equity indebtedness from the definition of qualified residence interest, unless the proceeds are used to acquire or improve the residence. Lastly, the OBBBA treats certain mortgage insurance premiums paid on acquisition indebtedness as qualified residence interest, thus allowing their deductibility. This provision applies to tax years beginning after December 31, 2025.

K. Child Tax Credit

Prior to the TCJA, taxpayers could claim a Child Tax Credit of up to \$1,000 per qualifying child. The entire \$1,000 credit was potentially refundable through the Additional Child Tax Credit. The earned income threshold to access the refundable portion was \$3,000, and the credit phased out at lower MAGI thresholds:

- \$110,000 for married filing jointly;
 - \$75,000 for single or head of household; and
 - \$55,000 for married filing separately.
- Note:* These thresholds were not indexed for inflation.

Further, identification requirements allowed the use of either a Social Security Number (SSN) or an Individual Taxpayer Identification Number (ITIN) for the qualifying child.

The TCJA temporarily increased the CTC from \$1,000 to \$2,000 per qualifying child, and this amount was not indexed for inflation.

Under the TCJA, up to \$1,400 of the \$2,000 credit was made refundable through the Additional Child Tax Credit, as indexed for inflation. The earned income threshold to access the refundable portion was reduced to \$2,500, making the credit more accessible to lower-income households. Under the TCJA, the MAGI phase-out thresholds were significantly increased to:

- \$400,000 for married filing jointly; and
- \$200,000 for all other filers.
- *Note:* These thresholds were not indexed for inflation.

The TCJA also added a strict SSN requirement:

- The qualifying child(ren) must have a valid SSN issued by the return due date; and
- Children with only ITINs no longer qualified.

The TCJA introduced a temporary \$500 nonrefundable credit for “other dependents” for tax years 2018 through 2025, and this credit was not indexed for inflation. All of these provisions were set to sunset after 2025, reverting to pre-TCJA rules unless extended by future legislation.

The OBBBA makes several key changes to the CTC, many of which make permanent or expand provisions originally introduced under the TCJA. Beginning in 2025, the nonrefundable portion of the CTC increases by \$200, bringing the maximum credit to \$2,200 per qualifying child (adjusted annually for inflation). This increase applies only to the nonrefundable portion of the credit, meaning it primarily benefits taxpayers with sufficient tax liability to fully utilize the credit.

The bill makes permanent the refundable portion of the credit, currently \$1,700 in 2026, as indexed for inflation. The OBBBA retains and makes permanent the higher income phase-out thresholds introduced under the TCJA (\$200,000 for single filers and \$400,000 for joint filers), as well as the \$500 nonrefundable credit (not indexed for inflation) for other dependents who do not qualify for the CTC.

Finally, the OBBBA tightens identification requirements. Under OBBBA, not only must the qualifying child have a Social Security Number (SSN), but also the taxpayer (or at least spouse, if filing jointly) must have a valid SSN to claim the credit. The omission of a valid SSN for either the child or taxpayer will now be treated as a mathematical or clerical error, allowing the IRS to deny the credit without a full audit. This new rule is effective for tax years beginning after December 31, 2024.

Child Tax Credit (CTC): Pre-OBBBA vs. Post-OBBBA				
Provision	Pre-TCJA	TCJA (2018-2025)	Post-OBBBA (2025 onward)	Notes
Total CTC per Qualifying Child	\$1,000	\$2,000	\$2,200	Nonrefundable portion increased by \$200 by OBBBA; indexed for inflation starting 2026
Refundable Portion	up to \$1,000	up to \$1,400 (indexed to \$1,700)	up to \$1,700 (Permanent)	Under OBBBA, adjusted for inflation annually
Earned Income Threshold	\$3,000	\$2,500	\$2,500	Lower threshold made permanent by OBBBA
Phaseout Threshold	\$55,000 (MFS) / \$75,000 (single/HOH) / \$110,000 (MFJ)	\$200,000 (single/others) / \$400,000 (MFJ)	Same (Permanent)	Not indexed for inflation
Credit for Other Dependents	None	\$500	\$500 (Permanent)	Not indexed for inflation
SSN Requirement – Child	Either SSN or ITIN	Required	Required	No change
SSN Requirement – Taxpayer/Spouse	Not Required	Not required	Now Required	IRS can disallow CTC automatically if SSN is missing
Sunset Date	End of 2017 (pre-TCJA law)	End of 2025 (pre-OBBBA law)	No expiration	Permanence increases planning certainty

L. Child and Dependent Care Credit

Prior to the OBBBA, taxpayers with one or more qualifying individuals, such as children or other dependents could claim a nonrefundable child and dependent care credit for employment-related expenses incurred for child and dependent care. Employment-related expenses include costs for household services and care expenses for qualifying individuals necessary for the taxpayer to work or actively seek work.

The credit is calculated by multiplying qualifying expenses up to \$3,000 for one qualifying individual or \$6,000 for two or more by a credit rate based on the taxpayer's AGI. Before the OBBBA was enacted, the maximum credit rate was 35%, which phased down to 20% for taxpayers with AGI exceeding \$43,000.

The OBBBA permanently increases the maximum credit rate from 35% to 50%, effective for tax years after December 31, 2025. The 50% credit rate is gradually reduced by one percentage point for every \$2,000 (or fraction thereof) by which the taxpayer's AGI exceeds \$15,000, but this reduction cannot lower the rate below 35%. For taxpayers with AGI between \$43,001 and \$75,000 (\$86,001 to \$150,000 for joint filers), the credit rate is fixed at 35%. For AGI between \$75,001 and \$105,000 (\$150,001 to \$210,000 for joint filers), the credit rate is further phased down to a minimum of 20%. In other words, the credit rate phases down in two stages: first from 50% to a minimum of 35% as AGI exceeds \$15,000, then from 35% to a minimum of 20% as AGI surpasses \$75,000 (or \$150,000 for joint filers).

Child and Dependent Care Credit – Single Taxpayers	
AGI Range	Credit Percentage
\$0 – \$15,000	50%
\$15,001 – \$45,000	Phases down from 50% to 35%
\$45,001 – \$75,000	35%
\$75,001 – \$105,000	Phases down from 35% to 20%
Over \$105,000	20%

Child and Dependent Care Credit – MFJ Taxpayers	
AGI Range	Credit Percentage
\$0 – \$15,000	50%
\$15,001 – \$45,000	Phases down from 50% to 35%
\$45,001 – \$150,000	35%
\$150,001 – \$210,000	Phases down from 35% to 20%
Over \$210,000	20%

Under the OBBBA, the qualifying expense caps remain unchanged:

- \$3,000 for one qualifying individual; and
- \$6,000 for two or more qualifying individuals.

The maximum credit under OBBBA is:

- Up to \$1,500 (one child); and
- Up to \$3,000 (two or more).

These OBBBA changes are not temporary, as the 50% rate and updated phase-out thresholds are permanent changes.

M. Basic Exclusion Amount

A basic exclusion amount, also known as the lifetime gift and estate tax exemption, is the combined lifetime exemption for estate tax, gift tax, and generation-skipping transfer (GST) tax. This unified exemption means that any portion used during one’s lifetime (e.g., for lifetime gifts) reduces the remaining exemption available at death for the estate.

Under pre-TCJA law, the basic exclusion amount for estate, gift, and GST taxes was \$5 million per person. This exclusion amount was adjusted annually for inflation. In addition, the deceased spousal unused exclusion (DSUE) amount was introduced as a portability provision, enabling the surviving spouse to utilize any unused exclusion from their deceased partner. Without future legislative changes, this \$5 million exclusion (as indexed for inflation) would have remained.

The TCJA temporarily doubled the basic exclusion amount from \$5 million to \$10 million per person (indexed annually for inflation), effective for gifts made and estates of decedents dying between 2018 and 2025. The temporary \$10 million (inflation-adjusted) exclusion enacted under the TCJA was set to revert to approximately \$7 million per person in 2026 absent legislative changes.

The OBBBA permanently increases the federal estate, gift, and generation-skipping transfer (GST) tax exclusion amount to \$15 million per person (or \$30 million for married couples filing jointly) for estates of decedents dying after December 31, 2025. The new \$15 million exclusion is adjusted annually for inflation, beginning in 2026. This expanded exemption applies to lifetime transfers and transfers at death. Lastly, portability rules remain intact, allowing the surviving spouse to claim any unused exclusion from the deceased spouse’s estate by timely filing an estate tax return.

Although the OBBBA offers a significant and permanent increase in the exclusion amount, estate planners should remain cautious, as future legislation could reverse or reduce the exclusion, increase transfer tax rates, or alter the structure of estate taxation entirely. Given the potential for legislative change, high-net-worth individuals may still benefit from using some or all of their available exclusion sooner rather than later.

III. New and Enhanced OBBBA Tax Provisions for Individuals

A. Temporary Senior Deduction

The OBBBA introduces a temporary deduction for taxpayers age 65 and older, effective for 2025 through 2028. Qualified individuals can deduct \$6,000 per eligible senior. This means single seniors can claim \$6,000, and married couples filing jointly can claim up to \$12,000 if both spouses qualify.

To qualify, an individual must be age 65 or older before the close of the taxable year. Married taxpayers must file a joint return in order to claim this deduction. This deduction is available in addition to the standard deduction, making it particularly beneficial for seniors who do not itemize.

If a taxpayer was born before January 2, 1961, but died in 2025 before reaching age 65, then the taxpayer does not qualify for the enhanced deduction for seniors. A person is considered to reach age 65 on the day before the person's 65th birthday.

Example: A taxpayer's spouse was born on February 14, 1960, and died on February 13, 2025. The taxpayer's spouse is considered age 65 at the time of death and would qualify for the enhanced deduction for seniors. However, if the taxpayer's spouse died on February 12, 2025, the spouse is not considered age 65 and would not qualify for the enhanced deduction for seniors.

The deduction is phased out when MAGI exceeds:

- \$75,000 for single filers; and
- \$150,000 for married filing jointly.

The deduction is fully phased out when MAGI exceeds:

- \$175,000 for single filers; and
- \$250,000 for married filing jointly.

A valid SSN must be provided for each qualifying individual to claim the deduction. Failure to provide such information is treated as a mathematical or clerical error, allowing the IRS to disallow the deduction without a formal audit. This provision is not permanent and is set to sunset after tax year 2028.

B. Tip Income Deduction

1. Background and Overview

Prior to the OBBBA, all tip income was includible in gross income and subject to both federal income tax and employment taxes (Social Security and Medicare). All tips received by an individual are subject to federal income taxation including:

- Cash tips received directly from customers;

- Electronically paid tips from credit and debit card charge customers; and
- Tips received under a tip-splitting or tip-pooling arrangement.

The value of noncash tips received, such as tickets, passes or other goods or commodities that a customer gives the individual are generally also subject to income taxation. Service charges added by the employer to a customer's bill (e.g., mandatory 18% gratuity) are not tips, and they are treated as wages and taxed accordingly.

To be classified as a "tip," the following conditions must generally apply:

- The payment is made voluntarily, not compelled;
- The amount is determined by the customer;
- The payment is not subject to negotiation or dictated by employer policy; and
- The customer decides who receives the tip.

Employees normally include tips in income when they are received. However, employees who are required to report cash tips to their employer in a written statement are treated as receiving the tips when they provide this statement. If an employee receives cash tips of \$20 or more in any calendar month, the employee must report those tips to the employer in one or more written statements by the tenth of the month following the month the tips were received. The employer reports that tip income to the employee on the employee's W-2.

The OBBBA introduces a temporary deduction for qualified tip income, available for tax years 2025 through 2028. Under this provision, individuals in occupations that customarily receive tips may deduct up to \$25,000 in qualified tip income annually. The total amount of qualified tips that can be deducted on a return per calendar year is \$25,000 regardless of filing status. The deduction is available to both employees (who receive Form W-2) and independent contractors who report tips on Form 1099-K, Form 1099-NEC, or Form 4317 (used to report unreported tip income). No deduction for qualified tips is allowed unless the taxpayer includes his or her SSN on the tax return for the taxable year. Itemizing is not required to take this deduction. Tip income remains subject to payroll taxes (i.e., Social Security and Medicare) and state income taxes.

The deduction is reduced by \$100 for every \$1,000 of MAGI exceeding \$150,000 (or \$300,000 for joint filers).

2. What Qualifies as a "Tip"

To qualify as a "tip" for purposes of the deduction, it must be:

- Voluntary (not negotiated) and properly reported on IRS forms (W-2, 1099, etc.);
- Made in cash and earned in occupations listed by the IRS as customarily tipped as of December 31, 2024; and
- Not received in "specified service trades or businesses" (as defined under §199A(d)(2)).
- *Note:* Cash tips include tips received from customers that are paid in cash or charged, and, in the case of an employee, tips received under any tip-sharing arrangement.

For purposes of the deduction, the following qualify as a "tip":

- **Cash Tips:** Cash tips are tips received from customers or, in the case of an employee, through a mandatory or voluntary tip-sharing arrangement, such as a tip pool, that are paid in a cash medium, including by cash, check, credit card, debit card, gift card,

tangible or intangible tokens that are readily exchangeable for a fixed amount (for example, casino chips), and any other form of electronic settlement or mobile payment app that is denominated in cash. Tips are the excess amount paid by a customer for services over the amount agreed to or otherwise reasonably expected to have been paid for the services in an arm's-length transaction.

- Cash tips do not include items paid in any medium other than cash, such as event tickets, meals, services, or other assets that aren't exchangeable for a fixed amount of cash. Further, as discussed, amounts are qualified tips only if they are paid voluntarily and without any consequence in the event of nonpayment. Qualified tips do not include service charges, automatic gratuities, or any other mandatory amounts automatically added to a customer's bill by the vendor or the establishment, unless the customer is expressly provided an option to disregard or modify such charges, gratuities, and amounts without consequence.

Lastly, the following amounts received are not considered qualified tips:

- **Specified Service Trade or Business (SSTB):** Tips earned by an employee working for an SSTB employer are excluded from qualified tip income. Similarly, if an individual is self-employed in an SSTB, any tips received in the course of that trade or business are not treated as qualified tips.
- **Felonies or Misdemeanors:** Tips received while performing a service that is a felony or misdemeanor under applicable law are not qualified tips. However, tips received for a service that is legal but were received while working for an establishment that violates applicable law in other respects may be qualified tips.
- **Other Activities:** Amounts received for prostitution and pornographic activity are not qualified tips.

3. Qualifying Occupations

On April 10, 2026, the IRS issued final regulations (TD 10044) listing occupations where workers customarily and regularly receive tips. The List of Occupations that Receive Tips is classified by the Treasury Tipped Occupation Code system, comprising a three-digit code and description for each of the occupations listed within the final regulations. As in the proposed regulations, the final regulations group the occupations into eight categories:

- 100s – Beverage and Food Service.
- 200s – Entertainment and Events.
- 300s – Hospitality and Guest Services.
- 400s – Home Services.
- 500s – Personal Services.
- 600s – Personal Appearance and Wellness.
- 700s – Recreation and Instruction.
- 800s – Transportation and Delivery.

Category	Example occupations included
100s – Beverage and food service	Bartenders, wait staff, chefs and cooks, dishwashers, host staff, restaurant / lounge / coffee shop workers, bakers
200s – Entertainment and events	Gambling dealers, dancers, musicians and singers, digital content creators
300s – Hospitality and guest services	Baggage porters and bellhops, concierges, maids and housekeeping cleaners
400s – Home services	Home maintenance and repair workers, landscaping and groundskeeping workers, home cleaning service workers, locksmiths, roadside assistance workers
500s – Personal services	Personal care and service workers, private event planners, private event and portrait photographers, pet caretakers, tutors, nannies and babysitters. <i>Final regs also added: visual artists and floral designers.</i>
600s – Personal appearance and wellness	Massage therapists, barbers, hairdressers, hairstylists and cosmetologists, exercise trainers and group fitness instructors, tattoo artists and piercers
700s – Recreation and instruction	Golf caddies, tour guides, sports and recreation instructors
800s – Transportation and delivery	Parking and valet attendants, taxi and rideshare drivers and chauffeurs, goods delivery workers, home movers. <i>Final regs also added: gas pump attendants.</i>

The final regulations expand the list to include visual artists and floral designers in the personal services category and add gas pump attendants in the transportation and delivery category. The final regulations further clarify that workers can take the deduction only for qualified tips that are included on Form W-2, Form 1099-NEC, Form 1099-MISC, Form 1099-K, or reported by the worker on Form 4137. Gig workers and other self-employed individuals can qualify for this deduction if their occupation is on the List of Occupations that Receive Tips and the other statutory and regulatory requirements are met.

4. The Net Income Limitation

For self-employed individuals and independent contractors, the deduction is subject to a net income limitation. If the individual operates a business receiving tips, the deduction applies only if gross income (including tips) exceeds deductible expenses. In other words, qualified tips from a trade or business cannot exceed the gross income from the trade or business in which the qualified tips were received, minus the total of all deductions allocable to that trade or business, including the deductible part of self-employment tax; the deduction for contributions to self-employed SEP, SIMPLE, and qualified plans; and the self-employed health insurance deduction, but not including the deduction for qualified tips. The net income limitation applies to each separate trade or business in which the taxpayer received qualified tips. Tips from a profitable business cannot be used to offset an excess from an unprofitable one. Further, amounts deducted under this provision are excluded from Qualified Business Income (QBI) for purposes of the 20% §199A deduction.

Example 1 Full Deduction Available:

Evan has a business tutoring for local schools as an independent contractor. He operates his business as a sole proprietorship. During 2025, Evan received \$500 in qualified tips from students that were reported to him by the schools on Forms 1099-NEC and reported separately in earnings statements provided by the schools.

Evan's gross income from the business for 2025 was \$5,000 and his deductible expenses from the business are \$500. As a result, his net income limitation from his tutoring business is \$4,500. On Schedule 1-A, line 5, \$500 is reported. Evan

can take the full amount of qualified tips from the business into account when figuring his deduction because the net income from that business was more than the amount of qualified tips from the business.

Example 2 **Net Income Limitation Applies:**

Evan is a rideshare driver who operates as a sole proprietor. During 2025, he received \$1,800 in qualified tips from customers that were reported to him on Form 1099-NEC and reported separately in his earnings statement provided on the rideshare company's app.

Evan's gross income from the business for 2025 was \$15,000 and his deductible expenses from the business were \$14,000. Evan's net income limitation for this business is \$1,000. On Schedule 1-A, \$1,000 of qualified tips is entered on line 5. However, \$800 of Evan's qualified tips from the business cannot be taken into account in figuring his deduction because it is more than his net income limitation from the business.

Example 3 **Multiple Businesses:**

The facts are the same as in Example 1 and Example 2, except that Evan owns and operates both businesses. On Schedule 1-A, \$1,500 of qualified tips is entered on line 5. This includes \$500 from the tutoring business because the net income from that business was more than the amount of qualified tips received in the course of that business. It also includes \$1,000 in qualified tips from his rideshare business. It does not include the remaining \$800 of qualified tips from his rideshare business because the qualified tips received in the course of the rideshare business were more than the net income from that business by that amount.

5. Substantiation

For 2025 only, employers may use any reasonable method to estimate tip amounts for reporting. In order to determine the qualified tips that a taxpayer received as an employee for 2025, they can use one of the following methods:

- They can use the amount reported on Form W-2 in box 7. This amount should be entered on line 4a of Schedule 1-A.
- They can use the total amount of tips reported to their employee on all Forms 4070 or any similar form used to report tips monthly to the employer. This amount may be more accurate if the amount in box 1 or box 5 is more than \$176,100. This amount should be entered on line 4a of Schedule 1-A.
- If the employer voluntarily chooses to report the amount of the taxpayer's tips in box 14 of Form W-2 or on a separate statement, the taxpayer can use the amount reported to them.
- If the taxpayer is submitting Form 4137, they can use the amount of qualified tips included for the employer in column 1(c) of Form 4137 to enter on line 4b of Schedule 1-A.

Example 1: Joe is a restaurant server and has only one employer. His Form W-2, box 7, is \$18,000. He has no unreported tips. Joe can use the \$18,000 in box 7 to figure the deduction for qualified tips. On Schedule 1-A, \$18,000 is entered on lines 4a and 4c.

Example 2: Jake is a bartender and has only one employer. His 2025 Form W-2 shows \$200,000 in box 1 and \$15,000 in box 7. Jake reports \$20,000 of tips on Form 4070 and reports \$4,000 of unreported tips on Form 4137, line 4. Jake can use the \$4,000 reported on Form 4137 plus either the \$15,000 from box 7 of his Form W-2 or the \$20,000 of tips reported on Form 4070 to figure the deduction for qualified tips.

As mentioned, since no changes have been made to Form 1099-NEC, Form 1099-MISC, or Form 1099-K for 2025, a separate accounting for cash tips received by a taxpayer as a non-employee won't appear on these Forms. The taxpayer should base their determination of the amount of their qualified tips on documentation such as receipts, point-of-sale system reports, daily tip logs, third party settlement organization records, or other documents showing the amount reported as qualified tips.

Example 1: Jess is a rideshare driver and receives a Form 1099-K from the rideshare company that includes tips in the total amount of compensation, income, or payments. The rideshare company reports separately in her earnings statement on its rideshare app or website the fares she earned and tips she received during the year. In order to figure the amount of her qualified tips for 2025, Jess can use the amount designated as tips by the rideshare company in her earnings statement on the rideshare app or website.

Example 2: Jill is a self-employed travel guide who operates as a sole proprietor. In 2025, she received cash tips from customers in connection with guided tours. These tips are voluntarily paid by customers in addition to the stated price of the tour. During 2025, Jill received a Form 1099-K from the online booking platform customers use to book the guided tours. The Form 1099-K shows \$55,000 of total payments, of which \$7,000 is customer tips. The Form 1099-K doesn't separately identify the tips, but Jill keeps a log of each tour that shows the date, customer, and tip amount.

Since Jill has daily tip logs substantiating the \$7,000 tip amount, she can use the \$7,000 tip amount to figure her deduction for qualified tips. Jill enters \$7,000 on Schedule 1-A, line 5.

The IRS is also required to update withholding procedures starting in 2026 to reflect the new deduction. Reporting entities (employers, platforms, third-party payers) must:

- Separately report designated cash tips and recipient occupations; and
- Update Forms W-2, 1099, 1099-K, and related filings.

The practical consequence is that 2026 will be the first year in which IRS matching programs can systematically compare the tip amounts reported by employers and platforms against the tip deductions claimed by taxpayers on Schedule 1-A. The tip income deduction will become a substantiation-heavy deduction, similar to meals/auto expenses in practice.

The new tip income deduction targets service industry and gig economy workers, many of whom experience income volatility and lack benefits. It also encourages accurate and transparent tip reporting, potentially reducing underreporting of tip income. Lastly, the deduction may result in increased compliance costs for employers and platforms handling payment processing and reporting.

6. Expansion of the FICA Tip Credit to Beauty Service Businesses

Prior to the OBBBA, only restaurants and other food and beverage establishments could claim a FICA tip credit under IRC §45B. The OBBBA permanently expands the FICA tip credit to include eligible beauty service businesses, effective for tax years beginning after 2024. Qualifying employers can now claim a FICA tip credit on tips paid to employees for services where tipping is customary, such as:

- Hair care;
- Nail care;
- Esthetics / skincare; and
- Body treatments and spa services.

C. Overtime Pay Deduction

1. Background and Overview

Prior to the OBBBA, all overtime compensation received by employees was fully includible in gross income and subject to both federal income taxes and FICA taxes. Overtime pay was considered wage income and taxed identically to regular hourly earnings. There was no specific deduction or exclusion that existed for overtime pay.

The OBBBA introduces a temporary deduction for qualified overtime compensation, available for tax years 2025 through 2028. Both itemizing and non-itemizing taxpayers may deduct up to \$12,500 per year (\$25,000 for MFJ filers) in qualified overtime compensation. To qualify, taxpayers must provide a valid SSN on the return. Additionally, married taxpayers must file jointly to claim the deduction.

Any omission of an SSN is treated as a mathematical or clerical error under §6213(g)(2), allowing the IRS to deny the deduction without audit.

The deduction phases out at a rate of \$100 for every \$1,000 of MAGI above the following thresholds:

- \$150,000 for single/other filers; and
- \$300,000 for MFJ filers.
- *Note:* The phaseout is not indexed for inflation.

2. The FLSA Requirement

Per the bill, “qualified overtime compensation” is defined as overtime pay received under Section 7 of the Fair Labor Standards Act of 1938, specifically, wages paid at a rate above the employee’s regular rate of pay for overtime hours. For example, if an individual is paid at “one and one-half times” their regular rate for an hour of overtime work as required by the FLSA, the “half” portion of the “one and one-half times” paid for an hour of overtime work is qualified overtime compensation. Tips already deducted under new §224 are excluded when calculating the overtime pay deduction. An individual who is ineligible for overtime under the FLSA does not receive qualified overtime compensation regardless of other laws or circumstances (such as a collective bargaining agreement) providing for overtime pay. As a result, because the FLSA overtime requirement applies only to employees, independent contractors are categorically ineligible for this deduction regardless of any premium pay they receive for hours exceeding 40 per week. This is a meaningful distinction from the qualified tips deduction, which extends to self-employed individuals and independent contractors in qualifying occupations.

It is relatively common for employees working in the United States to be covered by the FLSA; however, there are many exemptions from its overtime premium requirement. The overtime deduction applies to employees classified as non-exempt under the FLSA. This generally includes individuals working in non-professional roles, as well as certain salaried employees whose compensation falls below the applicable threshold, which was last set at \$35,568 in 2019 and has not been adjusted for inflation. Whether an individual is covered by and not exempt under the FLSA is a fact-specific determination that depends on the individual’s occupation, work activities, and/or earnings.

Non-exempt employees covered under the FLSA are required to receive overtime compensation at a rate not less than one and one-half times the regular rate of pay for any hours worked in excess of 40 in a workweek, defined as any fixed and regularly recurring period of 168 hours, or seven consecutive 24-hour periods. If an individual is eligible for overtime under the FLSA, but the individual’s employer pays more than is required under the FLSA, the qualified overtime compensation is limited to the portion of the

overtime that is required by the FLSA that is more than the regular rate. For example, if an employer pays double the individual's regular rate for hours worked over 40 in a workweek, only the one-half portion that is relied upon to comply with the FLSA requirement is qualified overtime compensation.

The FLSA does not impose a limit on the total number of hours that employees age 16 or older may work in any given workweek. Further, the FLSA does not require overtime pay for work performed on weekends, holidays, or regular days of rest, unless the individual worked overtime on such days. For purposes of determining hours worked, compensable time generally includes all periods during which an employee is required to be on the employer's premises, on duty, or at a designated work location.

Non-exempt employees who are paid a fixed salary are still entitled to overtime compensation for any hours worked over 40 in a workweek. The overtime rate is calculated based on the employee's regular rate of pay derived from that salary. Employers are required by law to maintain accurate records of the hours non-exempt employees work each day and each week to ensure proper payment of both wages and overtime.

The following amounts are not considered qualified overtime compensation and cannot be included for purposes of the deduction:

- **Premium Pay:** Some employers under a collective bargaining agreement and/or under state law provide more pay than section 7 of the FLSA requires. For example, an employer might choose to pay more than "time-and-a-half." The amount of overtime paid that is over "time-and-a-half" is not qualified overtime compensation.
- **Holiday and Weekend Pay:** Some employers may pay more for certain weekends or holidays even if the employee doesn't work more than 40 hours in the work week. Extra pay for certain weekends or holidays is generally not qualified overtime compensation if the employee doesn't work more than 40 hours in the workweek.
- **Qualified Tips:** Qualified overtime compensation doesn't include any amount you receive as a qualified tip.
- **Coverage under state rules:** Some FLSA-ineligible employees are eligible for overtime under state law or are paid premium rates for certain work for other reasons. Overtime pay that is paid to these FLSA-ineligible employees is not qualified overtime compensation and these amounts can't be included when figuring the deduction for qualified overtime compensation.

3. Calculating the Deduction

Similar to qualified tips, overtime is subject to payroll taxes and state tax. A transition rule applies to qualified overtime compensation required to be reported for periods before January 1, 2026, allowing those required to file certain returns and statements to approximate the amounts designated as qualified overtime compensation by any reasonable method specified by the Secretary. Specifically, for tax year 2025, employers and other payers are not required to report qualified overtime compensation separately on Forms W-2, 1099-NEC, and 1099-MISC. For 2025, some employers and other payers may choose to separately report the amount of qualified overtime compensation to employees using box 14 of Form W-2 or to employees or payees through an online portal or on a separate statement.

For tax year 2025, if a taxpayer's amount of qualified overtime compensation is not reported separately on Form W-2, Form 1099-NEC, or Form 1099-MISC, the taxpayer can calculate qualified overtime compensation as follows:

- **Statement received separately:** If a taxpayer receives a statement from their employer that separately shows the “half” portion of “time and a half” compensation, they can use the FLSA overtime premium that is separately shown to determine their amount of qualified overtime compensation.
- **Statement that shows overtime premium and regular wages:** If the taxpayer paid FLSA overtime premium and received a statement from their employer or the service recipient and the statement shows the total of all wages for the overtime hours (FLSA Overtime Premium plus regular wages), they can divide the total amount by three (3) and use the result when figuring their qualified overtime compensation.
- **Statement shows the overtime premium and the premium paid is more than the amount of the FLSA Overtime Premium:** If the taxpayer is paid more than the amount of FLSA Overtime Premium (for example, the employer pays the taxpayer double the taxpayer’s regular wages) and the taxpayer receives a statement from their employer or the service recipient that shows the portion of the overtime earnings that is more than their regular wage rate for the overtime hours, then the taxpayer can multiply that portion by the appropriate fraction to calculate the half portion of FLSA Overtime Premium.
- **Statement shows the overtime premium and regular wages and the amount paid is more than the amount of the FLSA Overtime Premium:** If the taxpayer is paid more than the amount of FLSA Overtime Premium (for example, the employer pays double the regular rate of pay) and the taxpayer receives a statement from their employer or the service recipient that shows the total of all pay for the overtime hours (for example, double their regular wages), then the taxpayer can multiply the total amount by the appropriate fraction to estimate the half portion of FLSA Overtime Premium.
- **Statement doesn’t show overtime and employer or service recipient won’t provide information:** If the statements the taxpayer receives from their employer or the service recipient don’t show the extra pay or the FLSA Overtime Premium and the employer or service recipient doesn’t give the taxpayer any additional information, they can use a reasonable method to figure the amount of their qualified overtime compensation, taking into account the regular rate paid by the employer or service recipient and the number of hours over the 40-hour workweek or an estimate if they don’t have records of the actual hours worked.

Example 1: Donna is an FLSA-eligible employee. In 2025, she received \$50,000 in regular pay and \$15,000 for overtime hours worked. Donna’s Form W-2 does not separately show her qualified overtime compensation; however, she has access to the payroll system that shows she was paid \$15,000 for overtime hours in 2025.

Donna can include \$5,000 of her wages for the overtime hours when figuring her deduction for qualified overtime compensation. The \$5,000 is the “half” portion of “time-and-a-half” (\$15,000 divided by 3).

Example 2: Nick is an FLSA-eligible employee and works for an employer who pays overtime equal to twice the regular pay. In 2025, Nick was paid \$50,000 for non-overtime hours and \$20,000 for overtime hours worked.

Nick’s Form W-2 does not separately show qualified overtime compensation. However, he has a pay stub showing that \$10,000 of the overtime pay was for the normal rate of pay for the overtime hours and \$10,000 of the overtime pay was the premium amount.

“Time-and-a-half” would be equal to \$15,000 (the \$10,000 for his regular wage for the overtime hours multiplied by 1.5) The “half” portion of the “time-and-a-half” rate required by the FLSA is \$5,000 (\$15,000 divided by 3). Nick can include \$5,000 when figuring his deduction for qualified overtime compensation.

Example 3: The facts are the same as in Example 2, but Nick’s pay stub does not separately show the premium amount of overtime pay that is more than his regular wages. Instead, it shows that \$20,000 was the total amount of pay for the overtime hours. The \$20,000 is double Nick’s regular wages for the overtime hours he worked.

Nick’s regular wages are \$10,000 (the \$20,000 total amount of overtime pay divided by 2). “Time-and-a-half” would be equal to \$15,000 (the \$10,000 of Nick’s regular wages for the overtime hours multiplied by 1.5). The “half” portion of the “time-and-a-half” rate required by the FLSA is \$5,000 (\$15,000 divided by 3) Nick can include \$5,000 when figuring his deduction for qualified overtime compensation.

Example 4: Ron works in law enforcement and his employer is covered by a special overtime rule in section 7 of the FLSA. In 2025, Ron was paid \$15,000 for overtime hours worked on a “work period” basis of 14 days. Ron can include \$5,000 of his overtime pay when figuring his deduction for qualified overtime compensation (\$15,000 divided by 3).

Example 5: Rita works for a state government agency that is covered by a special overtime rule in section 7 of the FLSA. Rita’s state agency pays compensatory time at a rate of one and one-half hours for each overtime hour worked.

In 2025, Rita was paid wages of \$4,500 for the compensatory time she took off during the year. Rita can include \$1,500 when figuring her deduction for qualified overtime compensation (\$4,500 divided by 3).

For tax years 2026 and later years, employers and other payers are required to separately report qualified overtime compensation. Taxpayers working substantial overtime should consider:

- Tracking separately reported overtime amounts;
- Monitoring MAGI levels to assess phase-out impact; and
- Coordinating with employers to ensure proper reporting.

This deduction, combined with the tip income deduction, creates opportunities for wage earners in service occupations to reduce taxable income.

D. Car Loan Interest Deduction

1. Background

The OBBBA introduces a temporary tax deduction for interest paid on loans used to purchase new personal-use passenger vehicles, effective for tax years 2025 through 2028. Taxpayers may deduct up to \$10,000 of qualified car loan interest per year, regardless of whether they itemize deductions or claim the standard deduction. This provision marks a significant departure from existing law by removing certain auto loan interest from the definition of nondeductible “personal interest” under §163(h). This provision applies only to qualified indebtedness incurred after December 31, 2024.

2. Loan Requirements

Interest must be paid or accrued on qualified indebtedness that generally meets all of the following requirements:

- The loan was originated after December 31, 2024;
- The loan was originated by the taxpayer;
- The proceeds from the loan were used to purchase an applicable passenger vehicle;
- The applicable passenger vehicle is for personal use; and
- The loan is secured by a first lien on the purchased applicable passenger vehicle.

The vehicle must be intended for personal (non-business) use, and the original use must begin with the taxpayer. Leases, used vehicles, or unsecured loans do not qualify for the deduction.

The obligor on the loan is generally the person responsible for paying the loan. If a loan met the applicable requirements at the time it was originated by a previous obligor, and the taxpayer became the obligor by reason of a previous obligor's death, interest paid by the taxpayer on the loan is generally qualified passenger vehicle loan interest if the loan continues to be secured by a first lien on the purchased applicable passenger vehicle. A change in obligor by reason of a previous obligor's death could occur, for example, when the taxpayer inherits an applicable passenger vehicle subject to a loan originated by the person who died.

Indebtedness that can be counted for purposes of determining qualified passenger vehicle loan interest includes indebtedness incurred to finance the purchase price of the applicable passenger vehicle, as well as items or amounts that are customarily financed in an applicable passenger vehicle purchase transaction and that are directly related to the purchased applicable passenger vehicle.

For example, this includes vehicle service plans, extended warranties, sales tax, and vehicle-related fees. Interest on items and services not customarily financed in an applicable passenger vehicle purchase transaction and that are directly related to the purchased applicable passenger vehicle, such as liability insurance, a trailer, or amounts representing debt on a vehicle traded in as part of the purchase transaction for the applicable passenger vehicle (so-called negative equity), is not eligible for the deduction.

If a prior loan that had qualified passenger vehicle loan interest is later refinanced, interest paid on the refinanced amount is generally eligible for the deduction, provided the new loan is secured by a first lien on the applicable passenger vehicle with respect to which the refinanced loan was incurred. The loan amount is limited to the outstanding balance of the refinanced loan as of the date of the refinancing.

3. Vehicle Requirements

To qualify for the deduction, the applicable passenger vehicle must meet all of the following:

- Original use commences with the taxpayer (used vehicles do not qualify);
- Primarily manufactured for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails);
- Must have at least two wheels;
- Vehicle types include: cars, minivans, vans, SUVs, pickup trucks, and motorcycles;
- Has a gross vehicle weight rating (GVWR) under 14,000 pounds;
- Must be a "motor vehicle" under Title II of the Clean Air Act; and

- Has final assembly that occurs in the United States.

The deduction does not apply to:

- Used vehicles;
- Trailers;
- Campers;
- ATVs, RVs;
- Leased vehicles;
- Unsecured loans or loans without a first lien; or
- Vehicles not assembled in the U.S.

Requirement	Details	Qualifies / Does not qualify
New vehicle only	Original use must commence with the taxpayer. Used vehicles do not qualify regardless of condition or prior ownership history.	New vehicles ✓ Used vehicles X
U.S. final assembly	Final assembly must occur in the United States, meaning the vehicle is delivered to a dealer with all component parts necessary for mechanical operation included, whether or not permanently installed. VIN and assembly information can be confirmed via the dealer sticker or the NHTSA VIN Decoder at nhtsa.gov .	U.S.-assembled ✓ Foreign-assembled X
Vehicle type	Must be a "motor vehicle" under Title II of the Clean Air Act, primarily manufactured for use on public streets, roads, and highways. Includes cars, minivans, vans, SUVs, pickup trucks, and motorcycles. Trailers, campers, ATVs, and RVs do not qualify. Leased vehicles do not qualify regardless of other characteristics. Unsecured loans or loans without a first lien on the vehicle do not qualify. Additionally, vehicles operated exclusively on rails are excluded.	Cars, SUVs, trucks, vans, motorcycles ✓ Rail vehicles, Trailers, campers, ATVs, RVs, leased vehicles X
Minimum two wheels	The vehicle must have at least two wheels to qualify.	Cars, motorcycles, etc. ✓
Gross vehicle weight rating (GVWR)	Must be under 14,000 pounds GVWR. This captures the full range of passenger vehicles, SUVs, pickup trucks, and motorcycles used for personal transportation.	Under 14,000 lbs GVWR ✓ 14,000 lbs or over X
Personal use	The vehicle must be purchased and used for personal (non-business) purposes. See Personal Use definition.	Personal use > 50% ✓ Business/investment use X

“Personal Use” means a use other than:

- Use in any trade or business (except for the use in the trade or business of performing services as an employee); or
- For the production of income.

An individual is considered to have purchased an applicable passenger vehicle for personal use if, at the time they incur a loan to purchase an applicable passenger vehicle, they expect that the applicable passenger vehicle will be used for personal use for more than 50% of the time by the taxpayer and/or any related individuals. The related individuals who count toward the 50% personal use threshold include the taxpayer's spouse; the taxpayer's or spouse's child, grandchild, parent, sibling; and any individual who shares the same main home as the taxpayer and is a member of the taxpayer's household.

The 50% threshold is evaluated based on expected use at the time of loan origination rather than actual use tracked throughout the year. This is a meaningful point, as a taxpayer who purchases a vehicle intending to use it primarily for personal purposes qualifies even if actual use deviates from expectations, provided the expectation was reasonable at origination.

Example 1: George purchases an applicable passenger vehicle that he expects to use to earn income as a driver for a rideshare service for 15% of the time he expects to own the applicable passenger vehicle. George expects to use the applicable passenger vehicle for personal use for the remaining 85% of the time. George is considered to have purchased his applicable passenger vehicle for personal use.

4. Deduction Limit and Phaseout

The deduction begins to phase out at \$100,000 MAGI for single filers and \$200,000 MAGI for married filing jointly filers. For every \$1,000 of MAGI above these thresholds, the deduction is reduced by \$200 until fully phased out. Taxpayers must include the Vehicle Identification Number (VIN) on the tax return. Lenders (or any person receiving interest) must file an information return with the IRS and provide a statement to the borrower. Reporting is required for any interest received of \$600 or more that may be deducted under this provision.

Example: Mariah purchases a new U.S.-assembled SUV in 2026, taking out a \$40,000 auto loan with 6% interest. She paid \$2,400 in interest during 2026, and the car/loan meet all requirements for the car loan interest deduction. She files using the Single filing status and has \$105,000 of AGI.

The base deduction limit is \$10,000, and the \$2,400 of interest paid is fully within that limit. However, phaseout begins at \$100,000 for single filers. Mariah is \$5,000 over the threshold, so her deduction is reduced as follows: $\$5,000/1,000 = 5 * \$200 = \$1,000$ reduction. Her resulting deduction is \$1,400 (\$2,400 interest paid less \$1,000 phaseout).

E. Schedule 1-A, Additional Deductions

Schedule 1-A, *Additional Deductions*, was introduced for the 2025 tax year to calculate the following new deductions created by the OBBBA --

- **No Tax on Tips:** A deduction of up to \$25,000 (regardless of filing status) for qualified cash or charged tips;
- **No Tax on Overtime:** A deduction for the "premium" portion (the "half" in time-and-a-half) of qualified overtime pay, capped at \$12,500 for individuals or \$25,000 for joint filers;
- **No Tax on Car Loan Interest:** A deduction of up to \$10,000 for interest paid on loans for new vehicles (cars, vans, SUVs, etc.) assembled in the U.S.; and
- **Enhanced Deduction for Seniors:** An additional deduction of \$6,000 (\$12,000 for MFJ) for taxpayers aged 65 or older.

The total of these deductions, as calculated on Schedule 1-A, line 38, is carried to Form 1040, line 13b.

**SCHEDULE 1-A
(Form 1040)**

Department of the Treasury
Internal Revenue Service

Additional Deductions

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to www.irs.gov/Form1040 for instructions and the latest information.

OMB No. 1545-0074

2025
Attachment
Sequence No. **1A**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

Your social security number

Part I Modified Adjusted Gross Income (MAGI) Amount

1	Enter the amount from Form 1040, 1040-SR, or 1040-NR, line 11b		1
2a	Enter any income from Puerto Rico that you excluded	2a	
b	Enter the amount from Form 2555, line 45	2b	
c	Enter the amount from Form 2555, line 50	2c	
d	Enter the amount from Form 4563, line 15	2d	
e	Add lines 2a, 2b, 2c, and 2d	2e	
3	Add lines 1 and 2e	3	

Part II No Tax on Tips

Caution: Fill out Part II only if you received qualified tips. These tips must have been received in an occupation listed at IRS.gov/TippedOccupations. You and/or your spouse who received qualified tips must have a valid social security number to claim the deduction. If married, you must file jointly to claim this deduction. See instructions.

4	Qualified tips received as an employee. If you received tips as an employee with respect to employment with more than one employer, enter -0- on lines 4a and 4b and see the instructions to determine the amount to enter on line 4c. If you received tips as an employee in more than one occupation, see the instructions.		
a	Enter qualified tips included on Form W-2, box 7, but see the instructions if Form W-2, box 5 is more than \$176,100 or you received tips that are not subject to social security and Medicare taxes	4a	
b	Qualified tips included on Form 4137, line 1, row A, column (c). If Form 4137 is not filed, enter -0-	4b	
c	If you only received qualified tips as an employee with respect to employment with one employer, enter the larger of line 4a or line 4b. Otherwise, see the instructions to determine the amount to enter on line 4c. If you received tips as an employee in more than one occupation, see the instructions	4c	
5	Qualified tips received in the course of a trade or business. Qualified tip amount included in Form 1099-NEC, box 1; Form 1099-MISC, box 3; or Form 1099-K, box 1a. Do not enter more than the net profit from the trade or business. If you received qualified tips in the course of more than one trade or business or in more than one occupation, see instructions	5	
6	Add lines 4c and 5	6	
7	Enter the smaller of the amount on line 6 or \$25,000	7	
8	Enter the amount from line 3	8	
9	Enter \$150,000 (\$300,000 if married filing jointly)	9	
10	Subtract line 9 from line 8. If zero or less, enter the amount from line 7 on line 13	10	
11	Divide line 10 by \$1,000. If the resulting number isn't a whole number, decrease the result to the next lower whole number. (For example, decrease 1.5 to 1, and decrease 0.05 to 0.)	11	
12	Multiply line 11 by \$100	12	
13	Qualified tips deduction. Subtract line 12 from line 7. If zero or less, enter -0-	13	

Part III No Tax on Overtime

Caution: Fill out Part III only if you received qualified overtime compensation. You and/or your spouse who received the qualified overtime compensation must have a valid social security number to claim this deduction. If married, you must file jointly to claim this deduction. See instructions.

14a	Qualified overtime compensation included in Form W-2, box 1. If you received qualified overtime compensation not reported on Form W-2, box 1, see instructions	14a	
b	Qualified overtime compensation included in Form 1099-NEC, box 1, or Form 1099-MISC, box 3 (see instructions)	14b	
c	Add lines 14a and 14b	14c	
15	Enter the smaller of the amount on line 14c or \$12,500 (\$25,000 if married filing jointly)	15	
16	Enter the amount from line 3	16	
17	Enter \$150,000 (\$300,000 if married filing jointly)	17	
18	Subtract line 17 from line 16. If zero or less, enter the amount from line 15 on line 21	18	
19	Divide line 18 by \$1,000. If the resulting number isn't a whole number, decrease the result to the next lower whole number. (For example, decrease 1.5 to 1, and decrease 0.05 to 0.)	19	
20	Multiply line 19 by \$100	20	
21	Qualified overtime compensation deduction. Subtract line 20 from line 15. If zero or less, enter -0-	21	

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 95872Q

Schedule 1-A (Form 1040) 2025 Created 11/4/25

Part IV No Tax on Car Loan Interest

Caution: Fill out Part IV only if you, or your spouse if married filing jointly, paid or accrued qualified passenger vehicle loan interest (QPVLJ). Column (iii) is the total QPVLJ paid in 2025 less the amounts reported in column (ii). See instructions.

22 Applicable passenger vehicle (see instructions). If more than two VINs, see instructions.

		Interest for this loan:	
(i) Vehicle identification number (VIN)		(ii) Deducted on Schedule C, Schedule E, or Schedule F	(iii) Schedule 1-A
a	<input type="text"/>		
b	<input type="text"/>		
23	Add lines 22a and 22b, column (iii)	23	
24	Enter the smaller of the amount on line 23 or \$10,000	24	
25	Enter the amount from line 3	25	
26	Enter \$100,000 (\$200,000 if married filing jointly)	26	
27	Subtract line 26 from line 25. If zero or less, enter the amount from line 24 on line 30	27	
28	Divide line 27 by \$1,000. If the resulting number isn't a whole number, increase the result to the next higher whole number. (For example, increase 1.5 to 2, and increase 0.05 to 1.)	28	
29	Multiply line 28 by \$200	29	
30	Qualified passenger vehicle loan interest deduction. Subtract line 29 from line 24. If zero or less, enter -0-	30	

Part V Enhanced Deduction for Seniors

Caution: You and/or your spouse must have a valid social security number. If married, you must file jointly to claim this deduction. See instructions.

31	Enter the amount from line 3	31	
32	Enter \$75,000 (\$150,000 if married filing jointly)	32	
33	Subtract line 32 from line 31. If zero or less, enter \$6,000 on line 35	33	
34	Multiply line 33 by 6% (0.06)	34	
35	Subtract line 34 from \$6,000. If zero or less, enter -0-	35	
36a	If you have a valid social security number (see instructions) and were born before January 2, 1961, enter the amount from line 35	36a	
b	If you are married filing jointly, your spouse has a valid social security number (see instructions), and your spouse was born before January 2, 1961, enter the amount from line 35	36b	
37	Enhanced deduction for seniors. Add lines 36a and 36b	37	

Part VI Total Additional Deductions

38	Add lines 13, 21, 30, and 37. Enter here and on Form 1040 or 1040-SR, line 13b, or on Form 1040-NR, line 13c	38	
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Schedule 1-A (Form 1040) 2025

F. Trump Accounts

1. Background and Eligibility Requirements

The OBBBA establishes "Trump Accounts," a new type of tax-deferred investment account for children under age 18. These accounts are a type of traditional IRA, but with additional restrictions, for the exclusive benefit of minors. To qualify, the child must:

- Be under age 18 at year-end;
- Be a U.S. citizen; and
- Possess a valid Social Security Number (SSN).

Accounts must be clearly designated as Trump Accounts at setup and follow strict compliance rules, and each child may have only one funded Trump Account at any time.

2. Establishing the Account

An authorized individual may elect to establish an initial Trump account for a child by completing Form 4547, *Trump Account Elections*, or through trumpaccounts.gov. Form 4547 can be filed at any time, including at the same time as the income tax return is filed. A Trump Account may be established at any time before January 1 of the calendar year in which the beneficiary attains the age of 18.

If the only election being made is to open an initial Trump account (and no election for a pilot program contribution is being made), an authorized individual is a legal guardian, parent, adult sibling, or grandparent of the child, in that order of priority.

If more than one person meets the conditions to be an authorized individual, subject to the order of priority, and no prior Trump account election has been made for the child, then any of the authorized individuals can make the election. For example, if the child doesn't have a legal guardian, then either parent of the child can make the election regardless of filing status.

The authorized individual who is making the election must enter their information in Form 4547, Part I, and then complete Parts II and IV. By making the election, the authorized individual is representing, under penalties of perjury, that he or she is authorized to open the initial Trump account for the child. For example, if an adult sibling is making the election, they would be representing that there was neither a legal guardian nor parent of the child available to make the election.

If both an election to open an initial Trump account and an election for a pilot program contribution are being made, an authorized individual is an individual who anticipates that the child will be his or her qualifying child for the tax year in which the election is made. If a taxpayer is filing the Form 4547 with their 2025 income tax return, then they do not have to have claimed the child as their dependent on the 2025 income tax return.

If it is later determined that the child is not the individual's qualifying child for the year the election is made, these elections may still be effective as long as the child has satisfied the other requirements for receiving the pilot program contribution. The authorized individual who is making these elections must enter their information in Form 4547, Part I, and complete Parts II, III, and IV.

After the election is made, the Treasury Department, or its agent, will send information to the authorized individual who made the election to activate the account. The activation of the Trump account will require an authentication process, after which the authorized individual can complete the opening of the initial Trump account.

The authorized individual who made the election and whose information appears in Form 4547, Part I, will be the responsible party for the initial Trump account of the child(ren) listed in Form 4547, Part II, while the child is a minor. The responsible party may generally:

- Select among any eligible investments;
- Request a transfer for a qualified rollover contribution to a rollover Trump account;
- Request a transfer for a qualified ABLE rollover contribution to an ABLE account of the child at age 17; or
- Select someone to take over their responsibilities as the responsible party (a successor responsible party for the account).

Parents or legal guardians can open and manage accounts on behalf of their child. The child listed on Form 4547, Part II, is the owner/beneficiary of the initial Trump account for tax purposes. All Trump accounts must have a trustee, and the trustee of a Trump account must either be a bank or another person who is approved by the IRS to be a nonbank trustee of a Trump account. When the child turns 18, the account will transfer to their control, and they will have full access to manage and use the funds.

3. The Growth Period — Contributions, Investments, and Restrictions

The growth period for a Trump account starts on the date the Trump account is established and ends on December 31st of the year before the calendar year in which the child turns age 18. For example, a child born on October 1, 2025, would turn age 18 on October 1, 2043. The last day of the growth period for this child would be December 31, 2042.

During the growth period, special rules apply, including:

- A Trump account can only be invested in eligible investments;
- Note: Funds in a Trump account may be invested in multiple eligible investments;
- A Trump account has a separate contribution limit from other IRAs;
- No deduction is allowed by an individual under §219 for any contribution to a Trump account; and
- A Trump account generally restricts distributions from the account.

After the growth period, most of the special rules no longer apply and the rules governing traditional IRAs generally apply.

During the growth period, a Trump account can only be invested in eligible investments. An eligible investment, generally, is a mutual fund or an exchange-traded fund (ETF) that tracks an index of primarily U.S. companies. The index cannot be industry- or sector-specific, but may be based on market capitalization. Additionally, the fund's annual fees and expenses must not exceed 0.1% of the invested balance.

The annual contribution limit is \$5,000 per beneficiary beginning in 2026 and adjusted for inflation beginning in 2028. Per the OBBBA, no contributions will be accepted before July 4, 2026 (12 months after enactment). Contributions may come from parents, relatives, employers, charitable organizations, and government entities. Once the child begins earning income, they can make contributions to their own account. Contributions cannot be made to the account after the beneficiary turns 18.

There are generally five types of contributions that can be made to a Trump account:

- **Pilot program contributions** from the U.S. Treasury of \$1,000 per child;
- **Qualified general contributions** (funded by states (or political subdivisions thereof), the United States, the District of Columbia, Indian tribal governments, or §501(c)(3) tax-exempt organizations) for members of a qualified class of account beneficiaries;
- **Employer contributions** that are not includible in the gross income of the employee under §128 (§128 employer contributions);
- **Qualified rollover contributions** (which are transfers to a rollover Trump account of the entire amount of the child's prior Trump account); or
- **Contributions from other sources** (such as the child, the child's parents, or any other person).

During the growth period, contributions may be made to a Trump account even if the child doesn't have compensation that is included in their income. Contributions exempt from the annual limit of \$5,000 include:

- Contributions from the pilot program;
- Qualified general contributions (from government/charities); or

- Note: General funding contributions from charities or government bodies are exempt from the \$5,000 limit, as long as they benefit a defined group (e.g., a specific birth year or geographic region).
- Qualified rollover contributions.

However, the total of all other contributions (including §128 employer contributions) during the growth period are subject to an annual limit of \$5,000 (subject to inflationary adjustments after 2027).

Under a pilot program, a \$1,000 one-time federal contribution will be made to accounts for U.S. citizens born between Jan. 1, 2025, and Dec. 31, 2028. As discussed, an authorized individual can make an election for a \$1,000 pilot program contribution to be made to a Trump account for a child, who:

- Is anticipated to be the qualifying child of the authorized individual for the year in which the election is made;
- Is born after December 31, 2024, and before January 1, 2029;
- Has not had a prior pilot program contribution election made for them;
- Is a U.S. citizen; and
- Has an SSN.

The election must be made on Form 4547. The pilot program contribution does not count against the annual \$5,000 contribution limit per Trump Account. As discussed, contributions to Trump Accounts may not begin until July 4, 2026, and the entire provision is effective for tax years beginning after December 31, 2025. The Treasury Department will make the pilot program contribution as soon as practicable after the election is made and the Treasury Department can confirm with the initial Trump account trustee that the initial Trump account has been opened. However, no pilot program contribution will be deposited in the Trump account of a child earlier than July 4, 2026. If the election for a pilot program contribution is made at the same time as the election to open the initial Trump account, then the pilot program contribution will be made to the initial Trump account.

Employers may choose to contribute to the Trump Accounts for their workers or their workers' children, supporting early savings and financial readiness. During the growth period, §128 employer contributions are subject to a \$2,500 annual limit (subject to inflationary adjustments after 2027). Such contributions are deductible by the employer as a business expense and are not included in the employee's gross income if made under a compliant plan. Employers may choose to offer employees a salary reduction program under a "cafeteria plan" so that employees can make pre-tax contributions to Trump Accounts.

This annual limit is per employee and not per dependent of the employee. For example, if an employee has two or more children that have Trump accounts, an employer with a Trump account contribution program may only contribute up to \$2,500 in the aggregate for 2026 to those Trump accounts. Section 128 employer contributions plus contributions from other sources (other than a pilot program contribution and qualified general contributions) are subject to the \$5,000 annual limit.

Contributions to a Trump account during the growth period are not includible in income by the account beneficiary when made. Pilot program contributions, qualified general contributions, and §128 employer contributions do not create basis in a Trump account.

Qualified rollover contributions are transfers from a prior Trump account and carry over any basis attributable to the funds being transferred. Contributions from other sources during the growth period

create basis in the Trump account. For any taxable year ending during the growth period, a contribution to a Trump account is counted for the year in which the contribution is made. For example, a contribution to a Trump account made on January 31, 2027, is for 2027 and cannot be applied to 2026.

Contribution type	Annual limit	Creates basis?	Details
Pilot program — U.S. Treasury	Exempt from \$5,000 limit — \$1,000 one-time per eligible child	No basis created	Available for children born Jan. 1, 2025 – Dec. 31, 2028. Elected via Form 4547. Not deposited before July 4, 2026.
Qualified general contributions (government entities, tribal governments, §501(c)(3) organizations for a qualified class)	Exempt from \$5,000 limit	No basis created	Must benefit a defined group (e.g., all children born in a specific year or geographic region). Cannot be targeted to a specific individual by a charity.
Employer contributions (§128)	\$2,500 per employee (counts <i>within</i> \$5,000 overall limit)	No basis created	Excluded from employee gross income. Deductible by employer as a business expense. Limit is per employee, not per child. For example, an employee with two children still receives maximum \$2,500 employer contribution in aggregate.
Qualified rollover contributions	Exempt from \$5,000 limit	Carries over prior basis	Trustee-to-trustee transfer of entire balance from one Trump Account to a rollover Trump Account. Only one funded account may exist at a time.
Individual contributions (child, parents, grandparents, etc.)	Subject to \$5,000 overall limit (combined with §128 employer contributions)	Creates basis	No deduction allowed under §219. Contributions counted in the year made (no prior-year contributions). No earned income requirement.

4. Distributions

As discussed, during the growth period, the only distributions that can be made from a Trump account are:

- Qualified rollover contributions to a rollover Trump account;
- Qualified ABLE rollover contributions at age 17 to an ABLE account of the account beneficiary;
- Distributions of excess contributions; and
- Distributions upon death of the account beneficiary.

During the growth period, a subsequent Trump account (rollover Trump account) can be established for a child. The rollover Trump account must be funded by a trustee-to-trustee transfer of the entire account balance from the child’s existing Trump account (qualified rollover contribution). As a result, there can only be one funded Trump account for an individual at any time.

If an account beneficiary of a Trump account dies after the growth period, the rules that apply to other individual retirement arrangements after the death of the account owner apply. If the account beneficiary dies during the growth period, the account ceases to be both a Trump account and an IRA as of the date of death. In such a case, the account is treated as if all the assets of the account were distributed on the date of death and, as a result, gross income of the inheriting beneficiary will include the FMV of the assets as of the date of death (reduced by basis). If the inheriting beneficiary is the estate of the account beneficiary, the amount will be included in the gross income of the account beneficiary for the last taxable year of the account beneficiary.

After age 18, funds may be withdrawn without penalty for:

- Education expenses;
- First-time home purchases; or
- Small business investments.
- Note: Withdrawals may be subject to restrictions and would be taxed at ordinary income rates to the extent they exceed basis.

Nonqualified distributions are taxed and may face penalties, similar to traditional IRA rules. Additionally, until age 18, assets in Trump Accounts are not counted for means-tested programs (e.g., SSI, SNAP, VA benefits).

After the growth period (that is, starting January 1st of the calendar year in which the child turns 18), most of the rules that apply to traditional IRAs will generally apply to the Trump account. For example, this means that distributions from the Trump account could be subject to the §72(t) 10% additional tax on early distributions, unless an exception applies with respect to the child (such as for distributions for higher education expenses or first home purchases).

The interaction between the basis rules and the post-growth distribution rules is worth emphasizing. Since pilot program contributions, government/charity contributions, and employer contributions create no basis, distributions attributable to those sources, including all associated growth, will be fully includible in ordinary income when withdrawn. Only distributions attributable to individual after-tax contributions (which did create basis) will have a tax-free component.

G. State and Local Tax (SALT) Cap

Prior to the TCJA, taxpayers were allowed to claim a deduction for certain state, local, and foreign taxes paid or accrued, including:

- Real property taxes (state, local, foreign);
- Personal property taxes (state and local); and
- State, local and foreign income, war profits, and excess profits taxes.

Taxpayers could elect to deduct state and local sales general taxes in lieu of income taxes. No dollar cap applied, as deductions were limited only by the overall itemized deduction rules, and no AGI thresholds or phaseouts applied specifically to SALT deductions.

The TCJA imposed a \$10,000 annual cap on the deduction of state and local taxes:

- \$10,000 for single and MFJ filers; and
- \$5,000 for MFS.

Deductible SALT categories under the TCJA SALT cap included:

- State and local income taxes;
- State and local real property taxes; and
- State and local sales taxes.

The SALT deduction consists of property taxes and either state and local income taxes or state and local sales taxes, but not both. Under the TCJA, the deduction of foreign real property taxes was disallowed

unless incurred in a trade or business. Additionally, under the TCJA, the SALT cap did not apply to state and local taxes paid in connection with:

- A trade or business; or
- The production of income (e.g., a rental property).

The TCJA did not adjust the SALT cap for inflation, and the SALT cap provision was set to expire after December 31, 2025.

The IRS and Treasury issued regulations to curtail SALT workaround schemes (e.g., charitable contributions for tax credits), and states responded by creating Passthrough Entity Tax (PTET) regimes. PTET allowed entities to pay tax at the entity level, bypassing the SALT cap for individual partners/shareholders. IRS Notice 2020-75 endorsed PTET deductibility at the entity level.

The OBBBA temporarily increases the SALT deduction cap from \$10,000 to \$40,000 for most filers (or \$20,000 for married individuals filing separately) for tax years 2025 through 2029. The cap will be adjusted for inflation, rising to \$40,400 in 2026 and increasing by 1% annually through 2029. Further, the OBBBA permanently disallows deduction of personal foreign real property taxes. Beginning in 2030, the SALT cap will revert to its current level of \$10,000 (\$5,000 for married separate filers), which was established by the TCJA.

A phaseout begins at \$500,000 MAGI (\$250,000 for MFS) in 2025:

- The deduction is reduced by 30% of the amount by which MAGI exceeds the threshold.
- The phaseout reduces the increased cap but never falls below a \$10,000 floor (\$5,000 for MFS).

The phase-out threshold increases to \$505,000 in 2026 and continues to rise by 1% annually through 2029. The maximum phasedown reaches the \$10,000 floor once MAGI reaches \$600,000 (\$300,000 for MFS). This phaseout applies only through 2029, after which the cap reverts to its original level.

SALT Deduction Cap Phaseout – All Filers Except MFS			
Tax Year	MAGI Limit	SALT Cap	MAGI at Full Phaseout
2026	\$505,000	\$40,400	\$606,333
2027	\$510,050	\$40,804	\$612,730
2028	\$515,151	\$41,212	\$619,191
2029	\$520,302	\$41,624	\$625,716
2030 and beyond	N/A	\$10,000	N/A

SALT Deduction Cap Phaseout – Married Filing Separately (MFS)			
Tax Year	MAGI Limit	SALT Cap	MAGI at Full Phaseout
2026	\$252,500	\$20,200	\$303,167
2027	\$255,025	\$20,402	\$306,365
2028	\$257,575	\$20,606	\$309,595
2029	\$260,151	\$20,812	\$312,858
2030 and beyond	N/A	\$5,000	N/A

While the temporary increase in the SALT deduction cap offers greater potential benefit for taxpayers who itemize, those with higher incomes may find their benefit limited due to new restrictions on the overall

value of itemized deductions. Further, because SALT deductions are added back when calculating AMT liability, the expanded deduction under OBBBA may inadvertently trigger AMT exposure for more taxpayers, particularly those in high-tax jurisdictions. Lastly, the OBBBA does not modify the current treatment of taxes paid under state PTET regimes. As a result, states may continue to offer PTET elections, which remain a viable workaround for high-income individuals seeking to bypass the individual SALT deduction limitations.

Example 1: Jimmy is a single taxpayer with MAGI of \$555,000 for 2026. In 2026, he pays the following state and local taxes:

- State income tax: \$25,400
- Local property tax: \$15,000
- Total SALT paid: \$40,400

In 2026, the base SALT cap is \$40,400 and the phase-out threshold for single taxpayers is \$505,000.

Jimmy exceeds the threshold by \$50,000 (\$555,000 MAGI less \$505,000). The phase-out amount is \$15,000 (30% x \$50,000).

Jimmy is allowed a \$25,400 SALT deduction (\$40,400 cap less \$15,000 phaseout).

Example 2: Ron is a single taxpayer with MAGI of \$655,000 for 2026. In 2026, he pays the following state and local taxes:

- State income tax: \$30,000
- Local property tax: \$15,000
- Total SALT paid: \$45,000

In 2026, the base SALT cap is \$40,400 and the phase-out threshold for single taxpayers is \$505,000.

Ron exceeds the threshold by \$150,000 (\$655,000 MAGI less \$505,000). The phase-out amount is \$45,000 (30% x \$150,000).

Even if the phase-out amount exceeds the cap (as it does here), the SALT deduction cannot fall below \$10,000, so Ron can deduct \$10,000.

H. Dependent Care Assistance Programs

Prior to the OBBBA, the maximum amount excludable from income under a dependent care assistance program was \$5,000 annually (\$2,500 for married individuals filing separately). The OBBBA permanently increases the annual exclusion for employer-provided dependent care assistance to \$7,500 (\$3,750 for married individuals filing separately).

These amounts continue to apply only to assistance furnished under a qualified employer-sponsored program. The exclusion applies to payments made for the care of a qualifying dependent to enable the employee (and spouse, if married) to work or look for work. This provision is effective for tax years beginning after December 31, 2025.

I. Charitable Contribution Deduction

For itemizing taxpayers, the OBBBA introduces a new 0.5% AGI floor on itemized charitable deductions beginning in 2026. Only the portion of aggregate charitable contributions that exceeds 0.5% of AGI is deductible. Any portion of a contribution disallowed due to the 0.5% floor may be carried forward, provided the taxpayer has sufficient charitable contribution carryforwards. The OBBBA permanently

extends the 60% AGI limit for cash contributions to public charities, originally set to expire after 2025 under the TCJA.

Beginning in 2026, the OBBBA allows non-itemizers to deduct up to \$1,000 (\$2,000 for MFJ filers) for qualified charitable contributions. To qualify, contributions must be:

- Cash donations.
- Made to public charities under §170(p).

This change revives and expands the temporary charitable deduction allowed briefly during the COVID-19 pandemic, now made permanent under the OBBBA. It provides a modest benefit to standard deduction filers, many of whom previously received no tax incentive for giving. The permanent nature of both the deduction for non-itemizers and the 60% AGI limit for itemizers provides a stable framework for long-term charitable planning.

J. Adoption Credit

Prior to the OBBBA, the Adoption Tax Credit was nonrefundable, meaning it could only reduce a taxpayer's federal income tax liability to zero. The OBBBA enhances the existing adoption credit by making up to \$5,000 of the credit refundable beginning in tax year 2025. The \$5,000 refundable limit will be adjusted annually for inflation, beginning in 2025.

The total maximum adoption credit for 2026 is \$17,670 per child, which includes both refundable and nonrefundable components. The refundable portion of the credit is not eligible for carryforward. The remaining portion of the credit (up to the total limit) remains nonrefundable and continues to be subject to five-year carryforward rules. This enhancement applies to tax years beginning after December 31, 2024.

K. ABLE Accounts

ABLE accounts (Achieving a Better Life Experience accounts) are tax-advantaged savings accounts designed to help individuals with disabilities save for qualified disability-related expenses without losing eligibility for certain public benefits, such as SSI (Supplemental Security Income) and Medicaid. The base amount of the limit on contributions to Achieving a Better Life Experience (ABLE) accounts for individuals with disabilities is equal to the gift tax exclusion in effect for the year (\$19,000 in 2026).

The TCJA originally enacted a provision allowing employed individuals with disabilities to make additional contributions to ABLE accounts, and this provision was set to expire on December 31, 2025. These additional contributions are allowed on top of the standard annual ABLE contribution limit. The OBBBA permanently extends the TCJA provision allowing employed individuals with disabilities to make these additional contributions.

The additional contributions are limited to the lesser of:

- The federal poverty level for a one-person household for the preceding year; or
- The beneficiary's earned income for the year.

This rule provides greater flexibility and savings potential for disabled individuals who are able to work, enabling them to accumulate more resources in a tax-advantaged account.

Prior to the OBBBA, eligibility for the Saver's Credit for designated beneficiaries who make qualified contributions to their ABLE accounts was set to expire on December 31, 2025. The OBBBA permanently

permits ABLE account contributions to qualify for the Saver's Credit. Under this provision, for taxable years beginning after December 31, 2026, eligible Saver's Credit contributions are limited to ABLE account contributions made during the taxable year by the account's beneficiary.

For tax years before 2027, the OBBBA provides a calculation that includes retirement contributions, elective deferrals, and voluntary employee contributions. The OBBBA increases the maximum annual contribution amount eligible for the Saver's Credit amount from \$2,000 to \$2,100 starting in tax years after December 31, 2026.

Lastly, the OBBBA permanently allows tax-free rollovers from §529 qualified tuition programs to ABLE accounts. This provision, enacted by the TCJA and originally set to expire at the end of 2025, is now a permanent feature of the tax code. These rollovers:

- Must be made to an ABLE account for the same beneficiary (or a qualifying family member); and
- Count toward the annual contribution limit for ABLE accounts (including any additional contributions permitted for employed beneficiaries)

The provision increases flexibility for families with unused 529 plan funds, particularly when educational goals change or a student has special needs.

L. Scholarship Credit

Beginning in tax years ending after December 31, 2026, individuals who are U.S. citizens or residents may claim a nonrefundable federal income tax credit for qualified cash contributions made to scholarship-granting organizations (SGOs). The credit is limited to \$1,700 per taxpayer per year and applies only in states that elect to participate and provide the IRS with a list of qualified SGOs.

The credit amount is reduced by any state tax credit received for the same contribution. A qualified contribution is a charitable contribution of cash made to a scholarship granting organization that uses the contribution to fund scholarships for eligible students attending elementary or secondary schools solely within the State in which the SGO is listed.

A qualifying SGO must be a public charity under §501(c)(3) and must maintain segregated accounts for qualified contributions. Qualified contributions must be in cash only and are not eligible for a charitable deduction under §170 if used to claim the credit. If a taxpayer's federal credit exceeds the limit on nonrefundable personal credits under §26(a), the excess may be carried forward up to five years. Contributions are subject to a national \$4 billion annual cap, with credits allocated on a first-come, first-served basis.

Under new §139K, scholarship amounts received by a taxpayer or a dependent from an SGO are excluded from gross income if used for qualified elementary or secondary education expenses. An "eligible student" must be from a household with income not exceeding 300% of area median gross income, as defined under §42, and be eligible to enroll in a public elementary or secondary school. These scholarships can be used for tuition, fees, books, supplies, and other qualified K–12 educational costs.

M. Learning Credits

Prior to the OBBBA, taxpayers could claim the American Opportunity Tax Credit (AOTC) or the Lifetime Learning Credit (LLC) by including the name and Taxpayer Identification Number (TIN) of the student on

their return. Beginning in 2026, the OBBBA imposes stricter identification requirements for claiming education these credits, tightening eligibility and compliance verification. To claim either the AOTC or LLC, taxpayers must include:

- Their own SSN (or spouse's, if applicable); and
- The SSN of each student for whom the credit is claimed.

Additionally, taxpayers must report the Employer Identification Number (EIN) of each institution that received qualifying tuition payments used to compute the AOTC or LLC. Missing or incorrect SSNs or EINs are treated as mathematical or clerical errors under §6213, enabling automatic IRS disallowance or correction. This provision applies to tax years beginning after December 31, 2025.

N. Employer Payments of Student Loans

Prior to the OBBBA, employees could exclude up to \$5,250 per year of “educational assistance” provided by an employer under a qualified educational assistance program. This exclusion covered various education-related costs, including tuition, fees, books, supplies, and equipment, provided they were for the employee's own educational benefit.

The CARES Act (2020) expanded this benefit temporarily to include employer payments of student loans, including both principal and interest, as a form of tax-free educational assistance. However, the inclusion of student loan repayment assistance was scheduled to expire after December 31, 2025, meaning any payments made after that date would have been taxable to employees.

The OBBBA makes the student loan repayment exclusion permanent, ensuring employer-paid student loan assistance remains tax-free to employees beyond 2025. Employers may continue to provide up to \$5,250 annually toward the repayment of an employee's qualified education loans. Beginning in 2027, the \$5,250 annual limit will be adjusted for inflation each year, ensuring the benefit retains its real value over time. This permanent extension provides long-term planning certainty for both employers and employees looking to use student loan repayment as a tax-advantaged compensation strategy.

O. 529 Plans

Prior to 2002, a qualified tuition program (QTP), sometimes referred to as a §529 plan, generally referred to a program established and maintained by a state. Contributions by donors are eligible for the \$19,000 annual gift-tax exclusion (\$38,000 for “split” gifts by married couples in 2026). Cash distributions made from qualified tuition programs are excluded from gross income to the extent that the distribution is used to pay for qualified higher-education expenses (as reduced by any in-kind distributions). This exclusion from gross income extends to distributions from qualified tuition programs established and maintained by an entity other than a state (or agency or instrumentality thereof).

The OBBBA significantly expands the list of qualified K–12 education expenses eligible for tax-exempt distributions from 529 savings plans and increases the annual distribution cap for K–12 expenses from \$10,000 to \$20,000, effective for tax years beginning after December 31, 2025. Under the OBBBA, newly eligible K–12 expenses include:

- Tuition for public, private, or religious schools;
- Curriculum and curricular materials;
- Books and other instructional materials;
- Online educational resources;

- Tutoring and educational classes outside the home;
- Fees for standardized tests, AP exams, and college admission exams;
- Dual enrollment program fees at higher education institutions; and
- Educational therapies for students with disabilities, provided by licensed professionals.

The expanded list of qualified K–12 expenses is effective for distributions made after the date of enactment.

The OBBBA also introduces §529(f), allowing 529 plan funds to be used for certain qualified postsecondary credentialing expenses. Postsecondary credentialing expenses include tuition, fees, books, supplies, and equipment required for participation in recognized postsecondary credential programs. Also included are costs for testing and continuing education required to obtain or maintain a recognized credential. This provision applies to distributions made after the date of enactment.

A “recognized postsecondary credential program” includes those that:

- Are listed under the Workforce Innovation and Opportunity Act (WIOA);
- Appear in the VA Web Enabled Approval Management System directory;
- Prepare individuals for exams required for industry credentials; and
- Are deemed industry-recognized by the Secretary of Labor.

Covered credentials include:

- State or federally issued licenses;
- Registered apprenticeship completion certificates;
- Credentials listed in the DoD Credentialing Opportunities On-Line (COOL) directory; and
- Certifications accredited by recognized bodies such as the Institute for Credentialing Excellence.

Historically, 529 plans were primarily viewed as vehicles for college savings. The OBBBA further transforms them into multi-stage education funding tools, now supporting K–12, career credentialing, and non-traditional education pathways. It remains important to coordinate 529 distributions with other tax benefits such as:

- The American Opportunity Tax Credit (AOTC);
- The Lifetime Learning Credit (LLC); and
- Scholarship tax benefits.

P. Limitation on Wagering Loss

Prior to the enactment of the OBBBA, losses from wagering transactions were deductible only to the extent of gains from such transactions. Taxpayers who were nonprofessional gamblers were required to itemize deductions in order to deduct such gambling losses. Professional gamblers could deduct ordinary and necessary business expenses in addition to such gambling losses. As a result, between 2018 and 2025, “losses” included all allowable deductions incurred in carrying on any wagering activity. The OBBBA permanently limits the deductibility of gambling-related losses to 90% of the amount of such losses, still only to the extent of gains from wagering transactions. As a result, a portion (10%) of losses will remain non-deductible, even when gains and losses are equal. This change is effective for tax years beginning after December 31, 2025.

- Example 1:** John has \$15,000 in gambling winnings and \$12,000 in gambling losses. John has realized net winnings of \$3,000 (\$15,000 in gambling winnings less \$12,000 in gambling losses). Under the new OBBBA limitation, only \$10,800 of those losses (\$12,000 gambling losses x 90%) may be deducted, resulting in net gambling income subject to tax of \$4,200.
- Example 2:** John has \$50,500 in gambling winnings and \$50,000 in gambling losses. John has realized net winnings of \$500 (\$50,500 in gambling winnings less \$50,000 in gambling losses). Under the new OBBBA limitation, only \$45,000 of those losses may be deducted (\$50,000 gambling losses x 90%), resulting in taxable gambling income of \$5,500 (\$50,500 gambling winnings less \$45,000).
- Example 3:** John has \$100,000 in gambling winnings and \$110,000 in gambling losses. John's realized net loss is \$10,000 (\$100,000 gambling winnings less \$110,000 gambling losses). Under the new OBBBA limitation, only \$99,000 of those losses may be deducted (\$110,000 gambling losses x 90%). This results in taxable gambling income of \$1,000 (\$100,000 gambling winnings less \$99,000).

The wagering provision is considered one of the more controversial provisions of the OBBBA, particularly due to its disproportionate impact on professional and high-volume sports bettors. Legislative developments, such as the proposed FAIR BET Act, aim to restore full deductibility of wagering losses, but have ultimately stalled in Congress. It is important to monitor legislative developments, which could be retroactive or future changes.

Q. Elimination of Energy Incentives

The OBBBA eliminates or accelerates the sunset of several clean energy credits that were extended or expanded under prior legislation. These rollbacks will significantly reduce tax incentives for residential and vehicle-based energy initiatives. Clean Energy Incentives terminated by OBBBA include:

- **Energy Efficient Home Improvement Credit:** Previously available through 2032; now expires for property placed in service after 12/31/2025. This credit covered items like insulation, windows, heat pumps, and audits.
- **Residential Clean Energy Credit:** Previously available through 2032; now expires for expenditures made after 12/31/2025. This credit included items like solar panels, wind turbines, geothermal systems, and battery storage.
- **New Energy Efficient Home Credit:** Previously available through 2032; now ends for homes acquired after 6/30/2026. This credit provided up to \$5,000 per unit for ENERGY STAR and Zero Energy Ready Homes.
- **Clean Vehicle Credit:** The OBBBA accelerates phase out to vehicles acquired after 9/30/2025 (as compared to 2032 under prior law). The OBBBA eliminates future increases in domestic content requirements for battery minerals and components.
- **Previously Owned Clean Vehicles Credit:** This credit was to run through 2032; now terminates for vehicles acquired after 9/30/2025. This credit offered up to \$4,000 for qualified used EV purchases.
- **Alternative Fuel Vehicle Refueling Property Credit:** Now expires for EV charging equipment and other property placed in service after 6/30/2026. This credit originally extended through 2032 for rural and low-income areas.

The Gig Economy and Independent Contractor/Employee Considerations

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The Gig Economy and Independent Contractor/Employee Considerations

Learning objectives

Upon reviewing this material, the reader will be able to:

- Understand the fundamentals of the gig economy;
- Analyze the complexities of worker classification within the gig economy; and
- Understand the factors used to distinguish between employees and independent contractors.

I. Overview of the Gig Economy

A. Introduction to the Fundamentals

The gig economy represents a labor market characterized by short-term, flexible, and freelance work arrangements. Within the gig economy, jobs are typically temporary or project-based, with individuals offering services or completing tasks for various clients or companies. Digital platforms and apps play a crucial role in facilitating work in the gig economy, connecting gig workers with potential clients or employers. Common examples of gig economy labor encompass roles such as ridesharing drivers, food delivery drivers, grocery shoppers, freelance writers, graphic designers, and other independent contractors. It is common for individuals to utilize multiple platforms to offer their services, contributing to the dynamic and ever-evolving nature of the gig economy.

The gig economy has grown significantly in recent years for several reasons, such as:

- **Technological Advancements:** The growth of digital technology and apps has made it easier for workers to connect with popular gig economy platforms.
- **Flexibility:** Gig work provides individuals with the flexibility of when and where they work, easily adapting to changing lifestyles and preferences.
- **Economic Circumstances:** For some individuals, gig work is a response to economic circumstances, providing a source of income in a challenging job market or an additional source of income to another job.

Common examples of gig economy work include:

- Driving a vehicle for scheduled rides (Uber/Lyft);
- Driving a vehicle for scheduled deliveries of food or goods (DoorDash, Instacart);
- Renting out property or a portion thereof (Airbnb, VRBO);
- Completing errands or tasks for an individual (TaskRabbit, Handy);
- Renting equipment;
- Selling merchandise or other goods online (eBay, Etsy);
- Providing professional or creative services (Upwork, Fiverr); and
- Engaging in other temporary, on-demand, or freelance assignments.

The 2022 "Freelance Forward" report by Upwork reported that the freelance / gig economy workforce represented 39% of the total workforce, increased from 36% of the workforce in 2021. The same report highlighted that freelance/gig economy workers contributed \$1.35 trillion to the U.S. economy in annual earnings in 2022, a substantial increase from \$50 billion in 2021. According to the Statista Research

Department, as of December 18, 2023, there were 57.3 million freelancers working in the U.S., with an average weekly workload ranging from 11 to 30 hours. These statistics underscore the rising prominence of gig work, reflecting its popularity as a flexible and accessible form of employment.

Gig Economy Platforms provide a digital marketplace where individuals can offer their services (such as driving, delivering food, or grocery shopping), to users seeking those services. Examples of popular Gig Economy Platforms include Uber, Lyft, DoorDash, Instacart, AirBnB, and TaskRabbit. Acting as intermediaries, these platforms connect gig economy workers with consumers seeking specific services.

Gig Economy Platforms typically do not directly employ gig workers but rather act as facilitators of transactions between the gig workers and consumers. As a result, individuals who work for these platforms are generally classified as independent contractors rather than traditional employees. This means they are not employees of the Gig Economy Platform provider, but instead work independently and have greater autonomy over their work schedules and operations.

With the expansion of the gig economy, it has become increasingly important for all small businesses to understand and correctly apply the rules related to classifying workers as either employees or independent contractors. For the worker, classification determines whether taxes are withheld, whether the worker bears the full self-employment tax burden, and which deductions are available. For the business, misclassification creates exposure to back employment taxes, penalties, interest, and legal liability under both federal and state law.

Factor	Employee	Independent contractor
Tax withholding	Employer withholds federal/state income tax, Social Security, and Medicare	No withholding - worker responsible for all taxes
FICA / self-employment tax	Split equally: employer pays 7.65%, employee pays 7.65%	Worker pays full 15.3% (12.4% SS + 2.9% Medicare) as self-employment tax
Unemployment tax (FUTA)	Employer pays FUTA on wages	Not applicable
Business expense deductions	Limited - unreimbursed employee expenses generally not deductible	Broad - ordinary and necessary business expenses deductible on Schedule C
Information reporting	Form W-2 issued by employer	Form 1099-NEC issued if payments ≥\$600; Worker must report all income even if no form received
Estimated tax payments	Generally not required if employer withholding is sufficient	Generally required quarterly if tax liability will be \$1,000 or more
Labor law protections (FLSA)	Minimum wage, overtime pay, and other FLSA protections apply	FLSA protections generally do not apply
Employer-provided benefits	May receive health insurance, retirement contributions, paid leave	No employer-provided benefits; worker provides own coverage

B. Rev. Rul. 87-41

The determination of whether an individual is an independent contractor or employee is based on the facts and circumstances of his or her specific situation. In 1987, the IRS issued Rev. Rul. 87-41, providing guidance on the classification of workers as employees or independent contractors for federal employment tax purposes. This ruling outlines 20 factors that may be considered in determining worker classification. It is important to note that no single factor is determinative, and the entire working relationship must be considered.

The 20 factors outlined in Rev. Rul. 87-41 are as follows:

#	Factor	Description	Suggests
1	Instructions	Worker required to comply with instructions on when, where, and how to work.	Employee
2	Training	Business provides training on how to perform services in a particular method or manner.	Employee
3	Integration	Worker's services are integrated into the business's operations; success of the business depends on the worker's performance.	Employee
4	Services rendered personally	Services must be rendered personally and the business controls the details of the work.	Employee
5	Hiring assistants	Business hires, supervises, and pays the worker's assistants, indicating control over workers on the job.	Employee
6	Continuing relationship	A continuous or ongoing relationship between the worker and the business.	Employee
7	Set hours of work	Business establishes fixed working hours; independent contractors typically set their own hours.	Employee
8	Full-time required	Worker is required to work full-time for the business, restricting other gainful work.	Employee
9	Work on employer's premises	Work performed on the employer's premises.	Employee
10	Order or sequence set	Worker must perform services in an order or sequence set by the business and cannot follow their own work pattern.	Employee

#	Factor	Description	Suggests
11	Oral or written reports	Worker must submit regular reports to the business.	Employee
12	Hourly/weekly/monthly pay	Payment on a time basis (hourly, weekly, monthly) rather than by the job or project.	Employee
13	Business/travel expense payment	Business pays the worker's business or travel expenses.	Employee
14	Furnishing tools/materials	Business provides tools, materials, or equipment to the worker.	Employee
15	Significant investment	Worker has a significant investment in their own facilities used to perform services.	Contractor
16	Profit or loss potential	Worker's potential for profit or loss based on their own managerial skill suggests contractor status.	Contractor
17	Multiple clients	Worker provides services to multiple businesses simultaneously.	Contractor
18	Services available to the public	Worker makes their services available to the general public.	Contractor
19	Right to discharge	Business has the right to discharge the worker (suggesting employment relationship).	Employee
20	Right to terminate	Worker has the right to terminate the relationship without liability (suggesting employment).	Employee

Many of the factors outlined in Rev. Rul. 87-41 center around the degree of control a business has over its workers. The classification of gig workers as independent contractors or employees has been an ongoing subject of legal and regulatory scrutiny. Both companies operating in the gig economy and gig workers alike should be aware of the factors delineated in Rev. Rul. 87-41 when evaluating worker classification for tax compliance.

C. Three-factor test

In addition to the 20 factors outlined in Rev. Rul. 87-41, the IRS utilizes a three-factor test to determine whether a worker is an independent contractor or an employee:

1. Behavioral control;
2. Financial control; and
3. The relationship between the parties.

Behavioral Control is the extent to which the individual receiving services has the right to direct or control what the worker does and how the worker performs his or her services. Factors to consider when determining behavioral control include:

- Type of instructions given;
- Degree of instruction;
- Evaluation systems; and
- Training.

Financial Control is the extent to which the individual receiving services has the right to control the economic aspects of the worker's job. Factors to consider when determining financial control include:

- Significant investment;
- Unreimbursed expenses;
- Opportunity for profit or loss;
- Services available to the market; and
- Method of payment.

The relationship between the parties refers to the extent to which the worker and individual for whom the services are provided see their relationship with each other. Factors to consider when determining the relationship between the parties include:

- Written contracts;
- Employee benefits (pension plan, insurance, vacation pay, etc.);
- Permanency of the relationship; and
- Services provided as key activity of the business.

If after analyzing all factors a business is unable to determine a worker's classification, they may file Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, to request a determination of the status of a worker. A Form SS-8 determination may be requested only in order to resolve federal tax matters. The IRS will not issue a determination letter for a tax year for which the statute of limitations on the tax return has expired. Additionally, the IRS will not issue a determination letter for proposed transactions, hypothetical situations, cases involving current worker classification litigation, cases involving state or local government workers who may be performing services under an agreement entered into pursuant to Section 218 of the Social Security Act, or business-to-business transactions, or for other reasons not in the best interests of tax administration.

Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding

Go to www.irs.gov/FormSS8 for instructions and the latest information.

For IRS Use Only:
Case Number:

Earliest Receipt Date:

Disclosure of Information

The information provided on Form SS-8 may be disclosed to the firm, worker, or payer named below to assist the IRS in the determination process. For example, if you are a worker, we may disclose the information you provide on Form SS-8 to the firm or payer named below. The information can only be disclosed to assist with the determination process. See *Privacy Act and Paperwork Reduction Act Notice* in the separate instructions for more information. **If you do not want this information disclosed to other parties, do not file Form SS-8.**

IMPORTANT THINGS YOU SHOULD KNOW

- **The Form SS-8 must be fully completed. If you provide incomplete information, we may not be able to process your request.**
- All questions in Parts I through IV must be explained with clear concise answers.
- Part V must be completed if the worker provides a service directly to customers or is a salesperson.
- If you cannot answer a question, enter "Unknown" or "Does not apply."
- If you need more space for a question, attach another sheet with the part and question number clearly identified. Write your firm's name (or worker's name) and employer identification number (or social security number) at the top of each additional sheet attached to this form.
- You **MUST** include copies of the Forms W-2, 1099-MISC, and/or 1099-NEC for each year you are contesting. See instructions.

Name of firm (or person) for whom the worker performed services		Worker's name	
Firm's mailing address (include street address, apt. or suite no., city, state, and ZIP code)		Worker's mailing address (include street address, apt. or suite no., city, state, and ZIP code)	
Trade name		Worker's daytime telephone number	Worker's alternate telephone number
Firm's fax number	Firm's website	Worker's fax number	Worker's social security number
Firm's telephone number (include area code)	Firm's employer identification number	Worker's employer identification number (if any)	

Note: If the worker is paid for services performed for a business or individual not listed above, enter the name, address, and taxpayer identification number of that business/individual who paid the worker, if known. Explain the relationship between the firm and the business/individual who paid the worker.

Part I General Information

1 This form is being completed by: Firm Worker
for services performed from beginning date MM/YYYY to ending date MM/YYYY .

Caution: Filing Form SS-8 does not prevent the expiration of the time in which a claim for refund must be filed.

2 Explain your reason(s) for filing this form.

<input type="checkbox"/> You received a bill from the IRS	<input type="checkbox"/> You believe you erroneously received a Form 1099 or Form W-2
<input type="checkbox"/> You are unable to get workers' compensation benefits	<input type="checkbox"/> You were audited or are being audited by the IRS
<input type="checkbox"/> Other (specify) _____	

Don't complete this form if payment was received for reasons unrelated to Form SS-8. See instructions.

**Did you remember to answer all questions and
refer to the Instructions for Form SS-8 at www.irs.gov/pub/irs-pdf/iss8.pdf?**

Part I General Information (continued)

- 3 Total number of workers who performed or are performing the same or similar services: _____
- 4 How did the worker obtain the job? Attach any advertisement.
 Application Bid Employment agency Other (specify) _____
- 5 **Attach copies of all supporting documentation (for example, contracts; invoices; memos; Forms W-2, Forms 1099-MISC, or Forms 1099-NEC issued or received; IRS closing agreements; or IRS rulings).**
 - a Inform us of any current or past litigation concerning the worker's status. _____
 - b If no income reporting forms (Form 1099-MISC, 1099-NEC, or W-2) were furnished to the worker, enter the amount of income earned for the year(s) at issue \$ _____
 - c If both Form W-2 and Form 1099-MISC, or both Form W-2 and Form 1099-NEC, were issued or received, explain why.

- 6 Describe the firm's business. _____
- 7 Did the worker receive pay from more than one entity (for example, two or more entities with different taxpayer identification numbers) because of a business sale, merger, acquisition, or reorganization? No. Skip to line 8. Yes. Complete the rest of line 7.
 Name of the firm's previous owner: _____
 Previous owner's taxpayer identification number: _____ Change was a: Sale Merger Acquisition Reorganization
 Other (specify) _____
 Description of above change: _____
 Date of change (MM/DD/YY): _____
- 8 What is the worker's job title? _____
 Describe the worker's duties. _____
- 9 Which do you believe the worker is? Check only one. Employee Independent contractor
 Explain. _____
- 10 Did the worker perform any services for the firm before or after the dates entered on line 1 on page 1 of this form? Yes No
 If "Yes," what were the dates of service? _____
 If "Yes," explain any differences between the services provided. _____
- 11a Is the work done under a written agreement between the firm and the worker? Yes No
 If "Yes," attach a copy (preferably signed by both parties).
 If "Yes," describe the terms and conditions of the work arrangement. _____
- b Is the work done under an oral agreement? Yes No
 If "Yes," describe the details of the agreement. _____

Part II Behavioral Control (Provide names and titles of specific individuals, if applicable.)

- 1 What specific training and/or instruction is the worker given by the firm? _____
- 2 Who gives the worker work assignments?
 How are the assignments received? In person Phone Email Text message
 Other (specify) _____
- 3 Who determines the methods by which the assignments are performed? _____
- 4 If problems or complaints arise, who is contacted? _____
 Who is responsible for their resolution? _____

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at www.irs.gov/pub/irs-pdf/iss8.pdf?

Part II Behavioral Control (Provide names and titles of specific individuals, if applicable.) (continued)

- 5 Is the worker required to complete reports? Yes No
If "Yes," attach examples.
- 6a How frequently does the worker perform services? As scheduled As needed As available
 Other (specify) _____
- b Describe the worker's primary services. Sales Timesheets Patient logs
 Other (specify) _____
- 7 Where are the services performed? If more than one location, what percentage of the worker's time is spent at each location?
 Firm premises _____ %
 Worker's office or shop _____ %
 Customer's location _____ %
 Other (specify) _____ %
- 8a Is the worker required to attend meetings? Yes No
If "Yes," what type of meetings? Sales Staff Other (specify) _____
- b Is the worker penalized if unable to attend a meeting? Yes No
If "Yes," what is the penalty? _____
- 9 Is the worker required to provide the services personally? Yes No
- 10 Can the worker hire substitutes or helpers? Yes No
- 11 If the worker hires the substitutes or helpers, is approval required? Yes No
If "Yes," who approves the hiring? Firm Other (specify) _____
- 12 Does the worker pay substitutes or helpers? Yes No
If "Yes," is the worker reimbursed? Yes No
If the worker is reimbursed, explain who reimburses them. _____

Part III Financial Control (Provide names and titles of specific individuals, if applicable.)

- 1a List the supplies, equipment, materials, and property provided by
The firm: _____
The worker: _____
- b Are supplies, equipment, materials, or property provided by another party? Yes No
If "Yes," explain. _____
- 2 Does the worker lease equipment, space, or a facility? Yes No
If "Yes," what are the terms of the lease? (Attach a copy or explanatory statement.) _____
- 3 Are expenses incurred by the worker in the performance of services for the firm? Yes No
If "Yes," explain. _____
- 4a Are expenses reimbursed by the firm? Yes No
If "Yes," provide the frequency and amount. _____
- b Are expenses reimbursed by another party? Yes No
If "Yes," explain. _____
- 5a What type of pay does the worker receive? Salary Commission Hourly wage Piece work Lump sum
 Other (specify) _____
- b If paid commission, does the firm guarantee a minimum amount of pay? Yes No
If "Yes," explain. _____
- 6 Can the worker request advance pay? Yes No
If "Yes," how often? Daily Weekly Monthly Other (specify) _____
- 7 Whom does the customer pay? Firm Worker
If worker, does the worker pay the total amount to the firm? Yes No If "No," explain. _____
- 8 Does the firm carry workers' compensation insurance on the worker? Yes No

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at www.irs.gov/pub/irs-pdf/iss8.pdf?

Part III Financial Control (Provide names and titles of specific individuals, if applicable.) (continued)

- 9a Does the worker take a financial risk by performing services? Yes No
If "Yes," explain. _____
- b Can the worker suffer a financial loss by performing services? Yes No
If "Yes," explain. _____
- 10a Who sets the rate of pay for the services performed? Firm Worker Other (specify) _____
- b If products are sold, who sets the product price? Firm Worker Other (specify) _____

Part IV Relationship of the Worker and Firm

- 1 Are benefits made available to the worker? Yes No
If "Yes," which benefits are available? Paid vacations Sick pay Paid holidays
 Personal days Pensions Insurance benefits Bonuses
 Other (specify) _____
- 2 Can the firm or worker end the work relationship without penalty? Yes No
If "No," explain. _____
- 3 Did the worker perform similar services for others during the time period entered in Part I, line 1? Yes No
If "Yes," is the worker required to get approval from the firm? Yes No
- 4 Is there an agreement prohibiting competition between the firm and the worker? Yes No
If "Yes," explain or attach available documentation. _____
- 5 Reserved for future use.
- 6 Does the worker advertise? Yes No
If "Yes," what type of advertising does the worker do? Provide copies, if available. _____
- 7 Does the worker assemble or process a product at home? Yes No
If "Yes," who provides the materials and instructions or patterns?
If "Yes," what does the worker do with the finished product? Return to the firm Provide to another party Sell it
 Other (specify) _____
- 8a Does the firm introduce the worker to its customers? Yes No
If "Yes," how is the worker introduced? Employee Partner Representative Contractor
 Other (specify) _____
- b Under whose name are services performed? Firm Worker
 Other (specify) _____
- 9 Does the worker still perform services for the firm? Yes No
If "No," how did the work relationship end? Firm ended the work relationship Worker ended the work relationship
 Job completed Contract ended Firm or worker went out of business
 Other (specify) _____

Part V For Service Providers or Salespersons. You must complete this part if the worker provided a service directly to customers or is a salesperson.

- 1 Is the worker responsible for contacting potential new customers? Yes No
If "Yes," what are the worker's specific responsibilities? _____
- 2 Is the worker provided leads (names and contact information) for potential new customers? Yes No
If "Yes," who provides the leads? _____
- 3 Is the worker required to report on potential new customers contacted? Yes No
If "Yes," what are the reporting requirements? _____
- 4 Does the firm set terms and conditions of sale? Yes No
If "Yes," explain. _____
- 5 Are orders submitted and subject to the firm's approval? Yes No
- 6 Who determines the worker's sales territory? Firm Worker
 Other (specify) _____

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at www.irs.gov/pub/irs-pdf/iss8.pdf?

Part V For Service Providers or Salespersons. You must complete this part if the worker provided a service directly to customers or is a salesperson. (continued)

7 Did the worker pay for the privilege of serving customers on the route or in the territory? Yes No
 If "Yes," whom did the worker pay? _____
 If "Yes," how much did the worker pay? _____ \$

8 Where does the worker sell the product? Home Retail establishment Online
 Other (specify) _____

9 List the product and/or services distributed by the worker (for example, meat, vegetables, fruit, bakery products, beverages, or laundry or dry cleaning services). If more than one type of product and/or service is distributed, specify the principal one. _____

10 Does the worker sell life insurance full time? Yes No

11 Does the worker sell other types of insurance for the firm? Yes No
 If "Yes," enter the percentage of the worker's total working time spent in selling other types of insurance _____ %

12 Does the worker solicit orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments? Yes No
 If "Yes," what percentage of the worker's time is spent in solicitation? _____ %

13 Is the merchandise purchased by the customers for resale or use in their business operations? Yes No
 Describe the merchandise and state whether it is equipment installed on the customers' premises. _____

Sign Here Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete.

_____ Print your name _____ Signature _____ Date

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at www.irs.gov/pub/irs-pdf/iss8.pdf?

Did you sign Form SS-8?

Did you attach copies of your Form W-2 or Form 1099 for each year contested?

When Form SS-8 is filed, the IRS generally tries to get information from all parties involved (typically two or more), by sending those parties blank Forms SS-8 to complete. An IRS technician will review the facts, potentially request additional information from the requestor or other parties and render a decision on the matter. Then, the IRS will typically issue a formal determination to the firm and send a copy to the worker. Any Form SS-8 determination only applies to the worker or class of workers requesting it, and the decision is binding on the IRS if there is no change in the facts or law that formed the basis for the ruling.

D. DOL worker classification

It is important to acknowledge that while the IRS primarily utilizes Rev. Rul. 87-41 and the three-factor test to determine whether a worker is an employee or independent contractor, the Department of Labor (DOL) utilizes different criteria to determine worker classification. Additionally, state laws governing worker classification may vary.

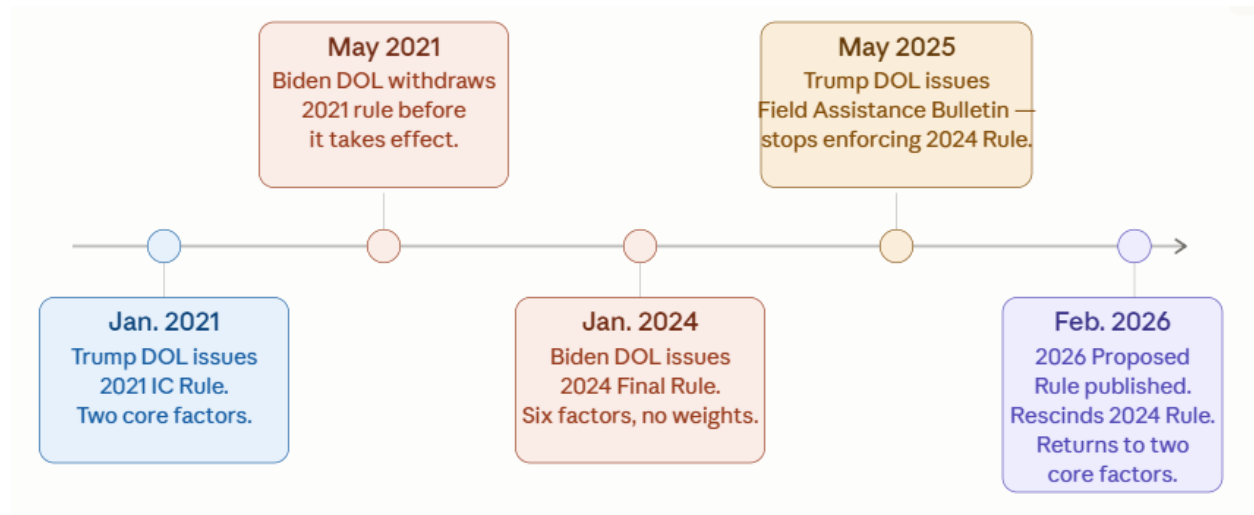
The Fair Labor Standards Act (FLSA), enacted in 1938, was enacted to safeguard workers' rights by establishing minimum wage, overtime pay eligibility, and protection against exploitation in the workplace. Notably, these protections do not apply to independent contractors. Since the 1940s, both the Department of Labor (DOL) and courts have utilized an economic reality test to discern a worker's classification under the FLSA, whether as an employee or an independent contractor. The economic reality test is a framework used to determine whether a worker is considered an employee or an independent contractor. It assesses various factors to determine the extent of economic dependence between the worker and the employer. When assessing economic dependence, the DOL and courts have historically conducted a totality-of-the-circumstances analysis, considering multiple factors to determine

whether a worker is an employee or an independent contractor, with no factor or factors carrying predetermined weight.

The DOL's approach to independent contractor classification under the FLSA has undergone a series of reversals that reflects the broader political and policy tensions surrounding the gig economy.

Understanding this history is essential context for evaluating where the law currently stands and where it is heading.

The Trump administration's 2021 IC Rule elevated two "core" factors, control and opportunity for profit or loss, above all others, creating a more streamlined, business-friendly classification analysis. The Biden administration rescinded that rule in 2021 before it took full effect, and in January 2024 finalized a six-factor, totality-of-the-circumstances test that gave no single factor predetermined weight. The current administration has now proposed reversing course once again.



On February 26 2026, the DOL announced a new Notice of Proposed Rulemaking (NPRM) that would significantly shift how workers are classified. If finalized, this rule will rescind the 2024 "multifactor economic reality test" and reinstate a framework that is substantially similar to the 2021 Independent Contractor Rule.

The 2026 proposal returns to the five-factor model with a heavy emphasis on the same two "core factors" outlined in the 2021 IC Rule:

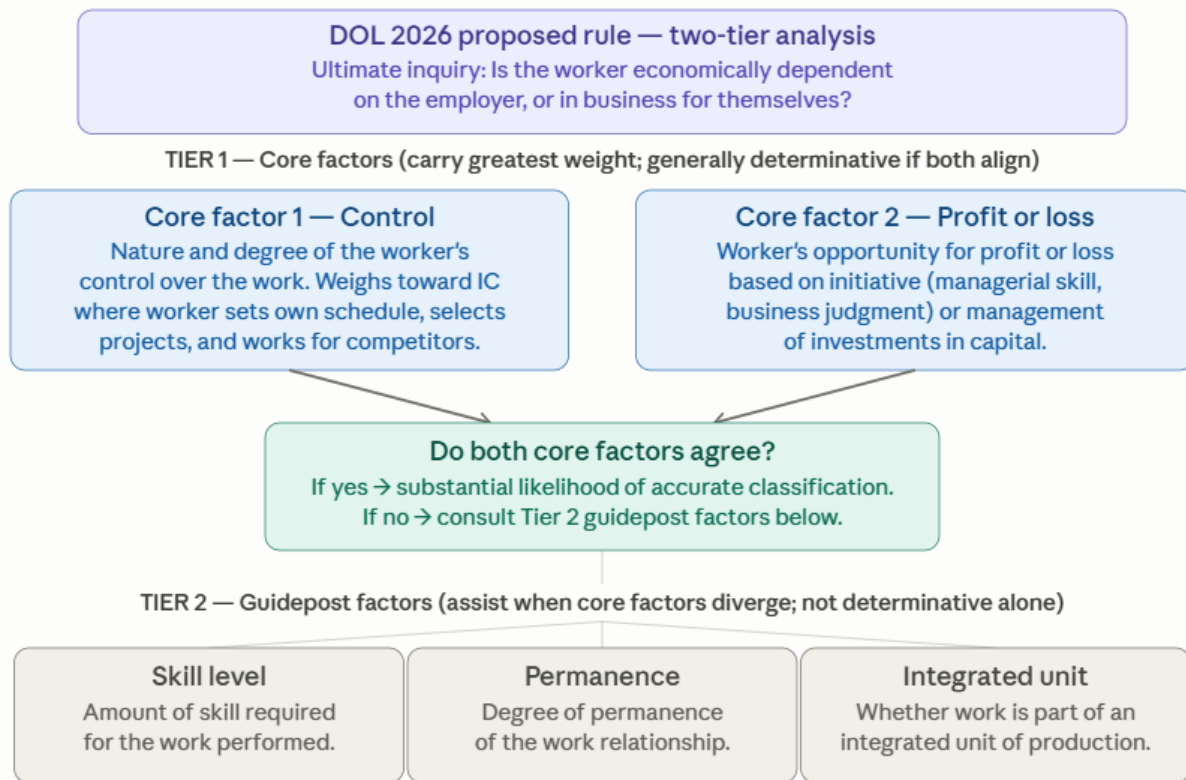
- **Nature and Degree of Control** – This factor focuses on the worker's autonomy over schedules and projects; and
- **Opportunity for Profit or Loss** – This factor examines if the worker's own business initiative or investment can lead to profit or loss.

If these two core factors point toward the same classification, there is a "substantial likelihood" it is correct. Further, it advises that the actual practice of the worker and the potential employer is more relevant than what may be contractually or theoretically possible.

Consistent with the 2021 Rule, the DOL is proposing to re-adopt the other factors that it identified in the 2021 Rule that also guide the economic reality analysis. These factors are provided less weight than the core factors:

- **The Amount of Skill Required for the Work –**
 - This factor would indicate independent contractor status to the extent the work at issue requires specialized training or skill that the potential employer does not provide.
 - Similarly, this factor would indicate employee status to the extent the work at issue requires no specialized training or skill and/or the individual is dependent upon the potential employer to equip him or her with any skills or training necessary to perform the job.
 - This factor would thus focus on training and skill rather than exercise of initiative.
- **The Degree of Permanence of the Working Relationship between the Individual and the Potential Employer –**
 - This factor would weigh in favor of the individual being classified as an independent contractor to the extent the work relationship is by design definite in duration or sporadic, which may include regularly occurring fixed periods of work.
 - Note: Seasonal nature of work by itself would not necessarily indicate independent contractor classification.
 - This factor would weigh in favor of the individual being an employee to the extent the work relationship is instead by design indefinite in duration or continuous.
- **Whether the Work Is Part of an Integrated Unit of Production –**
 - This factor would weigh in favor of the individual being an independent contractor to the extent his or her work is segregable from the potential employer's production process.
 - This factor would weigh in favor of the individual being an employee to the extent his or her work is a component of the potential employer's integrated production process for a good or service.

Upon analyzing the worker's status using the "economic reality" test, if the two "core" factors arrived at the same conclusion as to the worker's classification, the combined weight of these factors would outweigh the other three factors of less importance. If the two core factors did not arrive at the same worker classification conclusion, the remaining three factors may help determine the correct worker classification. The remaining three factors should always be evaluated in the context of the two core factors.



The 2026 Proposed Rule outlines eight examples to demonstrate how factors can be analyzed in the context of certain facts and scenarios.

Example 1: An individual is the owner and operator of a tractor-trailer and performs transportation services for a logistics company. The owner-operator substantially controls the key aspects of the work. However, the logistics company requires the owner-operator to comply with federally mandated transportation safety rules requiring drug and alcohol testing. The company also requires the owner-operator to meet certain contractually agreed-upon delivery deadlines, and her contract includes agreed-upon incentives for meeting, and penalties for missing, the deadlines.

Application 1: The owner-operator exercises substantial control over key aspects of his or her work, indicating independent contractor status. Contractually agreed-upon delivery deadlines, incentives, and penalties are typical of business relationships and do not constitute control. The fact that the company requires the owner-operator to complete certain drug and alcohol testing does not change the above conclusion.

- Example 2:** An individual accepts assignments from a company that provides an app-based service linking those who need home-repair work with those who perform home-repair work. The individual is able to meaningfully increase his earnings by exercising initiative and business acumen and by investing in his own equipment. The company, however, has invested millions of dollars in developing and maintaining the app, marketing itself, maintaining the security of information submitted by actual and prospective customers and workers, and monitoring customer satisfaction with the work performed.
- Application 2:** The opportunity for profit or loss factor favors independent contractor status for the individual. The individual controls his or her meaningful opportunity for profit or loss. The value of the investments made by each party is not relevant in determining whether the individual has a meaningful opportunity for profit or loss through his or her initiative, investment, or both.
- Example 3:** An individual worker works full-time performing home renovation and repair services for a residential construction company. She is also the part owner of a food truck, which she operates on weekends. In performing the construction work, the worker is paid a fixed hourly rate, and the company determines how many and which tasks she performs. Her food truck recently became very popular and has generated substantial profits for her.
- Application 3:** The individual does not have meaningful opportunity for profit or loss with respect to the construction work, indicating employee status, as she is paid a fixed hourly rate and the company determines the assignment of work. She is unable to increase her earnings by exercising initiative or managing investments, indicating employee status. The food truck business is separate from her construction work and is not relevant as to whether she was an employee of the construction company or in business for herself.
- Example 4:** An individual worker works for a commercial construction company and is assigned to the crew that installs roofs on buildings. The company required no roofing skills when he started working for it, and he had no roofing skills when he started. Over his time working for the company, the individual has developed skills through on-the-job experience and training provided by the company.
- Application 4:** The work performed by this individual requires no specialized training or skill, and the individual relies on the construction company to provide any training necessary to perform the work. Accordingly, the skill factor weighs in favor of the individual being an employee. The fact that the individual has developed skills over his time at the company does not change that outcome because those skills resulted from on-the-job experience and training provided by the company.
- Example 5:** An individual performs roofing work for a commercial construction company. He has specialized training in roofing and relies on his own skills to perform the work. The construction company provides him with no training and hired him based on his roofing skills and expertise. The individual touted his roofing skills when securing roofing work from the company and similarly relies on those skills when seeking work from other companies.
- Application 5:** This individual brings his own skills to the work and does not rely on the construction company to provide training. Accordingly, the skill factor weighs in favor of the individual being an independent contractor. The fact that the individual used his specialized skills to secure the work would not be considered under this factor, although it could be indicative of initiative to consider under the opportunity for profit or loss factor.

Example 6: A housekeeper works for a ski resort every winter. At the end of each winter, he stops working for the ski resort because the resort shuts down. At the beginning of each of the past several winters, the housekeeper returned to his prior position at the ski resort without formally applying or interviewing.

Application 6: The housekeeper has a long-term, indefinite work relationship with the ski resort under the permanence factor, which weighs in favor of employee status. The seasonal nature of the ski industry is not indicative of a sporadic relationship. The fact that the housekeeper returns to his prior position each new season indicates that his or her relationship with the ski resort is indefinite as a matter of economic reality.

Example 7: An editor works part-time for a newspaper. The editor works from home and is responsible for assigning and reviewing many articles published by the newspaper. Sometimes she also writes or rewrites articles. The editor is responsible for determining the layout and order in which all articles appear in the newspaper's print and online editions. She makes assignment and layout decisions in coordination with several full-time editors who make similar decisions with respect to different articles in the same publication and who are employees of the newspaper.

Application 7: The editor is part of an integrated unit of production of the newspaper, as she is involved in the entire production process, including assigning and reviewing work, writing articles, and determining the article layout. She also works in coordination with other employees. The editor's part of an integrated unit of production of the newspaper indicates employee classification. Although she does not physically work in the office, the integrated unit factor outweighs this consideration.

Example 8: A journalist writes articles for a newspaper on a freelance basis. The journalist does not have an office and generally works from home. He submits an article to the newspaper once every 2 to 3 weeks, which the newspaper may accept or reject. The journalist sometimes corresponds with the newspaper's editor regarding what to write about or regarding revisions to the articles that he submits, but he does not otherwise communicate or work with any of the newspaper's employees. The journalist never assigns articles to others, nor does he review or revise articles that others submit. He is not responsible for determining where his article or any other articles appear in the newspaper's print and online editions.

Application 8: The journalist is not part of an integrated unit of production of the newspaper, which indicates independent contractor status. The journalist's work is limited to specific articles and is segregated from other parts of the newspaper's processes. The fact that the journalist works from home is not indicative of either employee or independent contractor status, as the nature of a journalist's work makes the physical work location largely irrelevant.

Lastly, for the first time, the 2026 Proposed Rule would extend the DOL's streamlined analysis to the Family and Medical Leave Act (FMLA) and the Migrant and Seasonal Agricultural Worker Protection Act (MSPA), not just the FLSA. This change aims to create a single, uniform standard across all three statutes, as they already share a broad statutory definition of the term "employ."

For FMLA purposes, only employees are entitled to FMLA protections. If a worker is classified as an independent contractor under the new prioritized "core factors" (control and profit/loss), they are ineligible for FMLA leave. The extension to the MSPA has significant impacts for the agricultural sector. The MSPA protects migrant and seasonal workers from various labor abuses. By applying the narrower 2026 classification test, the DOL aims to clarify when agricultural workers are independent contractors versus employees of a grower or processor.

As discussed, the DOL and IRS use different tests for worker classification. In practice, the tests may often align; however, a worker may be an independent contractor under DOL rules and an employee under IRS rules or vice versa. For example, a worker might qualify as an independent contractor under the DOL's 2026 Proposed Rule because they have high control over their schedule, yet still be considered an employee by the IRS if they don't meet specific financial control markers. As a result, a company may avoid DOL overtime and minimum wage lawsuits but still get triggered by the IRS for unpaid payroll taxes, FICA, and backup withholding, often compounded by failure-to-file penalties.

E. Worker Misclassification

Worker misclassification of treating an employee as an independent contractor carries significant consequences for the business. From a tax perspective, the business can be held liable for:

- The employer's share of FICA taxes (7.65% of wages) that should have been paid but were not;
- The employee's share of FICA taxes (7.65%) if the business failed to withhold;
- Federal income tax that should have been withheld;
- Interest on all underpaid taxes; and
- Failure-to-deposit penalties and accuracy-related penalties.

In cases where misclassification was intentional, the Trust Fund Recovery Penalty (TFRP) under §6672 may be assessed against responsible individuals personally, including business owners, officers, and payroll managers for the amount of income tax withheld and FICA taxes that should have been paid. Specifically, the TFRP is a 100% personal liability penalty imposed by the IRS on individuals responsible for collecting and paying withheld payroll taxes (income tax, FICA) who willfully fail to do so. It equals the unpaid "trust fund" portion of taxes. This personal liability exposure is one of the most serious consequences in the employment tax context. Beyond taxes, misclassification can expose a business to liability under the FLSA for back wages (including overtime), state wage and hour law violations, and claims for denial of employee benefits.

The IRS offers the Voluntary Classification Settlement Program as an optional remedy for businesses that want to reclassify workers as employees going forward and resolve their past misclassification exposure at reduced cost. Key features of the VCSP include:

- **Partial federal employment tax relief** – Eligible businesses pay only 10% of the employment tax liability that would have been owed for the most recent tax year, based on compensation paid to the reclassified workers.
- **No interest or penalties** – The VCSP payment is not subject to interest or penalties on the federal employment tax portion covered by the program.
- **Audit Protection** – Participating businesses are not subject to employment tax audit for prior years with respect to the reclassified workers.
- **Prospective treatment** – As a condition of participation, the business agrees to treat the reclassified workers as employees going forward.

To participate, a business must meet eligibility requirements, including having consistently treated the workers as independent contractors in prior years, having filed all required Forms 1099 for those workers, and not currently being under employment tax audit. The application is made by filing Form 8952, *Application for Voluntary Classification Settlement Program*, and entering into a closing agreement with the IRS.

F. Tax implications

The tax implications for gig economy work vary for both the platform and the independent contractor providing services through the platform.

Tax considerations for gig economy platforms include:

- Information reporting:
 - Gig economy platforms are required to report payments made to independent contractors to the IRS, typically using Form 1099-NEC.
 - As discussed, the OBBBA raises the Form 1099 reporting threshold to \$2,000, effective for payments made in 2026 and beyond, subject to inflation adjustments starting in 2027.
- Compliance:
 - Gig economy platforms need to ensure compliance with regulations, including accurately reporting payments, providing necessary forms to contractors, and adhering to any applicable state or federal laws.
- State and local taxes:
 - Platforms should consider state and local tax implications, as tax rules can vary by jurisdiction.

Tax considerations for gig economy independent contractors include reporting income, self-employment taxes, quarterly estimated taxes, and deductions.

New provisions in the OBBBA provide notable changes for gig economy workers, including:

- **No tax on tips deduction:** Eligible gig economy workers can deduct up to \$25,000 in qualified tips based on filing status from their taxable income from tax year 2025 through 2028.
- **Permanent QBI deduction:** This deduction is now permanent and allows eligible workers to plan long term to maximize benefits. Certain tip income may be excluded when computing QBI.
- **Form 1099-K and the increased reporting threshold:** Third party payment platforms must issue a Form 1099-K if the payments made during the calendar year are more than \$20,000 and more than 200 transactions. Taxpayers must report all income when they file their tax return regardless of whether they receive a Form 1099-K or other information return.
- **Bonus depreciation:** The law allows 100% bonus depreciation on certain assets acquired after Jan. 19, 2025. This applies to gig workers who buy certain qualifying property solely for use in their business.

1. Reporting income

Gig economy workers must report income earned from any gig work on their tax return, including:

- Income from part-time or temporary work;
- Income not reported on an information return such as Form 1099-K, Form 1099-MISC, Form 1099-NEC, etc.;
- Note: Generally, gig economy workers receive Form 1099-NEC if they received payments of more than \$600 per year. Gig economy workers earning less than \$600 from a platform must still report their earnings on their tax return.
- Income paid in forms other than cash, such as property, goods, or virtual currency/digital assets; and
- Income derived from gig economy work outside of a platform.

Failure to report income on a tax return can result in penalties, such as:

- **A negligence or disregard of the rules or regulations penalty** applies when a taxpayer does not make reasonable attempts to follow the tax laws when preparing their tax return (negligence) or when they carelessly, recklessly, or intentionally ignore tax rules or regulations (disregard).
 - In the case of negligence or disregard of the rules or regulations, an accuracy-related penalty of 20% is applied to the portion of the underpayment of tax that happened because of negligence or disregard.
 - In the case of substantial understatement, an accuracy-related penalty of 20% of the portion of the underpayment of tax that was understated on the return applies.
 - **A substantial understatement of income tax penalty** applies if a taxpayer understates their tax liability by 10% of the tax required to be shown on their tax return or \$5,000, whichever is greater.
- Additional penalties may exist, and interest is charged on such penalties.

As discussed, the OBBBA introduces a tax deduction of up to \$25,000 annually for qualified tips earned, with phaseouts for higher incomes. Gig economy workers who earn tips, such as delivery drivers, rideshare operators, hair stylists, freelance servers, and personal care providers, are explicitly included in a targeted federal tax deduction for tipped income. This deduction applies to gig workers who receive tips (e.g., delivery workers, hair stylists), provided:

- They are in an occupation that customarily receives tips; and
- Their income from that tipped activity exceeds the total of allowable deductions for that trade.

The deduction is available starting in tax year 2026 and applies to taxpayers who receive tips as a customary part of their work.

To qualify for the deduction, three main conditions must be satisfied:

1. **Customary Tipping Occupation** – The taxpayer must work in an occupation recognized as one in which tipping is customary. This includes gig workers (e.g., Uber Eats, DoorDash, Instacart) as well as traditional service jobs.
2. **Net Income Threshold** – The individual's total income from the tipped trade or business must exceed the amount of their deductions (expenses) related to that trade.

3. **Annual Deduction Limit** – The deduction is capped at \$25,000 per year, with a phaseout for higher-income taxpayers.

Gig workers in service roles who regularly receive tips will now be eligible for a federal tax deduction that directly lowers their taxable income, reducing both income tax liabilities. This includes:

- **Food delivery drivers** who receive cash or digital tips;
- **Rideshare drivers** who earn post-trip gratuities;
- **Freelance** barbers, beauticians, or massage therapists operating via platforms or independently; and
- **Other app-based or informal service providers** (e.g., movers, furniture assemblers, dog groomers) in tipping-enabled roles.

Prior to the OBBBA, tips were fully taxable with no specific deduction.

2. Self-employment taxes

Employers are not required to withhold taxes or pay Social Security and Medicare tax on independent contractors. Consequently, independent contractors are responsible for the full 15.3% Social Security and Medicare taxes, referred to as the self-employment tax, comprised of 12.4% for Social Security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance). Conversely, employers are required to withhold income taxes and pay Social Security, Medicare, and unemployment tax on wages paid to employees. Employers generally withhold 6.2% for Social Security tax and 1.45% for Medicare tax (for a total of 7.65%) from wages paid to an employee. Employers are also required to pay the employer share of Social Security and Medicare taxes, which is also 7.65% of wages paid to an employee.

Misclassifying workers as independent contractors negatively impacts employees because the employer's share of taxes is not paid, and the employee's share is not withheld. If a business misclassifies an employee, the business can be held liable for employment taxes for that worker.

Individuals generally must pay self-employment tax and file Schedule SE if their net earnings from self-employment were \$400 or more. Generally, net earnings from self-employment are subject to the self-employment tax. Schedule C is typically used to figure net earnings from self-employment.

For 2026, the first \$184,500 of a taxpayer's combined wages, tips, and net earnings is subject to any combination of the Social Security part of self-employment tax. All of a taxpayer's combined wages, tips, and net earnings in the current year are subject to the 2.9% Medicare part of the self-employment tax. Taxpayers are liable for an additional 0.9% Medicare Tax if their wages, compensation, or self-employment income (together with that of their spouse if filing a joint return) exceed the threshold amount for their filing status:

Filing Status	Threshold Amount
Married filing jointly	\$250,000
Married filing separate	\$125,000
Single	\$200,000
Head of Household	\$200,000
Qualifying Surviving Spouse	\$200,000

Taxpayers may use Form 8919, *Uncollected Social Security and Medicare Tax on Wages*, to figure and report their share of the uncollected Social Security and Medicare taxes due on their compensation if they were an employee but were treated as an independent contractor by their employer. By utilizing this form, the taxpayer's Social Security earnings will be credited to their Social Security record.

Lastly, independent contractors may deduct the employer-equivalent portion of their self-employment tax when calculating their adjusted gross income.

3. Quarterly estimated taxes

If a taxpayer does not pay enough tax during the year either through withholding or by making estimated tax payments, they may have to pay a penalty. Since gig workers do not have taxes withheld from their paychecks, they are often required to make quarterly estimated tax payments to cover their tax liabilities throughout the year. Taxpayers who work as an employee and do gig economy work on the side may be able to avoid making estimated tax payments on their gig income by withholding more tax from their employee paycheck.

Estimated tax payments are generally due four times a year:

- April 15 for payment period January 1–March 31.
- June 15 for payment period April 1–May 31.
- September 15 for payment period June 1–August 31.
- January 15 for payment period September 1–December 31.

If a due date falls on a Saturday, Sunday or legal holiday, payment is due the next business day.

4. Deductions

Unlike employees, independent contractors may qualify for various tax deductions related to their business expenditures, including mileage/vehicle expense, phone/internet bills, home office, platform fees/commissions, tools/equipment, or other costs directly associated with their work. Generally, taxpayers may deduct ordinary and necessary expenses incurred in conducting a trade or business. Ordinary expenses are expenses that are common and accepted in the taxpayer's trade or business, while necessary expenses are expenses that are appropriate for the business. Additionally, independent contractors also may deduct the employer-equivalent portion of their self-employment tax when calculating their adjusted gross income. Lastly, self-employed gig workers who establish a SEP-IRA, SIMPLE IRA, or Solo 401(k) may deduct contributions.

It is pivotal for gig economy workers to maintain meticulous and accurate records in order to keep track of deductible expenses. By keeping accurate records, gig economy workers can ensure they do not miss out on any eligible deductions, thereby maximizing their tax savings. Certain expenses, such as those

associated with mixed-use assets like vehicles used in ridesharing, may need to be allocated between business and personal use, adding a layer of complexity. The IRS requires taxpayers to maintain adequate records to substantiate the deductions claimed on their tax returns. Keeping detailed records demonstrates compliance with tax laws and can help substantiate deductions in the event of an audit.

Further, independent contractors may deduct the employer-equivalent portion of their self-employment tax when calculating their adjusted gross income. Similarly, eligible self-employed gig workers can deduct 100% of health insurance premiums paid for themselves, as well as their spouse and dependent(s) if applicable. Taxpayers cannot deduct more than their net self-employment income for the year and are not eligible for the deduction in any month they were eligible to enroll in an employer-sponsored plan (such as through a spouse's job). Lastly, Eligible self-employed gig workers can deduct up to 20% of their net qualified business income.

5. Other considerations

To summarize, gig workers who are independent contractors share many of the filing obligations of small business owners, even if they earn relatively modest amounts.

- Gig workers who are independent contractors generally must report their income and expenses on Schedule C.
- Gig workers who are independent contractors must file Schedule SE if their net earnings from self-employment are \$400 or more.
- Gig workers who are independent contractors may be required to make estimated payments and file Form 1040-ES.
- Gig workers who are independent contractors may have additional state and local tax obligations.

It is essential to understand worker classification rules within the gig economy. Adhering to classification rules ensures compliance with labor laws and tax regulations, mitigating the risk of legal issues. Lastly, being aware of the classification rules helps prevent misclassification errors that could lead to penalties.

6. Summary of Worker Classification Rules within the Gig Economy

Factor	Employee	Independent contractor
Tax withholding	Employer withholds federal/state income tax, Social Security, and Medicare	No withholding - worker responsible for all taxes
FICA / self-employment tax	Split equally: employer pays 7.65%, employee pays 7.65%	Worker pays full 15.3% (12.4% SS + 2.9% Medicare) as self-employment tax
Unemployment tax (FUTA)	Employer pays FUTA on wages	Not applicable
Business expense deductions	Limited - unreimbursed employee expenses generally not deductible	Broad - ordinary and necessary business expenses deductible on Schedule C
Information reporting	Form W-2 issued by employer	Form 1099-NEC issued if payments ≥\$2,000; Worker must report all income even if no form received
Estimated tax payments	Generally not required if employer withholding is sufficient	Generally required quarterly if tax liability will be \$1,000 or more
Labor law protections (FLSA)	Minimum wage, overtime pay, and other FLSA protections apply	FLSA protections generally do not apply
Employer-provided benefits	May receive health insurance, retirement contributions, paid leave	No employer-provided benefits; worker provides own coverage

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Learning objectives

Upon reviewing this chapter, the reader will be able to:

- Describe the structure of the tax brackets for 2026;
- Quantify the standard deduction, the personal exemption, and the phase out of personal exemptions and itemized deductions;
- Identify the factors that determine the amount of earned income tax credit;
- Explain how and to what extent interest from certain bonds may be excluded from gross income;
- Define a dependent for purposes of, and calculate, the dependent-care credit;
- Discuss the various education credits;
- Describe what other education-related expenditures may be deductible;
- Quantify the mileage rates for automobiles owned or used in a trade or business, the SIFL rates for aircraft usage, and the per-diem rates that may be applicable to employee business expenses;
- Discuss the Social Security benefits applicable to retirees and their spouses;
- Explain the limitations that apply to long-term care insurance and health savings accounts; and
- Discuss other limitations applicable to taxpayers in 2026.

I. Tax rates and other information for 2026

A. Tax rates for the individual

The tax rate brackets for 2026 are as follows.¹

Single:

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

Head of Household:

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

¹ Rev. Proc. 2025-32.

Married Filing Jointly and Surviving Spouse:

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

Married Filing Separately:

If taxable income is:	The tax is:
Not over \$12,400	10% of taxable income.
Over \$12,400 but not over \$50,400	\$1,240 plus 12% of the excess over \$12,400.
Over \$50,400 but not over \$105,700	\$5,800 plus 22% of the excess over \$50,400.
Over \$105,700 but not over \$201,775	\$17,966 plus 24% of the excess over \$105,700.
Over \$201,775 but not over \$256,225	\$41,024 plus 32% of the excess over \$201,775.
Over \$256,225 but not over \$384,350	\$58,448 plus 35% of the excess over \$256,225.
Over \$384,350	\$103,291.75 plus 37% of the excess over \$384,350.

Estates and Trusts:

If taxable income is:	The tax is:
Not over \$3,300	10% of taxable income.
Over \$3,300 but not over \$11,700	\$330 plus 24% of the excess over \$3,300.
Over \$11,700 but not over \$16,000	\$2,346 plus 35% of the excess over \$11,700.
Over \$16,000	\$3,851 plus 37% of the excess over \$16,000.

Capital Gains Rate:

For 2026, the tax rate on capital gain and/or qualifying dividend income is available to individuals only with ordinary taxable income of the following:

2026 Capital Gains Rates

Filing Status	0%	15%	20%
Single	\$0-\$49,450	\$49,451-\$545,500	\$545,501 or more
Married Filing Jointly and Surviving Spouses	\$0-\$98,900	\$98,901-\$613,700	\$613,701 or more
Married Filing Separately	\$0-\$49,450	\$49,451-\$306,850	\$306,851 or more
Head of Household	\$0-\$66,200	\$66,201-\$579,600	\$ 579,601 or more
Estates, Trusts & Kiddie Tax	\$0-\$ 3,300	\$ 3,301-\$ 16,250	Over \$16,251
Unrecaptured Section 1250 gain			25%
Collectibles			28%
Eligible gain on qualified small business stock less the 1202 exclusion			28%

B. Standard deduction²

As discussed, the OBBBA increases the standard deduction amounts in 2026. The standard deduction in 2026 is as follows:

Filing status:	2026
Married filing jointly and Surviving spouses (§1(a))	\$32,200
Heads of Households (§1(b))	\$24,150
Unmarried (§1(c))	\$16,100
Married filing separately (§1(d))	\$16,100

For 2026, the standard deduction for a dependent is the lesser of: (i) the deduction for a single taxpayer; and (ii) the greater of (x) 1,350, or (y) the sum of \$450 and the dependent's earned income.

Additional standard deductions for the elderly and blind in 2026:³

Taxpayer	Either	Both
Unmarried	\$2,050	\$4,100
Married	\$1,650	\$3,300

C. Qualified Business Income deduction

As discussed, the OBBBA makes permanent the §199A QBI deduction and expands the income phase-in ranges for limitations by 50% (to \$150,000 for joint filers, \$75,000 for others). Further, it introduces a \$400 minimum deduction for taxpayers with at least \$1,000 in QBI from an active trade or business.

For taxable years beginning in 2026, the threshold amounts under §199A(e)(2) and phase-in range amounts under §199A(b)(3)(B) and §199A(d)(3)(A) are:

Filing Status	Threshold Amount	Phase-in Range Amount
Married Filing Jointly	\$403,500	\$553,500
Married Filing Separately	\$201,775	\$276,775
All Other Returns	\$201,750	\$276,750

D. Personal exemptions

The personal exemption amount under §151(d) is \$5,300.⁴ As discussed, the OBBBA permanently sets the personal exemption amount to zero.

The amount of the personal exemption still matters. The way OBBBA suspends the deduction is to reduce the amount of the deduction for an exemption to "zero." However, the reduction to zero is only for

² Rev. Proc. 2025-32.

³ Rev. Proc. 2025-32.

⁴ Rev. Proc. 2023-34.

the tax deduction. The amount still applies for other purposes, such as the income limit for a qualified relative.⁵

Example: Bob and Mary are married and file a joint return for 2026. Their son, Jay, is 20 years old. Jay graduated from college in 2025 but cannot find a job that utilizes his education. The family decided it would be better for Jay to live at home and not seek other full-time employment so that he can continue to seek employment in his chosen field. Jay worked at a local store part-time and earned \$4,000.

Jay is not a qualifying child because he is over 18 years old and is not a student. However, he is a qualifying relative to Bob and Mary because he lived with them all year, they provided over half of Jay's support, and Jay's gross income is less than the exemption amount for 2026 of \$5,300. If they are not subject to the child and family credit income limitation, Bob and Mary can take a family credit of \$500 for 2026.

On September 16, 2020, the IRS and Department of Treasury released final regulations, confirming that the definition of a qualifying relative is based on the inflation-adjusted personal exemption threshold, even though personal exemptions are suspended. Additionally, the final regulations clarify that the definition of a qualifying relative for purposes other than determining the deduction under §151(a) is based on the inflation-adjusted personal exemption threshold.⁶

E. Gift/Estate Exemptions

Tax year 2026 allows for a \$19,000 annual exclusion for gifts to any person (other than gifts in future interests in property). If spouses splitting gifts, the annual exemption is doubled to \$38,000. For tax year 2026, the first \$194,000 of gifts to a non-US citizen spouse (other than gifts of future interests in property) are not considered taxable gifts. The lifetime gift exemption in 2026 increases to \$15 million from \$13.99 million in 2025. The OBBBA permanently increases the exemption amount to \$15 million (\$30 million for married couples) for gifts made and decedents dying in 2026 and beyond.

F. Alternative Minimum Tax Exemption

For 2026, the AMT exemption is:

- \$140,200 for joint filers and surviving spouses;
- \$90,100 for single filers (other than surviving spouses);
- \$70,100 for married individuals filing separately; and
- \$31,400 for estates and trusts.

Filing status	2026 Threshold Phaseout Amount	2026 Complete Phaseout Amount
Married filing joint	\$1,000,000	\$1,280,000
Surviving Spouses	\$1,000,000	\$1,280,400
Single	\$ 500,000	\$ 680,200
Married filing separate	\$ 500,000	\$ 640,200
Estates and trusts	\$ 104,800	\$ 167,600

As shown in the chart above, the OBBBA reset the phaseout thresholds to their lower 2018 levels, as indexed for inflation. However, the AMT exemption phaseout rate doubles from 25% to 50%, causing

⁵ I.R.C. §151(d), created by the TCJA.

⁶ T.D. 9913.

higher-income taxpayers to lose the exemption twice as quickly as income exceeds the applicable threshold.

This change results in higher effective AMT liabilities for high-income taxpayers whose incomes fall well above the threshold, despite the increased exemption amounts. The AMT still applies only if it results in more tax than under the regular system, ensuring high-income taxpayers pay a minimum amount of tax, regardless of deductions or credits claimed under the regular system.

G. Pease Limitation

Under the OBBBA, the Pease limitation is permanently repealed and replaced with a new overall limitation on the tax benefit of itemized deductions, applicable to individuals, estates, and trusts. Beginning in tax years after December 31, 2025, this limitation applies to taxpayers whose taxable income (prior to reduction for itemized deductions) exceeds the threshold for the 37% marginal rate bracket. For these taxpayers, the value of itemized deductions is effectively limited to 35%. In other words, each dollar of otherwise allowable itemized deductions may reduce tax liability by no more than 35 cents.

H. Earned income tax credit (EITC)⁷

1. Earned income and AGI limits

The American Rescue Plan Act (ARPA) temporarily expanded the EITC for taxpayers, allowing more individuals to meet eligibility requirements for the credit in 2021. The temporary changes to the EITC for the 2021 tax year have since expired and are no longer applicable.

ARPA permanently modified the EITC as follows:

- a. **Qualifying Child Requirement** -- In prior years, to qualify for the EITC with qualifying children, taxpayers typically had to provide information about the qualifying child, including name, age, and TIN/SSN. ARPA removed this requirement, essentially allowing individuals who have qualifying children to claim the EITC, despite not being able to provide proper documentation.
- b. **Joint Return Requirement** – Prior to ARPA, individuals who were married were required to file a joint return in order to be eligible to claim the EITC. ARPA modified this requirement and provides that certain separated married individuals are not required to file jointly in order to claim the EITC. For EITC purposes, an individual will not be treated as “married” if the individual:
 - Is considered married per §7703(a).
 - Lives with his or her qualifying child for more than half of the tax year.
 - Does not file a joint return for the tax year.
 - Does not have the same principal place of abode as his or her spouse during the last six months of the tax year or has a decree, instrument, or agreement with regard to his or her spouse and is not a member of the same household with his or her spouse by the end of the tax year.

This provision applies to the tax years beginning after December 31, 2020.

⁷ All numbers from section E. are from Rev. Proc. 2023-34.

- c. **Investment Income Requirement** – Prior to ARPA, individuals with certain types of investment over \$3,650 were unable to claim the EITC. ARPA increased the threshold amount to \$10,000 for tax years beginning after December 31, 2020. The \$10,000 threshold will be indexed for inflation for tax years beginning after 2021 (\$12,200 in 2026).
- d. **Identification Requirement** -- Prior to ARPA, a taxpayer was required to provide a qualifying child's name, age, and taxpayer identification number in order to claim the qualifying child when determining the amount of the EITC. If the taxpayer was unable to provide the qualifying child's name, age, and taxpayer identification number, he or she was ineligible to claim the EITC as an eligible individual with no qualifying children. ARPA removed this requirement and allows an eligible individual who has qualifying children, but cannot provide the necessary identification for such children, to claim the EITC as an eligible individual with no qualifying children. This provision is effective for tax years beginning after December 31, 2020.

2. Investment income limit

Investment income must be \$12,200 or less for 2026.

3. Maximum credit amounts

Below are the following figures applicable to the 2026 tax year:⁸

If filing...	Qualifying Children Claimed			
	One	Two	Three or More	None
Earned Income Amount	\$13,020	\$18,290	\$18,290	\$8,680
Maximum Amount of Credit	\$4,427	\$7,316	\$8,231	\$664
Threshold Phaseout Amount (Married Filing Jointly)	\$31,160	\$31,160	\$31,160	\$18,140
Completed Phaseout Amount (Married Filing Jointly)	\$58,863	\$65,899	\$70,244	\$26,820
Threshold Phaseout Amount (All other filing statuses)	\$23,890	\$23,890	\$23,890	\$10,860
Completed Phaseout Amount (All other filing statuses)	\$51,593	\$58,629	\$62,974	\$19,540

Note:

The Welfare Reform Act of 1996 changed the definition of “adjusted gross income” for purposes of the phase out of the earned income credit. Adjusted gross income is now determined by disregarding net capital losses, net losses from trusts and estates, net losses from nonbusiness rents and royalties, and 50 percent of net losses from businesses.

I. Exclusion from income for certain redemptions of bonds

An exclusion is available for income from the redemption of United States savings bonds for taxpayers who pay qualified higher-education expenses (as defined in §135). This exclusion, however, is phased out by reducing the exclusion by the amount otherwise excludable income multiplied by a fraction. The numerator of the fraction is the excess of the taxpayer’s modified adjusted gross income over the threshold amount, and the denominator of the fraction is \$30,000 for joint returns or \$15,000 for all others. For tax years beginning in 2026, taxpayers with modified adjusted gross income above the “threshold

⁸ Rev. Proc. 2024-40.

phase-out amount” are subject to this phaseout, up to a “completed phase-out amount,” the point at which the benefit is no longer available.

The Service has announced that for 2026:⁹

Filing status	2026 threshold phaseout amount
Married filing jointly	\$152,650
Others	\$101,800

Example: In 2026, Mr. and Mrs. Smith redeem \$15,000 in U.S. savings bonds in order to help pay for their daughter’s college tuition. Mr. and Mrs. Smith file a joint income tax return for the 2026 taxable year. Their combined adjusted gross income for 2026 is \$162,650. The amount of the exclusion is \$10,000 ($\$15,000 - (\$15,000 \times \$10,000/\$30,000)$).

J. Dependent-care credit

1. In general

Prior to the OBBBA, taxpayers with one or more qualifying individuals, such as children or other dependents could claim a nonrefundable child and dependent care credit for employment-related expenses incurred for child and dependent care. Employment-related expenses include costs for household services and care expenses for qualifying individuals necessary for the taxpayer to work or actively seek work. For purposes of the dependent-care credit, a taxpayer who maintains a household that includes one or more qualifying individuals may claim a nonrefundable credit against income-tax liability for up to a certain percent of a limited amount of employment-related expenses.

The credit is calculated by multiplying qualifying expenses up to \$3,000 for one qualifying individual or \$6,000 for two or more by a credit rate based on the taxpayer’s AGI. Before the OBBBA was enacted, the maximum credit rate was 35%, which phased down to 20% for taxpayers with AGI exceeding \$43,000.

The OBBBA permanently increases the maximum credit rate from 35% to 50%, effective for tax years after December 31, 2025. The 50% credit rate is gradually reduced by one percentage point for every \$2,000 (or fraction thereof) by which the taxpayer’s AGI exceeds \$15,000, but this reduction cannot lower the rate below 35%. For taxpayers with AGI between \$43,001 and \$75,000 (\$86,001 to \$150,000 for joint filers), the credit rate is fixed at 35%. For AGI between \$75,001 and \$105,000 (\$150,001 to \$210,000 for joint filers), the credit rate is further phased down to a minimum of 20%. In other words, the credit rate phases down in two stages: first from 50% to a minimum of 35% as AGI exceeds \$15,000, then from 35% to a minimum of 20% as AGI surpasses \$75,000 (or \$150,000 for joint filers).

⁹ Rev. Proc. 2025-32.

Child and Dependent Care Credit – Single Taxpayers	
AGI Range	Credit Percentage
\$0 – \$15,000	50%
\$15,001 – \$45,000	Phases down from 50% to 35%
\$45,001 – \$75,000	35%
\$75,001 – \$105,000	Phases down from 35% to 20%
Over \$105,000	20%

Child and Dependent Care Credit – MFJ Taxpayers	
AGI Range	Credit Percentage
\$0 – \$15,000	50%
\$15,001 – \$45,000	Phases down from 50% to 35%
\$45,001 – \$150,000	35%
\$150,001 – \$210,000	Phases down from 35% to 20%
Over \$210,000	20%

Under the OBBBA, the qualifying expense caps remain unchanged:

- \$3,000 for one qualifying individual; and
- \$6,000 for two or more qualifying individuals.

The maximum credit under the OBBBA is:

- Up to \$1,500 (one child); and
- Up to \$3,000 (two or more).

These OBBBA changes are not temporary, as the 50% rate and updated phaseout thresholds are permanent changes.

2. Exclusion

Amounts paid or incurred by an employer for dependent-care assistance provided to an employee generally are excluded from the employee's gross income and wages if the assistance is furnished under a program meeting certain requirements. These requirements stipulate that the program be described in writing, satisfy certain nondiscrimination rules, and provide for notification to all eligible employees. Dependent-care assistance expenses eligible for the exclusion are defined the same as employment-related expenses with respect to a qualifying individual under the dependent-care tax credit. Prior to ARPA, the dependent-care exclusion was limited to \$5,000 per year, except that a married taxpayer filing a separate return could exclude only \$2,500. ARPA temporarily increased the exclusion amount for employer-provided dependent care assistance to \$10,500 for 2021. However, the exclusion amount for employer-provided dependent care assistance returned to \$5,000 per year (\$2,500 MFS) in tax year 2022 and beyond. Dependent-care expenses excluded from income are not eligible for the dependent-care tax credit.

3. Planning notes

- In 2026, the dependent-care credit is nonrefundable.
- Many taxpayers and accountants wrongly assume that the \$6,000 must be prorated between the two qualifying individuals. This is untrue. If \$5,900 is paid on behalf of one qualifying individual and \$100 on the other, the full \$6,000 is taken into account in computing the credit.
- Another often overlooked area is a non-child individual can be a qualifying individual. An individual who is incapable of self-care, such as one of the parents following certain surgical procedures after returning home for a few days, can be a qualifying individual.
- Payments to a non-dependent parent of the taxpayer for the care of the taxpayer's child qualify as payments for dependent care.

- e. Carryovers of unused dependent care assistance program amounts are generally not permitted (other than a 2 ½ month grace period). However, in 2021 and 2022, the CAA 2021 temporarily provided that employers could amend their plans to permit the carryover of unused dependent care assistance program amounts to plan years ending in 2021 and 2022, or to extend the permissible period for incurring claims to plan years over the same period.
- f. In 2026, OBBBA changes to the child and dependent care credit take effect.

K. Dependent Care FSA

Dependent Care FSAs allow individuals to make pretax contributions to pay qualified childcare expenses. As a result of the OBBBA, single or Married filing jointly taxpayers can contribute up to \$7,500 to an FSA in 2026. Married Filing Separately taxpayers can contribute up to \$3,750 to an FSA in 2026.

L. Adoption expenses

A tax credit is allowed for **qualified adoption expenses** paid or incurred by a taxpayer. In 2026 the maximum credit is \$17,670¹⁰ per eligible child, including special-needs children, which includes a refundable component of \$5,120. Any unused non-refundable portion can be carried forward for up to five years. A \$17,670 credit is provided in the year a special-needs adoption is finalized, regardless of whether the taxpayer has qualified adoption expenses.

- a. Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys' fees, and other expenses that are: (i) directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer; (ii) not incurred in violation of state or federal law, or in carrying out any surrogate parenting arrangement; (iii) not for the adoption of the child of the taxpayer's spouse; and (iv) not reimbursed (e.g., by an employer).
- b. A taxpayer may exclude up to \$17,670 in 2026 per eligible child, including special-needs children, for employer-provided adoption assistance to reimburse qualified adoption expenses. In the case of a special-needs adoption, the exclusion is provided regardless of whether the taxpayer has qualified adoption expenses. The exclusion does not apply for purposes of payroll taxes.

¹⁰ Rev. Proc. 2025-32.

Note:

Adoption expenses paid or reimbursed by the employer under an adoption assistance program are not eligible for the adoption credit. A taxpayer may be eligible for the adoption credit (with respect to qualified adoption expenses he or she incurs) and also for the exclusion (with respect to different qualified adoption expenses paid or reimbursed by his or her employer).

The dollar limitation applies separately to both the credit and the exclusion of employer-reimbursements for adoption related expenses. Taxpayers can claim both the credit and the exclusion, but the exclusion must be claimed before any allowable credit. Expenses used for the exclusion will reduce the amount of qualified adoption expenses available for credit. Thus, taxpayers may not claim both an exclusion and credit for the same expenses.

Example 1: Leslie, a single taxpayer, paid \$12,000 of qualified adoption expenses in 2026. Her employer reimbursed her for \$5,000 of those expenses in 2026 when the adoption became final. Her 2026 modified adjusted gross income is \$165,000. Leslie will exclude the \$5,000 of employer-reimbursed expenses from income. The expenses for the adoption credit will be limited to \$7,000 (\$12,000 expenses paid less \$5,000 of employer reimbursement).

Example 2: Patricia, a single taxpayer, paid \$20,950 of qualified adoption expenses in 2026. Her employer reimbursed her for \$5,000 of those expenses in 2026 when the adoption became final. Her 2026 modified adjusted gross income is \$125,000. Patricia will exclude the \$5,000 of employer-reimbursed expenses from income. The expenses for adoption credit will be limited to \$15,950 (\$20,950 expenses paid less \$5,000 of employer reimbursement).

Example 3: Margorie, a single taxpayer, paid \$40,000 of qualified adoption expenses in 2026. Her employer reimbursed her for \$17,670 of those expenses in 2026 when the adoption became final. Her 2026 modified adjusted gross income is \$225,000.

Margorie will exclude the \$17,670 of employer-reimbursed expenses from income. Margorie's expenses available for credit total \$22,330 (\$40,000 expenses paid less \$17,670 reimbursed by her employer).

However, the expenses for the adoption credit will be limited to \$17,670. Thus, \$4,660 (\$22,330 creditable expenses - \$17,670 credit limitation) will go unused for either an exclusion or credit.

- c. The adoption credit (and the employer-provided adoption assistance exclusion) is phased out ratably for taxpayers with modified adjusted gross income between \$265,080 and \$305,080 in 2026.¹¹ The dollar/credit limitation must be reduced for a particular year for credits claimed in a prior year for the same adoption effort.

Example: A \$3,000 adoption credit was claimed in 2025 with an additional \$15,000 of qualified expenses paid in 2026 for the same adoption. The maximum credit that can be claimed in 2026 is \$14,670 (\$17,670 credit limitation less \$3,000 of qualified expenses claimed in 2025).

- d. Qualified adoption expenses related to unsuccessful adoption attempts must be combined with those expenses related to subsequent attempts, whether or not those attempts are successful.

Example: Jennifer claimed \$8,000 of qualified adoption expenses credit in 2024 related to an unsuccessful adoption. In 2025 and 2026, she spent an additional \$10,000 for qualified adoption expenses in connection with successful adoptions finalized in

¹¹ Adoption credit amounts and limitations updated by Rev. Proc. 2024-40.

2026. The maximum allowable credit in 2026 is \$9,670 (\$17,670 credit limitation less \$8,000 previously claimed).

Note:

For S corporation employers, adoption expenses provided to a more-than-2% shareholder are not excludable from income. A more-than-2% shareholder is any shareholder with greater than 2% of the value of stock, the percentage of stock, or the voting power of the stock.

- e. An eligible child is an individual who: (i) has not attained age 18; or (ii) is physically or mentally incapable of caring for himself or herself. A special-needs child is an eligible child who is a citizen or resident of the United States who a state has determined: (i) cannot or should not be returned to the home of the birth parents; and (ii) will not be adopted unless special assistance is provided to the adoptive parents. Factors include whether the child has a specific factor or condition (such as the child's ethnic background, age, or membership in a minority or sibling group), and whether the child has a medical condition, or a physical, mental, or emotional handicap.
- f. Generally, both domestic and foreign adoptions qualify for the credit, however, there are differing timing rules for when the credit can be claimed based on the type of adoption.
 - Qualified expenses related to a domestic adoption become creditable in the tax year following the payment. This is the case even if the adoption is never finalized or the eligible child is yet to be identified.
 - Qualified expenses related to a foreign adoption become creditable in the tax year the adoption is finalized. Once the adoption is finalized, all qualified expenses from prior years and the year the adoption becomes final are available for the credit.
 - Whether domestic or foreign, adoption expenses paid after the year the adoption becomes final are available for credit in the year of payment.

Example 1: Mark and Julie paid qualified adoption expenses of \$3,000 in 2024, \$4,000 in 2025, and \$5,000 in 2026. This domestic adoption became final in 2025. The timing analysis is as follows:

- The \$3,000 paid in 2024 is creditable on the 2025 tax return (i.e., the year following the payment).
- The \$4,000 paid in 2025 is creditable on the 2026 tax return (i.e., the year following the payment).
- The \$5,000 paid in 2026 is creditable on the 2026 tax return (i.e., the year of finalization).
- Accordingly, no credit is allowed on the 2024 tax return.
- The 2025 tax return would have \$3,000 of available expenses for credit to offset the 2025 tax liability, with any excess credits available to be carried forward for up to 5 years.
- The 2026 tax return would have \$9,000 (\$4,000 from 2025 and \$5,000 from 2026) of available expenses for credit to offset the 2026 tax liability, with any excess credit from either 2025 or 2026, being carried forward to later years.

Example 2: Mark and Julie paid qualified adoption expenses of \$3,000 in 2024, \$4,000 in 2025, and \$5,000 in 2026. This foreign adoption became final in 2026. The timing analysis is as follows:

- The \$12,000 (\$3,000 from 2024 + \$4,000 from 2025 + \$5,000 from 2026) becomes creditable on the 2026 tax return as this is the year the adoption becomes final.

- Any excess credits would be available for a carryforward of up to five years.
 - Whether domestic or foreign, any additional expenses paid in 2027 would be creditable in 2027 as the adoption has been finalized.
- g. The adoption credit is generally available to all filing statuses except married filing separately. Married taxpayers filing separately may still be able to claim the credit if the filer is considered unmarried because of legal separation or living apart from spouse.

If taxpayers filed married filing separately in the year qualified adoption expenses are first allowable, the taxpayer generally can't claim the credit or exclusion for those particular expenses. Additionally, changes in filing status can impact the availability of the credit.

Example: John and Patty paid qualifying adoption expenses of \$2,000 in 2024, \$5,000 in 2025, and \$4,000 in 2026. The domestic adoption became final in 2026. For tax year 2026, the taxpayers will file jointly, but all prior year tax filings were filed using the married filing separately filing status.

- When claiming the qualified adoption expenses in 2026, only \$9,000 (\$5,000 from 2025 and \$4,000 from 2026) will be creditable in 2026.
 - Because the taxpayers filed separately in 2025 when the first \$2,000 of expenses became creditable, those adoption expenses may not be claimed in 2026.
 - If claiming the credit is a priority, amended returns could be filed for 2025 within the appropriate period of limitations to change the filing status and claim \$2,000 qualified expenses for purposes of the adoption credit.
- h. The adoption credit and exclusion are both claimed on Form 8839, *Qualified Adoption Expenses*, which is attached to a filed individual income tax return. Creditable expenses should be tracked and provided by the taxpayer, and employer-provided adoption assistance should be reported on the employee's Form W-2, box 12, code T. Adoption documentation is no longer required to be attached to the filed return, though documentation should be retained as part of accurate record keeping.
- i. The SECURE Act contains favorable updates for both **qualified adoption expenses** and **qualified births**. The SECURE Act allows for penalty-free withdrawals from retirement plans of up to \$5,000 per individual in the event of a qualified birth of a child or adoption for distributions made after December 31, 2019. This provision is a new exemption from the 10% penalty tax of §72(t) for early withdrawals from qualified plans and IRAs.

Married couples may separately take a \$5,000 distribution for a qualified birth or adoption, providing for a \$10,000 total distribution allowance per married couple. An eligible adoptee includes any individual under the age of 18 or who is incapable of self-support, specifically excluding any child(ren) of the taxpayer's spouse. The distribution must be taken within a one-year period beginning on the date on which the child is born or on which the adoption of a child is finalized.

Note:

As discussed, prior to the OBBBA, the Adoption Tax Credit was nonrefundable. The OBBBA enhances the existing adoption credit by making up to \$5,000 (adjusted for inflation) of the credit refundable beginning in tax year 2025. The refundable portion of the credit is not eligible for carryforward. The remaining portion of the credit (up to the total limit) remains nonrefundable and continues to be subject to five-year carryforward rules.

M. Education benefits

Note:

For taxable years beginning after December 31, 2025, in the case of an American Opportunity Tax Credit or Lifetime Learning Credit with respect to qualified tuition and related expenses of an individual other than the taxpayer or the taxpayer's spouse (for example, the dependent child of the taxpayer), the taxpayer is allowed the credit only if the taxpayer includes on the return the SSN of both the individual and the taxpayer.

1. Education credits

An individual taxpayer is allowed a nonrefundable education tax credit against income tax for the taxable year. The amount of the education tax credit is the total of the Hope Scholarship credit plus the Lifetime Learning credit.¹²

- a. In the same taxable year, a taxpayer may claim a Hope Scholarship credit for each eligible student's **qualified tuition and related expenses** and a Lifetime Learning credit for one or more other students' qualified tuition and related expenses. However, a taxpayer may not claim both a Hope Scholarship credit and a Lifetime Learning credit with respect to the same student in the same taxable year.¹³
- b. Subject to certain limitations, a Hope Scholarship credit may be claimed for the qualified tuition and related expenses paid during a taxable year with respect to each eligible student. Qualified tuition and related expenses paid during a taxable year with respect to one student may not be taken into account in computing the amount of the Hope Scholarship credit with respect to any other student. In addition, qualified tuition and related expenses paid during a taxable year with respect to any student for whom a Hope Scholarship credit is claimed may not be taken into account in computing the amount of the Lifetime Learning credit.¹⁴
- c. Subject to certain limitations, a Lifetime Learning credit may be claimed for the aggregate amount of qualified tuition and related expenses paid during a taxable year with respect to students for whom no Hope Scholarship credit is claimed.¹⁵
- d. As a result of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTRA), for tax years beginning in 2021, the Lifetime Learning tax credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified adjusted gross income between \$80,000 and \$90,000 (\$160,000 and \$180,000 for married individuals who file a joint return). Thus, taxpayers with modified adjusted gross income above \$90,000 (or \$180,000 for joint filers) may not claim an education tax credit.

¹² Treas. Regs. §1.25A-1(a).

¹³ Treas. Regs. §1.25A-1(b)(1).

¹⁴ Treas. Regs. §1.25A-1(b)(2).

¹⁵ Treas. Regs. §1.25A-1(b)(3).

- The increased limitations are the result of TCDTRA repealing the tuition and fees deduction for tax years beginning after 2020. Previously, §222 provided taxpayers with a deduction for qualified tuition and related expenses.

For 2026, the Lifetime Learning tax credit phases out as follows:

Taxpayer	MAGI Level Where Phaseout Begins	MAGI Level Where Phaseout Is Complete
Married, filing jointly	\$160,000	\$180,000
All other taxpayers	\$80,000	\$90,000

- e. Subject to the phaseout of the education tax credit described above, the Lifetime Learning credit amount is 20 percent of up to \$10,000 of qualified tuition and related expenses paid during the taxable year for education furnished to the taxpayer, the taxpayer's spouse, and any claimed dependent during any academic period beginning in the taxable year (or treated as beginning in the taxable year).¹⁶ Those expenses paid with respect to a student for whom the Hope Scholarship credit is claimed are not eligible for the Lifetime Learning credit.¹⁷ Thus, in 2026, the maximum Lifetime Learning credit is \$2,000.

Note:

The Lifetime Learning credit is available to eligible students when the Hope credit/American Opportunity credit is not available. In 2026, the Lifetime Learning credit is 20 percent of the first \$10,000 of qualifying expenses. The qualifying expense limit is not subject to an annual inflation adjustment.

- f. For any taxable year beginning after 2008, the Hope Scholarship is redesignated as the American Opportunity credit.¹⁸ For 2026, the American Opportunity credit is an amount equal to the sum of ¹⁹ 100 percent of so much of the qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished to the eligible student during any academic period beginning in such taxable year) as does not exceed \$2,000,²⁰ plus 25 percent of such expenses so paid as exceeds \$2,000 but does not exceed \$4,000.²¹ For 2026, the maximum American Opportunity credit is \$2,500.

¹⁶ Treas. Regs. §1.25A-4(a)(2).

¹⁷ Treas. Regs. §1.25A-4(a)(3).

¹⁸ The American Recovery and Reinvestment Act of 2009.

¹⁹ I.R.C. §25A(i)(1).

²⁰ I.R.C. §25A(i)(1)(A).

²¹ I.R.C. §25A(i)(1)(B).

The change generally increases the credit:

Qualified expenses	Hope Scholarship credit (as if still in force in 2026)	American Opportunity credit (in force for 2026)	Lifetime Learning credit
\$500	\$500	\$500	\$100
\$1,000	\$1,000	\$1,000	\$200
\$1,300	\$1,300	\$1,300	\$260
\$1,500	\$1,400	\$1,500	\$300
\$2,000	\$1,650	\$2,000	\$400
\$2,400	\$1,850	\$2,100	\$480
\$2,600	\$1,950	\$2,150	\$500
\$3,000	\$1,950	\$2,250	\$600
\$3,500	\$1,950	\$2,375	\$700
\$4,000	\$1,950	\$2,500	\$800
\$5,000	\$1,950	\$2,500	\$1,000
\$9,000	\$1,950	\$2,500	\$1,800
\$10,000	\$1,950	\$2,500	\$2,000

- (i) The Act extends the period during which the credit applies. It not only applies to as many as four years of post-secondary education (provided that the student has not completed the first four years of post-secondary education before the beginning of the fourth taxable year),²² but also to all four years of post-secondary education.²³

Planning point:

Looking at the above table, the American Opportunity tax credit exceeds the Lifetime Learning credit at all levels of qualified expense. Formerly, one could squeeze an additional \$200 (.20 x \$10,000) at expense levels of or more than \$10,000. The Lifetime Learning credit was larger for qualified expenses above \$9,000. The effect of the provision is to limit Lifetime Learning credits to situations in which the taxpayer (or taxpayer's dependent) is a less-than-half-time student or has been convicted of a federal or state felony offense consisting of the possession or distribution of a controlled substance before the end of the taxable year within which such period ends, since in either case an individual does not qualify for the Hope Scholarship (or its surrogate, the American Opportunity, for 2009 through 2026) credit.²⁴

- (ii) In general, the personal credits are applicable only to the excess of the regular tax liability over the tentative tax; it is not applicable against any AMT, i.e., the excess of the tentative tax over the regular tax liability as reduced by the personal nonrefundable credits.²⁵ However, since 2000, Congress has enabled this and other such nonrefundable personal credits to be applied against the sum of the regular tax liability (reduced by the foreign tax credit) and the AMT (essentially the tentative tax).²⁶ This was made permanent by the 2012 ATRA legislation. That, in effect, permits this credit to offset and reduce an AMT liability.
- (iii) The Hope credit is a nonrefundable personal credit. However, the Act treats 40 percent of so much of the education credit allowed as is attributable to the Hope Scholarship (American Opportunity) credit (after taking into account the income

²² I.R.C. §25A(b)(2)(A). I.R.C. §25A(i)(2).
²³ I.R.C. §25A(b)(2)(C). I.R.C. §25A(i)(2).
²⁴ I.R.C. §25A(b)(2)(B) and §25A(b)(2)(D).
²⁵ I.R.C. §26(a)(1).
²⁶ I.R.C. §26(a)(2).

phase out, but without regard to the limitation of the credit against the AMT or regular tax liability, as the case may be) as a refundable credit.²⁷

Note:

This means that the American Opportunity tax credit must be bifurcated into the refundable and nonrefundable portions after computing the aggregate amount after income phase out, then the nonrefundable portion of the credit must be applied against the AMT or the regular tax liability in excess of tentative tax²⁸ and then the refundable portion must be applied as other refundable credits are.

Caution:

However, no portion of the modified credit is refundable if the taxpayer claiming the credit is a **child to whom the kiddie tax applies for such taxable year** (generally, any child under age 18 or any child under age 24 who is a student providing less than one-half of his or her own support who has at least one living parent and does not file a joint return).

Example 1: Married Taxpayer has MAGI of \$128,000 and has graduate school Lifetime Learning expenses of \$10,000 and \$5,000 of qualifying undergraduate expenses. Prior to TCDTRA, the Lifetime Learning Credit was \$1,000 (\$2,000 credit reduced by 50% due to AGI threshold). As a result of TCDTRA, the taxpayer can claim the entire \$2,000 credit as her MAGI is under the new threshold limits.

Example 2: Same as **Example 1** above, except that Taxpayer's MAGI is \$170,000. In this case, the Lifetime Learning credit is phased out 50 percent (\$170,000 MAGI - \$160,000 threshold)/\$20,000 to \$1,000.

Comparison of American Opportunity Tax Credit and Lifetime Learning Credit

Credit	Maximum Amount	Refundability	Qualifying Expenses	Education Level	MAGI Phaseout
American Opportunity Tax Credit (AOTC)	\$2,500 per student	40% Refundable	<ul style="list-style-type: none"> • Tuition and Enrollment Fees • Required Books, supplies, and course materials 	<ul style="list-style-type: none"> • Maximum 4 years of post-secondary education • Must pursue degree 	Single: \$80,000-\$90,000 MFJ: \$160,000 - \$180,000
Lifetime Learning Credit	\$2,000 per return	Nonrefundable	<ul style="list-style-type: none"> • Tuition and Enrollment Fees 	<ul style="list-style-type: none"> • Unlimited years • All levels of post-secondary education or courses to improve job skills 	Single: \$80,000-\$90,000 MFJ: \$160,000 - \$180,000

²⁷ I.R.C. §25A(i)(6). It is not treated as a Hope credit, so the limitations (other than the income phase out) of §25A do not apply.

²⁸ Any reference in §25A or §§24, 25, 26, 25B, 904, or 1400C to a credit allowable under this subsection shall be treated as a reference to so much of the credit allowable as is attributable to the Hope Scholarship Credit.

Planning point:

Sometimes these credits can be utilized by the child/student because the parents cannot qualify under the AGI phase outs. In order to do so, the taxpayer who is eligible to claim the student as a dependent (usually the parent) must choose not to do so (and lose the dependency exemption). Then the student may claim the education credit for the student's qualified tuition and related expenses **even if** the tuition and expenses were paid by the parent. The surprise in the proposed regulations was the specific reference to the possibility of a parent to waive the exemption. Most practitioners believed that the exemption was mandatory because of "there shall be allowed" language.

Example 1: In 2026, Client pays qualified tuition and related expenses for Client's dependent, Child, to attend Ole Alma Mater during 2026. Client claims Child as a dependent on Client's federal income tax return. Therefore, assuming all other relevant requirements are met, Client is allowed an education credit on Client's federal income tax return, and Child is **not** allowed an education credit on Child's federal income tax return. The result would be the same if Child paid the qualified tuition and related expenses.²⁹

Example 2: In 2026, Client has one dependent, Child. In 2026, Child pays qualified tuition and related expenses to attend Ole Alma Mater during 2026. Although Client is eligible to claim Child as a dependent on Client's federal income tax return, Client does not do so. Therefore, assuming all other relevant requirements are met, Child is allowed an education credit on Child's federal income tax return, and Client is not allowed an education credit on Client's federal income tax return with respect to Child's education expenses. The result would be the same if Client paid the qualified tuition and related expenses on behalf of Child.³⁰

The new tax structure may suggest higher wages to be paid to certain children, since now the kiddie tax applies to a student who has not attained age 24 or a child who has not attained age 19 unless, in either case, the child has earned income in excess of one-half of the child's support. This means that a child, assuming all other conditions are met, may earn up to \$39,000 of earned income and pay no income tax if eligible for the American Opportunity credit or \$34,833 if eligible for the Lifetime Learning credit.

Earned income	\$39,000
Less Standard deduction	\$16,100
Taxable income	\$22,900
Tax before credits	\$2,500
American Opportunity credit	\$2,500
Net tax	\$0

Earned income	\$34,833
Less Standard deduction	\$16,100
Taxable income	18,733
Tax before credits	\$2,000
Lifetime Learning credit	\$2,000
Net tax	\$0

2. Qualified tuition expenses

For taxable years through 2017, taxpayers were allowed an above-the-line deduction for qualified tuition and related expenses paid by the taxpayer during a taxable year. The deduction was not allowed if the

²⁹ See Treas. Regs. §1.25A-1(f)(2), Ex. 1.

³⁰ See Treas. Regs. §1.25A-1(f)(2), Ex. 2.

individual elects to apply the Hope/American Opportunity or Lifetime Learning credits. This popular provision was renewed on December 20, 2019 through December 31, 2020 for tax years 2018, 2019, and 2020.³¹ During these tax years, a taxpayer was allowed to claim an above-the-line deduction of qualified tuition and related expenses, up to \$4,000 if AGI did not exceed \$65,000 (\$130,000 joint) and up to \$2,000 if AGI did not exceed \$80,000 (\$160,000 joint). To claim this deduction, eligible taxpayers had to file Form 8917.

Form 8917 <small>(Rev. January 2020) Department of the Treasury Internal Revenue Service</small>	Tuition and Fees Deduction ▶ Attach to Form 1040 or 1040-SR. ▶ Go to www.irs.gov/Form8917 for the latest information.	OMB No. 1545-0074 Attachment Sequence No. 60																			
Name(s) shown on return		Your social security number																			
<div style="display: flex; align-items: center;"> <p style="font-size: small;">Use this form for qualified tuition and fees paid in 2018, 2019, or 2020, and later years if legislation extends the deduction (see instructions). File a separate Form 8917 for each year after 2017 for which you qualify to take the deduction.</p> <p>You can't take both an education credit from Form 8863 and the tuition and fees deduction from this form for the same student for the same tax year.</p> </div>																					
<p>Before you begin:</p> <ul style="list-style-type: none"> ✓ To see if you qualify for this deduction, see <i>Who Can Take the Deduction</i> in the instructions below. ✓ If you file Form 1040 or 1040-SR, figure any write-in adjustments. <ul style="list-style-type: none"> • For 2018: Figure any write-in adjustments to be entered on the dotted line next to Schedule 1 (Form 1040), line 36. • For 2019: Figure any write-in adjustments to be entered on the dotted line next to Schedule 1 (Form 1040 or 1040-SR), line 22. • For 2020 and later years: Figure any write-in adjustments for Schedule 1 (Form 1040 or 1040-SR); see the instructions for Forms 1040 and 1040-SR. 																					
1	(a) Student's name (as shown on page 1 of your tax return) <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 50%;">First name</th> <th style="width: 50%;">Last name</th> </tr> </thead> <tbody> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> </tbody> </table>	First name	Last name							(b) Student's social security number (as shown on page 1 of your tax return) <table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td> </td><td> </td><td> </td></tr> <tr><td> </td><td> </td><td> </td></tr> </table>							(c) Adjusted qualified expenses (see instructions) <table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> </table>				
First name	Last name																				
2	Add the amounts on line 1, column (c), and enter the total	2																			
3	Enter the amount from your "total income" line of Form 1040 or 1040-SR	3																			
4	<ul style="list-style-type: none"> • For 2018: Enter the total of the amounts on your 2018 Schedule 1 (Form 1040), lines 23 through 33, plus any write-in adjustments you entered on the dotted line next to Schedule 1 (Form 1040), line 36. • For 2019 and 2020: Enter the total of the amounts on your 2019 Schedule 1 (Form 1040 or 1040-SR), lines 10 through 20, plus any write-in adjustments you entered on the dotted line next to Schedule 1 (Form 1040 or 1040-SR), line 22. • For later years: See www.irs.gov/Form8917 to find out if the line references above for 2019 have changed 	4																			
5	Subtract line 4 from line 3.* If the result is more than \$80,000 (\$160,000 if married filing jointly), stop; you can't take the deduction for tuition and fees <small>* If you're filing Form 2555, 2555-EZ, or 4563, or you're excluding income from Puerto Rico, see <i>Effect of the Amount of Your Income on the Amount of Your Deduction</i> in Pub. 970 to figure the amount to enter on line 5.</small>	5																			
6	Tuition and fees deduction. Is the amount on line 5 more than \$65,000 (\$130,000 if married filing jointly)? <input type="checkbox"/> Yes. Enter the smaller of line 2, or \$2,000. } <input type="checkbox"/> No. Enter the smaller of line 2, or \$4,000. }	6																			
<small>Also enter this amount on line 21 of the 2019 and 2020 Schedule 1 (Form 1040 or 1040-SR), or line 34 of the 2018 Schedule 1 (Form 1040). See www.irs.gov/Form8917 to find out if the line references above for 2019 have changed.</small>																					

³¹ The Consolidated Appropriations Act, 2021.

Beginning in 2021, the TCDTRA repealed the deduction for qualified tuition and related expenses and increased the income limitation phaseout range for the Lifetime Learning credit.

3. Coverdell education savings accounts (CESAs)

A Coverdell education savings account (CESA), a product of the Taxpayer Relief Act of 1997, is a tax-free savings account for educational expenses. A CESA is a trust or custodial account that is created or organized in the United States exclusively for the purpose of paying the qualified higher-education expenses of the designated beneficiary of the account. The account must be designated as a Coverdell education savings account when it is created in order to be treated as a Coverdell savings account for tax purposes.³²

- a. Taxpayers may deposit up to \$2,000 per year into a CESA for a child younger than age 18. Parents, grandparents, other family members, friends, and the child may contribute to the child's CESA, provided that the total contributions for the child during the taxable year do not exceed the \$2,000 limit. Amounts deposited in the account grow tax-free until distributed, and the child will not owe tax on any withdrawal from the account if the child's qualified higher-education expenses at an eligible educational institution for the year equal or exceed the amount of the withdrawal.
- b. Any individual, again including the beneficiary, can contribute to a CESA if their modified adjusted gross income is under \$110,000 (\$220,000 for joint returns).
- c. Distributions from a CESA are not included in the gross income of the distributee to the extent of the beneficiary's qualified higher-education expenses during the taxable year.³³ "Qualified higher-education expenses" are defined as tuition, fees, books, supplies, and equipment required for the enrollment or attendance at a college or university (or certain vocational schools). They now include reasonable costs for room and board incurred by the designated beneficiary who is an eligible student for any academic period while attending such institution.³⁴ Unique to a CESA is the inclusion as qualified higher-education expenses "qualified elementary and secondary school expenses,"³⁵ meaning expenses for:
 - (i) Tuition, fees, academic tutoring, special-needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12) as determined under state law;
 - (ii) Room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such a school in connection with such enrollment or attendance of the beneficiary; and
 - (iii) The purchase of any computer technology, equipment, or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is educational in nature.

³² Notice 97-60, 1997-46 I.R.B. 8, §3, Q&A-1.

³³ I.R.C. §530(d)(2)(A).

³⁴ I.R.C. §529(e)(3)(B)(i).

³⁵ I.R.C. §530(b)(4)(A).

- d. A distribution otherwise taxable from a CESA to the extent that the amount received is paid into another CESA for the benefit of the same beneficiary or a **member of the family** of such beneficiary not later than the sixtieth day after the date of such payment or distribution is not included in the gross income of the distributee.³⁶ A member of the family means: (i) the spouse of the beneficiary; (ii) a son or daughter of the beneficiary, or a descendant of either; (iii) a stepson or stepdaughter of the beneficiary; (iv) a brother, sister, stepbrother, or stepsister of the beneficiary; (v) the father or mother of the beneficiary, or an ancestor of either; (vi) a stepfather or stepmother of the beneficiary; (vii) a son or daughter of a brother or sister of the beneficiary; (viii) a brother or sister of the father or mother of the beneficiary; (ix) a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the beneficiary; (x) a first cousin of the beneficiary, but not the spouse of a first cousin; or (xi) any spouse of an individual named in (ii) - (ix).³⁷ However, the rollover does not avoid tax with respect to any payment or distribution if the rollover was applied to any prior payment or distribution during the 12-month period ending on the date of the payment or distribution.
- e. Tax-free transfers or rollovers of account balances may be made from one CESA benefiting one beneficiary to another CESA benefiting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a **member of the family of the old beneficiary** and is under age 30. Any balance remaining in a CESA is deemed distributed within 30 days after the date that the beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies). The age limitations with respect to rollovers and required distributions are eliminated in the case of a beneficiary who is a special-needs beneficiary. Thus, a deemed distribution of any balance in a CESA does not occur when a special-needs beneficiary reaches age 30.
- f. Finally, the age-30 limitation does not apply in the case of a rollover contribution for the benefit of a special-needs beneficiary or a change in beneficiaries to a special-needs beneficiary.

Note:

The Department of Education has announced that for financial-aid purposes, it will no longer treat the CESA as the student's asset, but the parent's asset. Generally, 35 percent of the student's assets are considered available resources while only 5.6 percent of a parent's assets are so treated.

The Case to Kill the Coverdell:

Once an attractive option for families looking to save for college, the popularity of CESAs have dwindled in recent years, especially due to the impact of the TCJA and the SECURE Act. Consider the following:

- CESAs once had the advantage of allowing qualified withdrawals for K-12 expenses. The TCJA expanded §529 plans by allowing qualified withdrawals for K-12 expenses, eliminating that advantage of CESAs over §529 plans.
- The SECURE Act expanded §529 plans by allowing qualified withdrawals for student loan repayment (up to \$10,000) and apprenticeship programs. Student loan repayment and apprenticeship program expenses are not considered qualified withdrawals for CESAs.
- Combined contributions are capped at \$2,000 per beneficiary, per year, not indexed for inflation.

³⁶ I.R.C. §530(d)(5). This includes, besides the taxpayer and spouse, sons, daughters, brothers, sisters, nephews and nieces, certain in-laws, etc. and any spouse of such persons.

³⁷ I.R.C. §529(e)(2).

- Section 529 plans have an indefinite life and can last for generations, whereas CESAs must be disbursed for qualified education expenses or given to another family member under age 30 by the time the original beneficiary turns 30 years old.
- Section 529 plans can qualify for state tax deductions and credits, whereas CESAs do not.

CESAs are not necessarily *bad* college savings instruments. CESAs generally provide a broad range of investment options, while §529 plan investment options are more limited in nature. Despite the broader range of investment options, recent law has made other options, such as §529 plans, much more attractive.

4. Qualified Tuition programs (§529 plans)

Prior to 2002, a qualified tuition program (QTP) generally referred to a program established and maintained by a **state**. The basic thrust of the program was to permit persons to: (i) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher-education expenses of the beneficiary; or (ii) make contributions to an account that is established for the purpose of meeting qualified higher-education expenses of the designated beneficiary of the account (a “savings-account plan”). The terms and conditions of these programs vary from state to state.³⁸ However, there are some standard federal income-tax rules that apply to these programs.³⁹ The tax on earnings attributable to prepayments or contributions is deferred until the earnings are distributed from the QTP.

Note:

Prepaid tuition plan: Account Owner (e.g., a parent) contributes cash to a plan account for Beneficiary (e.g., a child), and the contribution purchases tuition credits (e.g., credit hours) based on then-current tuition rates. Account Owner’s contribution qualifies for the annual gift-tax exclusion. When Beneficiary attends a college participating in the program, Beneficiary’s tuition credits may be used to pay for all or a portion of Beneficiary’s tuition and other college expenses, regardless of tuition rates at that time. If Beneficiary does not go to college or goes to a nonparticipating college, the tuition credits will be refunded in cash (based on a set formula or index), which may then of course be used to pay tuition and other college expenses at a nonparticipating college. Prior to the 2001 Act, the difference between: (i) the value of the tuition and other expenses covered by the plan; and (ii) the total amount of Account Owner’s contributions to the plan was taxable ordinary income to Beneficiary. Under the 2001 Act, that difference is generally tax-free.

College-savings plan: Account Owner contributes cash to a plan account for Beneficiary, and the contribution is invested according to the terms of the plan. Account Owner’s contribution qualifies for the annual gift-tax exclusion. When Beneficiary attends virtually any college, the funds in the account (that is, Account Owner’s contributions plus all of the investment earnings thereon) may be used to pay for Beneficiary’s tuition and other college expenses. Prior to the 2001 Act, the investment earnings were taxable ordinary income to Beneficiary, but only at the time they were used for Beneficiary’s tuition and other college expenses.

A specified individual must be designated as the beneficiary at the commencement of participation in a qualified tuition program (i.e., when contributions are first made to purchase an interest in such a program), unless interests in such a program are purchased by a state or local government or a tax-exempt §501(c)(3) charity as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships.

³⁸ Notice 97-60, 1997-46 I.R.B. 8, §6.

³⁹ I.R.C. §529.

- a. Under the 2001 Act, tax-exempt status is granted to a qualified tuition program, which includes both a qualified tuition program as before and prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions) that satisfy the requirements under §529 (other than the state-sponsorship rule).⁴⁰ In the case of a qualified tuition program maintained by one or more **private eligible educational institutions**, persons are able to purchase tuition credits or certificates on behalf of a designated beneficiary, but would not be able to make contributions to a savings-account plan.⁴¹ For these purposes, the term “eligible educational institution” means an institution that is described in §481 of the Higher Education Act of 1965,⁴² as in effect on June 7, 2001 (the date of the enactment), and is eligible to participate in programs under Title IV of that Act.⁴³
- b. The beneficiary pays tax on the earnings at the time of distribution. If amounts saved through a QTP are used to pay for college, the student or the student’s parents still may be eligible to claim either the Hope Scholarship credit or the Lifetime Learning credit.⁴⁴ However, an amount contributed to a Coverdell savings account on behalf of a designated beneficiary during any taxable year in which an amount is also contributed to a qualified tuition program on behalf of the same beneficiary will not be treated as an excess contribution to the CESA.⁴⁵ However, cash distributions made in taxable years beginning after December 31, 2001 from qualified tuition programs are excluded from gross income to the extent that the distribution is used to pay for qualified higher-education expenses (as reduced by any in-kind distributions). This exclusion from gross income is extended to distributions from qualified tuition programs established and maintained by an entity other than a state (or agency or instrumentality thereof) for distributions made in taxable years after December 31, 2003.
- c. Contributions by donors are eligible for the \$19,000 annual gift-tax exclusion (\$38,000 for “split” gifts by married couples). Therefore, for transfer-tax purposes such contributions are treated as a completed gift to the beneficiary.

Questions to ponder:

Should, say, grandparents, consider the implications of fully funding grandkids’ secondary education taking that obligation away from the parents? Should that conversation be undertaken with the parents?

Planning point:

If the contribution is larger than the amount of the gift-tax annual exclusion, the donor may prorate the contribution to the prepaid tuition plan over five years for purposes of claiming the gift-tax annual exclusion. This allows the contribution of **up to five times the amount of the annual exclusion (up to \$95,000 for an individual and up to \$190,000 for split gifts)** to be made **without gift-tax consequences**.

The limits on the amount of contributions imposed by state plans vary. Some, however, have limits high enough to take advantage of this advantage. For example, Fidelity Investments’ Unique College Investing Plan, which is open to New Hampshire residents, has an account maximum of \$621,411 per beneficiary.

⁴⁰ I.R.C. §529(b)(1).

⁴¹ I.R.C. §529(b)(1)(A)(i).

⁴² 20 U.S.C. 1088.

⁴³ I.R.C. §529(e)(5).

⁴⁴ Notice 97-60, 1997-46 I.R.B. 8, §6, Q&A-2.

⁴⁵ Notice 97-60, 1997-46 I.R.B. 8, §6, Q&A-4.

The gift-tax annual exclusion increases to \$19,000 in 2025. Although the amount is indexed for inflation, it rounds down to the next lowest multiple of \$1,000.⁴⁶

Note:

The exemption of gifts of QTPs on a change of beneficiary is limited to cases where the new beneficiary is a member of the family of the old beneficiary. Also, the exemption does not apply if the new beneficiary is of a lower generation than the old beneficiary.

- d. PPA repealed the sunset provisions of Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) that would have expired at the end of 2010 and that relate to qualified tuition programs (§529 plans):
- (i) The provision that makes qualified withdrawals from qualified tuition accounts exempt from income tax;
 - (ii) The repeal of a pre-EGTRRA requirement that there be more than a de minimis penalty imposed on amounts not used for educational purposes and the imposition of the 10-percent additional tax on distributions not used for qualified higher education purposes;
 - (iii) A provision permitting certain private educational institutions to establish prepaid tuition programs that qualify under §529 if they receive a ruling or determination to that effect from the Internal Revenue Service, and if the assets are held in a trust created or organized for the exclusive benefit of designated beneficiaries;
 - (iv) Certain provisions permitting rollovers from one account to another account;
 - (v) Certain rules regarding the treatment of room and board as qualifying expenses;
 - (vi) Certain rules regarding coordination with Hope and Lifetime Learning credit provisions;
 - (vii) The provision that treats first cousins as members of the family for purposes of the rollover and change-in-beneficiary rules; and
 - (viii) Certain provisions regarding the education expenses of special-needs beneficiaries.
- e. Three significant changes have been made recently to the rules for §529 plans:
- (i) The PATH Act of 2015 expanded the definition of qualified expenses to include computers and peripheral equipment. This modernized the rules to be more in step with today's use of technology in education.
 - (ii) The TCJA added a provision to allow distributions to cover grades K-12, with an annual limit of \$10,000.
 - (iii) The SECURE Act expanded §529 education savings accounts coverage (discussed later).

⁴⁶ I.R.C. §26(b)(2).

Note:

The Pension Protection Act of 2006 permanently extended the amendments to §529, which previously were scheduled to expire at the end of 2010, including the provision that exempts from federal income tax distributions made from §529 accounts that are used to pay qualified higher education expenses. At the same time, it also enacted §529(f), which provides that, notwithstanding any other provision of §529, such regulations as may be necessary or appropriate to carry out the purposes of §529 and to prevent abuse of such purposes are authorized. The Joint Committee on Taxation provided two examples of how present law creates the opportunity for abuse of §529 accounts. Abuse may arise because of the ability to change designated beneficiaries (DBs) in certain circumstances without triggering transfer tax. For example, taxpayers may seek to establish and contribute to multiple accounts (taking advantage of the five-year rule) with different DBs with the intention of subsequently changing the DBs of such accounts to a single, common beneficiary and distributing the entire amount to such beneficiary without further transfer-tax consequences. Abuse may also arise because taxpayers seek to use §529 accounts as retirement accounts, with all of the tax benefits but none of the restrictions and requirements of qualified retirement accounts.

The Service is aware of other situations where current law raises the potential for abuse of §529 accounts. For example, abuse may also arise if a person contributes a large sum to an account for himself or herself and then changes the DB to a member of his or her family who is in the same or a higher generation as the contributor. The contributor's contributions to his or her own account would not trigger the gift tax because an individual cannot make a gift to himself or herself. The contributor may claim that the subsequent change of DB to a member of the contributor's family who is in the same or a higher generation avoids the gift tax under the special transfer tax rules of §529. Abuse may also arise because contributions to accounts are treated as completed gifts to the DB even though the account owner (AO) may be able to withdraw the money at his or her discretion.

Accordingly, **the Service intends to issue a notice of proposed rulemaking to address the potential for abuse of §529 accounts.** The notice of proposed rulemaking will provide a general anti-abuse rule that will apply when §529 accounts are established or used for purposes of avoiding or evading transfer tax or for other purposes inconsistent with §529. In addition, the notice of proposed rulemaking will include rules relating to the tax treatment of contributions to and participants in QTPs, including rules addressing the inconsistency between §529 and the generally applicable income and transfer tax provisions of the Code. The notice of proposed rulemaking also will include rules relating to the function and operation of QTPs and §529 accounts. The Service anticipates that the forthcoming notice of proposed rulemaking also will address additional comments that have been received with regard to certain administrative, income tax, and other issues affecting QTPs and §529 accounts.

The Service anticipates that the new rules to be provided in the notice of proposed rulemaking will generally apply prospectively to all §529 accounts. However, the anti-abuse rule may be applied on a retroactive basis.

The IRS and the Treasury Department also anticipate that the notice may require some states (or agencies or instrumentalities thereof) and eligible educational institutions that have established and maintained QTPs to make changes to the terms and operating provisions of their programs in order to ensure that their programs remain qualified under §529. The forthcoming notice of proposed rulemaking will provide a grace period of no less than 15 months to implement most changes.

These changes are not proposed to apply to a CESA (§530). So presumably the changing beneficiary strategy outlined above will survive the modification proposed.

Note:

Present law creates opportunities for abuse of qualified tuition programs. For example, taxpayers may seek to avoid gift and generation-skipping transfer taxes by establishing and contributing to multiple qualified tuition program accounts with different designated beneficiaries (using the provision of §529 that permits a contributor to contribute up to five times the annual exclusion amount per donee in a single year and treat the contribution as having been made ratably over five years), with the **intention of subsequently changing the designated beneficiaries of such accounts to a single, common beneficiary and distributing the entire amount to such beneficiary** without further transfer-tax consequences. Taxpayers also may seek to use qualified tuition program accounts as retirement accounts with all of the tax benefits but none of the restrictions and requirements of qualified retirement accounts. The provision grants the Secretary broad regulatory authority to clarify the tax treatment of certain transfers and to ensure that qualified tuition program accounts are used for the intended purpose of saving for higher education expenses of the designated beneficiary, including the authority to impose related record-keeping and reporting requirements. The provision also authorizes the Secretary to limit the persons who may be contributors to a qualified tuition program and to determine any special rules for the operation and federal tax consequences of such programs if such contributors are not individuals.

5. SECURE Act update: Section 529 plans

Section 302 of the SECURE Act expands §529 education savings accounts coverage to include expenses associated with registered apprenticeship programs and distributions for qualified education loan repayments. In the past, distributions were only considered qualified to the extent that the expenses were incurred at a qualified higher education institution. With the rising costs of college, it has become increasingly common for individuals to go into trades or apprenticeships, and now §529 accounts can be used to pay related expenses.

In addition, the SECURE Act allows for up to \$10,000 (lifetime maximum) to be withdrawn from a §529 plan to pay student loan principal amounts and related interest expenses for the beneficiary or the beneficiary's siblings. This provision applies to distributions made after December 31, 2018.

6. Student loan interest

As discussed, the OBBBA further expands §529 education savings accounts coverage to be used for additional educational expenses in connection with enrollment or attendance at an elementary or secondary school, as well as for additional qualified higher education expenses, including qualified postsecondary credentialing expenses. These provisions apply to distributions made after July 4, 2025.

There is an **above-the-line deduction for interest** paid on certain loans used to pay **qualified higher-education expenses**. This deduction applies to payments that would otherwise be treated as nondeductible personal interest except for the new special rules.⁴⁷ The amount allowable cannot exceed \$2,500. It is not indexed for inflation.

Under current law, married couples are penalized, as the above-the-line deduction for interest is capped at \$2,500 per return, not per individual. Over the years, legislation has been introduced to attempt to amend §221(b)(1) to allow married couples to apply the student loan interest deduction limitation separately to each spouse. Ultimately, no legislation has been passed to provide a \$2,500 above-the-line deduction per individual (rather than per return), but it is possible that future legislation may be introduced to provide an expanded above-the-line deduction for interest.

⁴⁷ I.R.C. §221.

Note:

These income phaseout ranges are adjusted annually for inflation, rounded down to the closest multiple of \$5,000.

In 2026, the education interest-expense deduction phases out as follows:

Taxpayer	MAGI Level Where Phaseout Begins	MAGI Level Where Phaseout is Complete
Married filing jointly	\$175,000	\$205,000
Single (including head of household)	\$85,000	\$100,000

N. Transportation

1. Mileage

- a. For automobiles first provided by employers to employees that meet certain requirements, the value to the employee of the use of the automobile may be determined under the vehicle cents-per-mile valuation rule,⁴⁸ but only if the fair market value of the automobile on the first date the automobile is made available to the employee does not exceed a “base value” amount. For years prior to 2018 this base value was \$16,000 (\$17,900 for vans and trucks). In IRS Notice 2019-08, the Treasury Department raised these amounts for 2018 significantly to \$50,000. The IRS Notice 2019-08 was issued to adjust the numbers because of the changes to the luxury automobile depreciation limits made by the Tax Cuts and Jobs Act of 2017. The \$50,000 limit for 2018 also applies for the fleet-average valuation rules. The 2026 figure is \$61,700.⁴⁹

Planning note:

The limitation on using the cents-per-mile method has been low for so long that many business owners have disregarded the method as an option. The increased limit should be considered by business owners to simplify record keeping.

- b. For 2026, the standard mileage rate is the number of business miles driven multiplied by 72.5 cents.
- c. For 2026, the standard mileage rate for deductible medical or moving expenses (available for active-duty members of the military) remains at 20.5 cents per mile.
- d. The standard mileage rate for miles driven in connection with service of charitable organizations remains at 14 cents per mile.

2. Lease-deduction reduction

For leased automobiles, §280F(c) requires a reduction in the deduction allowed to the lessee of the automobile. The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of automobiles. This reduction requires the lessees to include in gross income an inclusion amount determined by applying a formula to the amount obtained from a table.

⁴⁸ Treas. Regs. §1.61-21(e).

⁴⁹ Rev. Proc. 2026-15.

Table for Autos with a Lease Term Beginning in 2026⁵⁰

REV. PROC. 2026-15 TABLE 3

DOLLAR AMOUNTS FOR PASSENGER AUTOMOBILES
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2026

Fair Market Value of Passenger Automobile Over	Fair Market Value of Passenger Automobile Not Over	1 st Tax Year During Lease	2 nd Tax Year During Lease	3 rd Tax Year During Lease	4 th Tax Year During Lease	5 th Tax Year During Lease & Later
\$62,000	\$64,000	8	15	21	25	27
64,000	66,000	19	38	56	66	76
66,000	68,000	29	62	91	108	123
68,000	70,000	40	86	125	149	172
70,000	72,000	51	109	160	191	220
72,000	74,000	61	133	195	232	268
74,000	76,000	72	156	230	274	316
76,000	78,000	83	179	265	316	364
78,000	80,000	93	203	299	358	412
80,000	85,000	112	244	360	431	496
85,000	90,000	139	302	447	535	617
90,000	95,000	166	361	534	639	737
95,000	100,000	192	420	621	743	858
100,000	110,000	232	507	752	900	1,038
110,000	120,000	286	624	926	1,108	1,279
120,000	130,000	339	742	1,099	1,317	1,520
130,000	140,000	392	859	1,273	1,526	1,760
140,000	150,000	446	976	1,447	1,734	2,001
150,000	160,000	499	1,093	1,621	1,943	2,242
160,000	170,000	553	1,210	1,795	2,151	2,483
170,000	180,000	606	1,328	1,968	2,360	2,723
180,000	190,000	659	1,445	2,142	2,569	2,964
190,000	200,000	713	1,562	2,316	2,777	3,205
200,000	210,000	766	1,679	2,490	2,986	3,445
210,000	220,000	820	1,796	2,664	3,194	3,686
220,000	230,000	873	1,913	2,838	3,403	3,927
230,000	240,000	926	2,031	3,012	3,610	4,168
240,000	250,000	980	2,148	3,185	3,820	4,408
250,000	260,000	1,033	2,265	3,360	4,027	4,650
260,000	270,000	1,086	2,382	3,534	4,236	4,890
270,000	280,000	1,140	2,499	3,708	4,444	5,131
280,000	290,000	1,193	2,617	3,881	4,653	5,372
\$290,000	\$300,000	1,247	2,733	4,056	4,862	5,612

⁵⁰ Rev Proc. 2025-16.

3. Depreciation

There are limitations to the allowable depreciation on luxury vehicles. The depreciation limitations are applied, by reference to the year the vehicle was first placed in service. The §280F “luxury car” caps continue to be avoided by purchasing cars with “unloaded gross curb weights” of over 6,000 pounds and trucks and vans with a load capacity over 6,000 pounds. Leasing the car or vehicle also serves to avoid these caps, although there is a minimal add-back (i.e., annual income inclusion) that serves to offset the write-off.

The TCJA made changes to the luxury auto limits for tax years beginning after December 31, 2017.

- a. Prior to TCJA, there were two sets of limits. One set of limits applied to autos (not trucks and vans), and the other applied to trucks and vans. Under TCJA, there is one set of limits for all passenger automobiles.
- b. The law maintained the difference in how the 6,000-pound maximum weight is calculated for autos and for trucks and vans. For autos that are not trucks and vans, the maximum weight is the unloaded weight, but for trucks and vans it is the loaded weight (gross vehicle weight rating).

Note:

Certain “qualified non-personal-use vehicles” continue to be exempt from the luxury-auto limits *regardless of their weight*.

The annual depreciation dollar caps for vehicles that are in fact subject to the luxury-auto limits of §280F and placed in service in calendar year 2026 follow.

Autos (including trucks or vans):

- \$12,300 for the placed-in-service year;
- \$19,800 for the second tax year;
- \$11,900 for the third tax year; and
- \$7,160 for each succeeding year.

The additional-first-year (bonus) depreciation amount of \$8,000 was reinstated by TCJA for vehicles acquired and placed in service after September 27, 2017.

Note:

As always, the dollar limits must be proportionately reduced if business/investment use of a vehicle is less than 100 percent.

Note:

The rule under §179 limiting the amount of the expensing deduction (after application of the phase-out rule) to the amount of taxable income from any of the taxpayer's active trades or businesses was not affected. Any amount that cannot be deducted because of the taxable-income limit may be carried over indefinitely until it can be deducted.

Note:

There is no AMT adjustment with respect to property expensed under §179.⁵¹

⁵¹ S. Rept. (1986).

Caution:

Under the OBBBA, for tax years beginning in 2025, the maximum is \$2,500,000, phasing out for expenditures in excess of \$4,000,000.⁵² In 2026, the maximum increases to \$2,560,000, phasing out for expenditures in excess of \$4,090,000.⁵³

The §179 expense limitation with respect to a sport-utility vehicle placed in service after October 22, 2004 is limited to \$25,000. TCJA added a provision to index the \$25,000 for inflation for years after 2018. The indexed amount for 2026 is \$32,000.

- c. A sport-utility vehicle is a four-wheeled vehicle that:
- Is primarily designed or which can be used to carry passengers over public streets, roads, or highways (except any vehicle operated exclusively on a rail or rails);
 - Is not subject to §280F; and
 - Is rated at not more than 14,000 pounds gross vehicle weight.
- d. However, a sport-utility vehicle does **not** include any vehicle that:
- Is designed to have a seating capacity of more than nine persons behind the driver's seat;
 - Is equipped with a cargo area of at least six feet in interior length, which is an open area or is designed for use as an open area but is enclosed by a cap and is not readily accessible directly from the passenger compartment; or
 - Has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

Note:

There are a number of vehicles that still do not meet the definition of a sport-utility vehicle. The provision does not make the sport-utility vehicle a passenger automobile, so it is eligible for depreciation using the general depreciation recovery scheme (20 percent, 32 percent, etc.) without recourse to the annual caps that apply to passenger automobiles.

Example: A purchases and places in service a used Hummer for \$50,000 in 2026 and elects out of bonus depreciation. A takes a \$32,000 §179 expense and \$5,000 regular depreciation, a total of \$37,000.

Because of changes included in the TCJA, used property qualifies for bonus depreciation. Since the vehicle is over 6,000 pounds, A can take 100-percent bonus depreciation on the vehicle.

4. Qualified transportation expenses

Employees can exclude a limited amount of **qualified transportation fringe** benefits provided by the employer from gross income and wages for both income and payroll taxes within specific limitations, without regard to working-condition fringe benefits and de minimis fringe benefits.⁵⁴ However, for tax years beginning after December 31, 2017, the amounts are not deductible by the employer.⁵⁵

- a. Qualified transportation fringe benefits include the following.

⁵² OBBBA.

⁵³ Rev. Proc. 2025-32.

⁵⁴ I.R.C. §132(a)(5).

⁵⁵ I.R.C. §274(a)(4), as amended by the TCJA.

- (i) Transportation in a **commuter highway vehicle** is transportation provided by an employer to an employee in connection with travel between the employee's residence and place of employment.⁵⁶ A commuter highway vehicle is a highway vehicle with a seating capacity of at least six adults (excluding the driver) and with respect to which at least 80 percent of the vehicle's mileage is reasonably expected to be used for transporting employees in connection with travel between their residences and their place of employment and on trips during which the number of employees transported for commuting is at least one-half of the adult seating capacity of the vehicle (excluding the driver).⁵⁷ Transportation is considered provided by the employer if the transportation is furnished in a commuter highway vehicle operated by or for the employer.⁵⁸
- (ii) Also included is any **transit pass**,⁵⁹ which is any pass, token, farecard, voucher, or similar item (including an item exchangeable for fare media) that entitles a person to transportation or transportation at a reduced price if such transportation is on mass-transit facilities (whether or not publicly owned), or is provided by any person in the business of transporting persons for compensation or hire in a highway vehicle with a seating capacity of at least six adults (excluding the driver).⁶⁰
- (iii) Finally, any **qualified parking** that is parking provided to an employee by an employer:⁶¹
- On or near the employer's business premises; or
 - At a location from which the employee commutes to work by carpool, commuter highway vehicle, mass-transit facilities, transportation provided by any person in the business of transporting persons for compensation or hire, or by any other means.⁶²
- b. The amount of the fringe benefits that are provided to any employee and that may be excluded in 2026 may not exceed \$340 per month in the aggregate for transportation in a commuter highway vehicle and transit passes,⁶³ and \$340 per month in the case of qualified parking.⁶⁴
- c. Only employees are eligible for a qualified transportation fringe. For these purposes, an employee does not include a sole proprietor, a partner, or a more-than-two-percent shareholder of an S corporation.⁶⁵
- d. Unlike the de minimis fringe benefits rule, under which \$1 above the facts-and-circumstances amount converts the entire benefit into a taxable benefit, the statute with respect to qualified transportation fringes merely places a limitation on the amount of the exclusion. Thus, the employer's payment of a \$341 monthly parking fee only subjects \$1 to tax in 2026.

⁵⁶ Treas. Regs. §1.132-9, A-2.

⁵⁷ I.R.C. §132(f)(5)(B).

⁵⁸ I.R.C. §132(f)(5)(D).

⁵⁹ I.R.C. §132(f)(1)(B).

⁶⁰ Treas. Regs. §1.132-9, A-3.

⁶¹ I.R.C. §132(f)(1)(C).

⁶² Treas. Regs. §1.132-9, A-4(a).

⁶³ I.R.C. §132(f)(2)(A), Rev. Proc. 2023-34.

⁶⁴ I.R.C. §132(f)(2)(B). Both of these limitations will be adjusted to the nearest \$5 to account for inflation.

⁶⁵ I.R.C. §132(f)(7). A more-than-two-percent shareholder is treated the same as a partner for purposes of fringe benefits.

5. Federal per-diem rates

The General Services Administration changed the COLI adjustment that affects the period October 1, 2025 through September 30, 2026. The per diem for 10/1/25 to 9/30/26 is \$319 for any high-cost locality, consisting of \$233 for lodging and \$86 for meals and incidentals. The 2026 per diem is \$225 for travel to any other locality, consisting of \$151 for lodging and \$74 for meals and incidentals.⁶⁶ Taxpayers may elect to treat this table as applicable to the calendar year 2026. The special M&IE rates for transportation workers are \$80 for the continental United States and \$86 for any locality outside the continental United States.

- a. For travel away from home, the term “incidental expenses” has the meaning given to it in the Federal Travel Regulations.⁶⁷ For example, the term “incidental expenses” includes fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries but does not include expenses for laundry, cleaning and pressing of clothing, lodging taxes, or the costs of telegrams or telephone calls.
- b. In lieu of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary incidental expenses paid or incurred for travel away from home, employees and self-employed individuals who do not pay or incur meal expenses for a calendar day (or partial day) of travel away from home may use an amount computed at the rate of \$5 per day for each calendar day (or partial day) the employee or self-employed individual is away from home.

Note:

In 2010, the Internal Revenue Service requested public comment on the continuing need for the high-low method for substantiating, under §274(d) of the Internal Revenue Code, lodging, meal, and incidental expenses incurred in traveling away from home. The Service received no comments.⁶⁸ Accordingly, the Service announced that it intended to **discontinue authorizing the high-low substantiation method**.⁶⁹ In 2011, the Service planned to publish a revenue procedure providing the general rules and procedures for substantiating lodging, meal, and incidental expenses incurred in traveling away from home (omitting the high-low substantiation method). However, based on comments received from tax professionals, the Service withdrew this guidance and reinstated the high-low method.

⁶⁶ Notice 2025-54.

⁶⁷ 41 C.F.R. Part 300 (2003).

⁶⁸ Rev. Proc. 2010-39, 2010-42 I.R.B. 459.

⁶⁹ Ann. 2011-42, 2011-32 I.R.B. 1.

Localities eligible for \$319 (\$86 M & IE) Per-Diem Under High-Low Substantiation Method in 2025-2026		
State	Key city	County or other defined location
Alabama	Gulf Shores (June 1-July 31)	Baldwin
Arizona	Phoenix/Scottsdale (February 1-March 31)	Maricopa
	Sedona (October 1-December 31 and March 1-September 30)	City limits of Sedona
California	Los Angeles (October 1-September 30)	Los Angeles
	Mammoth Lakes (December 1-March 31)	Mono
	Monterey (June 1-August 31)	Monterey
	Napa (October 1-September 30)	Napa
	Palm Springs (October 1-April 30)	Riverside
	San Diego (October 1-September 30)	San Diego
	San Francisco (October 1-September 30)	San Francisco
	San Luis Obispo (June 1-July 31)	San Luis Obispo
	Santa Barbara (October 1-September 30)	Santa Barbara
	Santa Monica (October 1-September 30)	City limits of Santa Monica
	South Lake Tahoe (December 1-March 31)	El Dorado
	Sunnyvale/Palo Alto/San Jose (October 1-September 30)	Santa Clara
	Yosemite National Park (January 1-April 30)	Mariposa
Colorado	Aspen (October 1-September 30)	Pitkin
	Denver/Aurora (October 1-October 31 and April 1-September 30)	Denver, Adams, Arapahoe, and Jefferson
	Silverthorne/Breckenridge (December 1-March 31)	Summit
	Steamboat Springs (December 1-March 31)	Routt
	Telluride (October 1-September 30)	San Miguel
	Vail (October 1-September 30)	Eagle
Delaware	Lewes (June 1-August 31)	Sussex
District of Columbia	Washington D.C. (also the cities of Alexandria, Falls Church, and Fairfax, and the counties of Arlington and Fairfax, in Virginia; and the counties of Montgomery and Prince George's in Maryland) (See also Maryland and Virginia) (October 1-September 30)	
Florida	Boca Raton/Delray Beach/Jupiter (January 1-April 30)	Palm Beach and Hendry
	Bradenton (February 1-March 31)	Manatee
	Cocoa Beach (February 1-March 31)	Brevard
	Fort Lauderdale (January 1-April 30)	Broward

⁷⁰ Notice 2025-54.

	Fort Meyers (January 1-March 31)	Lee
	Fort Walton Beach/De Funiak Springs (June 1-July 31)	Okaloosa and Walton
	Gulf Breeze (June 1-July 31)	Santa Rosa
	Key West (October 1-September 30)	Monroe
	Miami (December 1-May 31)	Miami-Dade
	Naples (December 1-April 30)	Collier
	Panama City (June 1-July 31)	Bay
	Sarasota (February 1-April 30)	Sarasota
	Sebring (February 1-March 31)	Highlands
	Stuart (February 1-March 31)	Martin
	Tampa/St.Petersburg (February 1-April 30)	Pinellas and Hillsborough
	Vero Beach (December 1-April 30)	Indian River
Georgia	Atlanta (January 1-March 31)	Fulton and DeKalb
	Jekyll Island/Brunswick (March 1-July 31)	Glynn
Idaho	Boise (October 1-October 31 and June 1-September 30)	Ada
	Coeur d'Alene (June 1-August 31)	Kootenai
	Sun Valley/Ketchum (December 31-March 31 and June 1-September 30)	Blaine and Elmore
Illinois	Chicago (October 1-November 30 and April 1-September 30)	Cook and Lake
Maine	Bar Harbor/Rockport (October 1-October 31 and May 1-September 30)	Hancock and Knox
	Kennebunk/Kittery/Sanford (July 1-August 31)	York
	Portland (October 1-October 31 and June 1-September 30)	Cumberland and Sagadahoc
Maryland	Ocean City (June 1-August 31)	Worcester
	Washington DC Metro Area (October 1-September 30)	Montgomery and Prince George's
Massachusetts	Boston/Cambridge (October 1-September 30)	Suffolk, city of Cambridge
	Falmouth (July 1-August 31)	City limits of Falmouth
	Hyannis (July 1-August 31)	Barnstable less the city of Falmouth
	Martha's Vineyard (October 1-September 30)	Dukes
	Nantucket (June 1-September 30)	Nantucket
Michigan	Mackinac Island (July 1-August 31)	Mackinac
	Petoskey (June 1-August 31)	Emmet
	Traverse City (July 1-August 31)	Grand Traverse
Minnesota	Duluth (October 1-October 31 and June 1-September 30)	St. Louis
Montana	Big Sky/West Yellowstone/Gardiner (June 1-September 30)	Gallatin and Park
	Kalispell/Whitefish (July 1-September 30)	Flathead
New Jersey	Tom's River (July 1-August 31)	Ocean

New York	Glens Falls (July 1-August 31)	Warren
	Lake Placid (July 1-August 31)	Essex
	New York City (October 1-December 31 and March 1-September 30)	Bronx, Kings, New York, Queens, and Richmond
	Saratoga Springs/Schenectady (July 1-August 31)	Saratoga and Schenectady
North Carolina	Kill Devil Hills (June 1-August 31)	Dare
Oregon	Bend (June 1-August 31)	Deschutes
	Eugene/Florence (June 1-July 31)	Lane
	Seaside (July 1-August 31)	Clatsop
Pennsylvania	Hershey (June 1-August 31)	Hershey
	Philadelphia (October 1-November 30, and April 1-September 30)	Philadelphia
Rhode Island	Jamestown/Middletown/Newport (October 1 – October 31 and June 1-September 30)	Newport
South Carolina	Charleston (October 1-September 30)	Charleston, Berkeley and Dorchester
	Hilton Head (March 1-August 31)	Beaufort
Tennessee	Nashville (October 1-September 30)	Davidson
Utah	Moab (October 1-October 31, March 1-June 30, and September 1-September 30)	Grand
	Park City (October 1-September 30)	Summit
Vermont	Burlington (October 1-October 31 and May 1-September 30)	Chittenden
	Manchester (October 1-October 31 and August 1-September 30)	Bennington
	Montpelier (October 1-October 31 and August 1-September 30)	Washington
Virginia	Virginia Beach (June 1-August 31)	City of Virginia Beach
	Wallops Island (July 1-August 31)	Accomack
	Washington, DC Metro Area (October 1-September 30)	Cities of Alexandria, Fairfax, and Falls Church; counties of Arlington and Fairfax
Washington	Port Angeles/Port Townsend (July 1-August 31)	Clallam and Jefferson
	Seattle (October 1-September 30)	King
Wyoming	Jackson/Pinedale (October 1-September 30)	Teton and Sublette
*The per diem rate for all other localities within the continental U.S. is \$225 (\$74 M & IE)		

6. SIFL rates

For the 2025 tax year, a new Line 24c was added to Part V of Form 4562, specifically to track business aircraft use:

24a Do you have evidence to support the business/investment use claimed?	<input type="checkbox"/> Yes	<input type="checkbox"/> No
b If "Yes," is the evidence written?	<input type="checkbox"/> Yes	<input type="checkbox"/> No
c Do you own, lease, or charter an aircraft? Check all that apply. See instructions	<input type="checkbox"/> Own	<input type="checkbox"/> Lease <input type="checkbox"/> Charter

This box must be checked if the taxpayer owns, leases, or charters an aircraft for which they are claiming a depreciation deduction. This new line suggests that the IRS is implementing a targeted effort to identify and examine companies using private aircraft, particularly to ensure personal use by employees is correctly valued as a taxable fringe benefit.

Under current IRS regulations, an employer must include the value of an employee's personal flight in their gross income as a taxable fringe benefit. To determine this value, the employer can generally choose between two methods:

- **General Fair Market Value (FMV) Method:** The value is based on what it would cost an individual to charter a comparable aircraft for a similar flight in an arm's-length transaction.
- **Special Valuation (SIFL) Rules:** A formulaic approach using Standard Industry Fare Level rates, which are updated semi-annually by the Department of Transportation.

Per the 2025 Form 4562 instructions, taxpayers must maintain contemporaneous records to substantiate the following:

- The amount of the aircraft expense;
 - Time and place of travel;
 - Business purpose of the travel; and
 - Business relationship of each individual using the aircraft.
- a. The final regulations retain the aircraft travel valuation method based upon Standard Industry Fare Level ("SIFL") statistics published semiannually by the Civil Aeronautics Board of the Department of Transportation ("CAB/DOT"). The regulations provide the applicable SIFL statistics for the first half of 1989; updates are provided unless or until such time as the CAB/DOT discontinues publication of these statistics.⁷¹

Rates for the first half of 2026 are as follows:

2026	Terminal Charge	Rate for Miles 0-500	Rate for Miles 501-1500	Rate for Miles Over 1,500
Jan.1- June30	\$54.48	\$0.2980	\$0.2272	\$0.2184

- b. To determine the value of any employee's flight on a noncommercial aircraft, these cents-per-mile SIFL rates are multiplied by a percentage that varies with both the weight of the aircraft and the kind of employee (as a control or noncontrol employee), and that product is added to the terminal charge. Because the SIFL statistics have not kept pace with inflation in airline travel, these safe-harbor valuation rates offer a bargain, especially for noncontrol employees, in valuing any flight.

⁷¹ Treas. Regs. §§1.61-21(g)(5) and (6).

Aircraft Take-Off Weight	Multiple for a Control Employee	Multiple for a Noncontrol Employee
0-6,000	0.625	0.156
6,001-10,000	1.25	0.234
10,001-25,000	3	0.313
25,001 and above	4	0.313

Example: An executive flies 1,000 miles on the corporate aircraft having 15,000 lbs. take-off weight in Feb 2026; the value of this trip is \$842.28 $((500 \times \$0.2980 + 500 \times \$0.2272) \times 3) + \$54.48$; for the noncontrol employee it is \$136.67 $((500 \times \$0.2980 + 500 \times \$0.2272) \times 0.313) + \54.48 .

Planning point:

Under the special valuation rules, the value of a flight is determined by using the Standard Industry Fare Level (SIFL) formula, which involves multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by an appropriate aircraft multiple, and then adding an applicable terminal charge for the period in which the flight was taken. The value of personal flights provided to employees under these special rules does not correspond with the employer's actual costs in providing the flights. In a recent case, the employer was entitled to deduct the full costs of providing its executives with a company jet for vacation flights, even though those costs exceeded the compensation that the employees included in income because of the flights.⁷² This ran contrary to the Service's position, which caps the employer's deduction for a noncash fringe benefit by the amount of the recipient's reported income from the benefit.⁷³

O. Social Security adjustments

1. Wage base

In 2026, the taxable wage base is \$184,500⁷⁴ resulting in a maximum OASDI tax of \$11,439.00 (employer's share), \$11,439.00 (employee's share), or \$22,878.00 (self-employed individual). The Medicare portion of the tax remains a combined 2.9 percent on all earned income.

Note:

The retirement benefits of a worker are determined with reference to the worker's primary insurance amount (PIA). The PIA is determined by the worker's adjusted indexed monthly earnings (AIME) over a computation period that generally encompasses the worker's "highest average" 35 years of AIME multiplied by "break point" percentages. (Earnings for this purpose cannot exceed the taxable wage base for the year the earnings accrue.) The indexing takes into account a recalculation of actual earnings increased to reflect percentage increases in the average wages of the population in the interim between the time the earnings are earned and the current year (but generally not after the time the worker turns 60).

⁷² *Sutherland Lumber-Southwest, Inc. v. Commissioner*, 114 T.C. 14 (2000).

⁷³ TAM 9615002 and 9715001. The case was overturned by the enactment of I.R.C. §274(e)(2).

⁷⁴ SSA.gov *Update 2025*, <https://www.ssa.gov/OACT/COLA/cbb.html>.

2. Excess earnings

- a. Deductions are made from the monthly benefits payable to a worker who is under normal retirement age and to the worker's dependents for each month the worker is charged with earnings in excess of certain amounts. A similar deduction is made in the dependent's benefits when the dependent has excess earnings. These rates do not apply to Social Security benefits based on disability, to persons who are age 70 or older, or to work performed outside the United States not covered by Social Security. Likewise, a divorced spouse's benefits are not reduced because of the insured's excess earnings, provided the divorce has been in effect for two years.
- b. The maximum amount that a beneficiary, the year he or she reaches normal retirement age, might earn in 2026 without affecting the beneficiary's own benefit or those of dependents is \$65,160 (\$5,430 per month). Benefits are reduced by \$1 for every \$3 earned over the annual exempt amount. (Note that this limitation ends with the month in which the beneficiary attains full retirement age. Hereafter, a periodic cost-of-living increase in these benefits will be provided. There is no reduction for persons from full retirement age through age 69.
- c. A lower number is used as a ceiling for those under the normal retirement age; this is \$24,480 (\$2,040 monthly) in 2026. Benefits are reduced \$1 for every \$2 if the individual is between 62 and the year preceding the year he reaches full retirement age. However, an individual is entitled to one grace year, usually the calendar year during which retirement occurs, when excess earnings are not offset against old-age benefits. The grace year occurs when a retiree or survivor entitled to benefits does not receive excess earnings for at least one month, called a **nonservice month**.

Planning point:

The excess earnings reduce the direct and derivate benefits that arise from that earner. Thus, the decision to take early benefits must be tempered by the reduction not just to the worker but also the spouse. Those intending to continue working may find the early retirement decision to result in a greater reduction than the nominal 25-percent reduction. However, note the repayment planning option discussed below.

3. Full retirement age

Listed below are the ages to receive full Social Security benefits (called "full retirement age" or "normal retirement age"). Persons born on January 1 of any year should refer to the previous year. Persons born in 1943 through 1954 may receive full retirement benefits beginning at age 66 years.

Age to receive full Social Security benefits	
<i>Year of birth</i>	<i>Full retirement age</i>
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67
<i>NOTE: People born on January 1 of any year, refer to the previous year.</i>	

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Note:

The basic benefits of a worker and the worker's dependents and survivors are reduced by early retirement. The wage earner's benefits are reduced five-ninths of one percent for each month the worker receives benefits before normal retirement age, up to 36 months, and five-twelfths of one percent for each month the worker receives benefits before normal retirement age in excess of 36 months.

If the full retirement age is older than 65, retirement benefits may still be taken at age 62, but the reduction in the benefit amount will be greater than it is for people retiring earlier. If your full retirement age is 67, the reduction for starting benefits at 62 is about 30 percent; at age 63, it is about 25 percent; at age 64, about 20 percent; at age 65, about 13-1/3 percent; and at age 66, about 6-2/3 percent.

If the full retirement age is 66, then the reduction for starting benefits at age 62 is 25 percent.

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SSA.gov 2026 Retirement Benefits, Securing Today and Tomorrow

Full Retirement and Age 62 Benefit By Year Of Birth

Year of Birth ^{1.}	Full (normal) Retirement Age	Months between age 62 and full retirement age ^{2.}	At Age 62 ^{3.}			
			A \$1000 retirement benefit would be reduced to	The retirement benefit is reduced by ^{4.}	A \$500 spouse's benefit would be reduced to	The spouse's benefit is reduced by ^{5.}
1943-1954	66	48	\$750	25.00%	\$350	30.00%
1955	66 and 2 months	50	\$741	25.83%	\$345	30.83%
1956	66 and 4 months	52	\$733	26.67%	\$341	31.67%
1957	66 and 6 months	54	\$725	27.50%	\$337	32.50%
1958	66 and 8 months	56	\$716	28.33%	\$333	33.33%
1959	66 and 10 months	58	\$708	29.17%	\$329	34.17%
1960 and later	67	60	\$700	30.00%	\$325	35.00%

1. If you were born on January 1st, you should refer to the previous year.
2. If you were born on the 1st of the month, we figure your benefit (and your full retirement age) as if your birthday was in the previous month. If you were born on January 1st, we figure your benefit (and your full retirement age) as if your birthday was in December of the previous year.
3. You must be at least 62 for the entire month to receive benefits.
4. Percentages are approximate due to rounding.
5. The maximum benefit for the spouse is 50% of the benefit the worker would receive at full retirement age. The percentage reduction for the spouse should be applied after the automatic 50% reduction. Percentages are approximate due to rounding.

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⁷⁶ <https://www.ssa.gov/benefits/retirement/planner/whileworking.html>

Note:

Workers who delay retirement beyond age 66 and consequently do not receive benefits are entitled to an increase in old-age benefits of 8 percent per year for workers reaching retirement age in 2026.

Note:

A husband or wife of an insured individual is entitled to 50 percent of the PIA when the husband or wife reaches normal retirement age. Reduced benefits will be paid if the husband or wife is younger than the normal retirement age, if either spouse has excess earnings under the retirement test, or if either spouse is entitled to a public pension based on the person's own work in noncovered government employment. The benefit of a surviving widow or widower of a worker who died fully insured is generally entitled to 100 percent of the benefit the worker would receive if still living. The widow or widower receives the full benefit if the widow or widower is normal retirement age, or a smaller benefit if between ages 60 and normal retirement age (19/40 percent reduction in benefit per month for retirement prior to normal retirement age). Of course, a spouse may claim benefits based on his or her status as a worker rather than as a spouse. But since the spouse will automatically receive 50 percent of the retirement amount of the other spouse as a floor, certain spouses rejoining the workforce may have to work for some period of time in order to be entitled to a higher retirement benefit than a spousal Social Security benefit.

4. Medicare

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 imposes a premium on high-income enrollees in Medicare Part B (physician services) that will vary based on the income reported by each enrollee to the IRS for federal income-tax purposes.⁷⁷ The premium is calculated based on the most-recently-available tax returns (usually a two-year look back). The 2026 premium is based on taxable income for 2024. Termed the "income-related reduction in Part B subsidy," the new premium will effectively constitute an income-tax surcharge. The premium will be in addition to the current flat Part B premium. The two premiums together will be capped at 85 percent of the per-enrollee Part B program costs.⁷⁸ The premium applies to individual seniors with adjusted gross income exceeding \$109,000 per year (adjusted for inflation) and to married couples with adjusted gross income exceeding \$218,000 per year (adjusted for inflation). Furthermore, the Act phases in the maximum premium, so that seniors with even the highest incomes will pay only a fraction of the amount of the Part B subsidy in the early years.⁷⁹

In 2026:⁸⁰

2024 Individual AGI Range	2024 Married Filing Jointly Income Range	Premium Amount
Less than or equal to \$109,000	Less than or equal to \$218,000	\$202.90
Greater than \$109,000 and less than or equal to \$137,000	Greater than \$218,000 and less than or equal to \$274,000	\$284.10
Greater than \$137,000 and less than or equal to \$171,000	Greater than \$274,000 and less than or equal to \$342,000	\$405.80
Greater than \$171,000 and less than or equal to \$205,000	Greater than \$342,000 and less than or equal to \$410,000	\$527.50
Greater than \$205,000 and less than \$500,000	Greater than \$410,000 and less than \$750,000	\$649.20
Greater than or equal to \$500,000	Greater than or equal to \$750,000	\$689.90

⁷⁷ 42 U.S.C. §1395r(i), I.R.C. §6103(l)(20).

⁷⁸ 42 U.S.C. §1395r(i)(3).

⁷⁹ The statute does not prescribe an explicit rate for the new premium. Rather, the rate will vary from year to year, based on the actuarial value of the Part B benefits for each year.

⁸⁰ Data for Medicare Parts B and D are available at Medicare.gov.

5. Premiums for prescription drugs

The drug prescription program is implemented through private insurers so premiums vary from plan-to-plan. Starting January 1, 2011, the Part D monthly premium could be higher based on income. This includes Part D coverage from a Medicare Prescription Drug Plan, a Medicare Advantage Plan, or Medicare Cost Plan that includes Medicare prescription drug coverage. If modified adjusted gross income as reported on your IRS tax return from the most recent tax return information provided to Social Security by the IRS is above a certain amount, you will pay a higher monthly premium.

In 2026:

2024 Individual AGI Range	2024 Married Filing Jointly Income Range	Monthly Premium Amount
Less than or equal to \$109,000	Less than or equal to \$218,000	\$0.00
Greater than \$109,000 and less than or equal to \$137,000	Greater than \$218,000 and less than or equal to \$274,000	\$14.50
Greater than \$137,000 and less than or equal to \$171,000	Greater than \$274,000 and less than or equal to \$342,000	\$37.50
Greater than \$171,000 and less than or equal to \$205,000	Greater than \$342,000 and less than or equal to \$410,000	\$60.40
Greater than \$205,000 and less than \$500,000	Greater than \$410,000 and less than \$750,000	\$83.30
Greater than or equal to \$500,000	Greater than or equal to \$750,000	\$91.00

† The Social Security Administration will use the most recent Form 1040 available to it. Consequently, as of some point during 2026 the MAGI could reference 2025, rather than the current 2024.

P. Medical expenses

1. Long-term-care insurance

Under the law, medical care includes **eligible long-term care premiums for qualified long-term-care insurance contracts**.⁸¹ A qualified long-term-care insurance contract means any insurance contract if the only insurance protection provided under such contract is coverage of **qualified long-term care services**, the contract does not pay or reimburse expenses incurred for services or items to the extent that such expenses are reimbursable under Title XVIII of the Social Security Act or would be so reimbursable, but for the application of a deductible or coinsurance amount, they are guaranteed renewable, the contract does not provide for a cash-surrender value or other money that can be paid, assigned, or pledged as collateral for a loan, or borrowed, and all refunds of premiums and all policyholder dividends or similar amounts under such contract are to be applied as a reduction in future premiums or to increase future benefits. They must also generally conform to the long-term-care insurance model act promulgated by the National Association of Insurance Commissioners (as adopted as of January 1993).

- a. For these purposes, **qualified long-term care services** means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and **maintenance or personal care services**, which are required by a chronically ill individual, and are provided pursuant to a plan of care prescribed by a licensed health care practitioner.

⁸¹ I.R.C. §213(d)(1) [flush language].

- (i) For these purposes, a chronically ill individual means any individual who has been certified by a licensed health care practitioner as:
- Being unable to perform (without substantial assistance from another individual) at least two **activities of daily living** for a period of at least 90 days due to a loss of functional capacity;
 - Having a level of disability similar to the level of disability with respect to two activities of daily living; or
 - Requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment.

Such term does not include any individual otherwise meeting the requirements of the preceding sentence, unless within the preceding 12-month period a licensed health care practitioner has certified that such individual meets such requirements.

- (ii) For these purposes, each of the following is an activity of daily living:
- Eating;
 - Toileting;
 - Transferring;
 - Bathing;
 - Dressing; and
 - Continence.

A contract shall not be treated as a qualified long-term-care insurance contract unless the determination of whether an individual is a chronically ill individual takes into account at least five of such activities.

- (iii) For these purposes, maintenance or personal care services means any care the primary purpose of which is the provision of needed assistance with any of the disabilities as a result of which the individual is a chronically ill individual (including the protection from threats to health and safety due to severe cognitive impairment).

- b. If the long-term-care insurance contract is an indemnity policy (one which reimburses actual long-term-care costs), all benefits received under the policy are tax-free. If, on the other hand, the long-term-care insurance contract is a per-diem policy (one which pays a set amount per day regardless of actual expenses), a taxpayer can exclude the greater of \$400 per day or actual daily expenses.⁸²

Planning point:

The provision of long-term-care insurance is fast becoming a significant part of any retirement plan. Medicaid can only be relied on by the indigent (and, even then, not in every circumstance). It is often impossible (and always time-consuming and frustrating) to try to qualify for Medicaid as a member of the middle class. In addition, there is little personal choice in the context of Medicaid.

⁸² Per diem amount and maximum deductible premiums are from Rev. Proc. 2024-25.

Age	2026 Maximum Deductible Premium
40 or less	\$500
More than 40 but not more than 50	\$930
More than 50 but not more than 60	\$1,860
More than 60 but not more than 70	\$4,960
More than 70	\$6,200

2. Health savings accounts

The Medicare Act of 2003 established a new tax-favored vehicle, the **health savings account (HSA)**, which permits, effective for taxable years beginning after December 31, 2003, an eligible individual for any month during the taxable year to deduct for the taxable year an amount equal to the aggregate amount paid in cash during such taxable year by or on behalf of such individual to the HSA.⁸³ This deduction is taken above-the-line in determining adjusted gross income.⁸⁴

- a. The amount allowable as a deduction to an individual for the taxable year may not exceed the sum of the **monthly limitations** for months during such taxable year that the individual is an eligible individual.⁸⁵
 - (i) The monthly limitation for any month is one-twelfth of an amount that depends on the kind of coverage under a high-deductible health plan as of the first day of such month:⁸⁶
 - In the case of an eligible individual who has self-only coverage, the amount of \$4,400 in 2026;⁸⁷ or
 - In the case of an eligible individual who has family coverage, the amount of 8,750 in 2026.⁸⁸
 - (ii) In the case of an individual who has attained age 55 before the close of the taxable year, the applicable limitation is increased by the additional contribution amount.⁸⁹ The additional contribution amount is the amount determined in accordance with the following table.⁹⁰

For taxable years beginning in:	The additional contribution amount is:
2009 and thereafter	\$1,000

- (iii) The limitation that would otherwise apply to an individual for any taxable year is reduced (but not below zero) by the sum of:
 - The aggregate amount paid for such taxable year to Archer MSAs of such individual;⁹¹ and
 - The aggregate amount contributed to health savings accounts of such individual, which is excludable from the taxpayer's gross income for such taxable year under §106(d) and such amount shall not be allowed as a

⁸³ I.R.C. §223(a).
⁸⁴ I.R.C. §62(19).
⁸⁵ I.R.C. §223(b)(1).
⁸⁶ I.R.C. §223(b)(2).
⁸⁷ Rev. Proc. 2025-19.
⁸⁸ Rev. Proc. 2015-19.
⁸⁹ I.R.C. §223(b)(3)(A).
⁹⁰ I.R.C. §223(b)(3)(B).
⁹¹ I.R.C. §223(b)(4)(A).

deduction.⁹² The aggregate amount paid for such taxable year to Archer MSAs of such individual is not a reduction with respect to any individual in the following paragraph.

- (iv) In the case of individuals who are married to each other, if either spouse has family coverage: both spouses are treated as having only such family coverage (and if such spouses each have family coverage under different plans, as having the family coverage with the lowest annual deductible)⁹³ and the monthly limitation (after the application of the reduction for aggregate contribution to Archer MSAs, and without regard to any additional contribution amount):
- Shall be reduced by the aggregate amount paid to Archer MSAs of such spouses for the taxable year; and
 - After such reduction, shall be divided equally between them unless they agree on a different division.
- (v) No deduction is allowed to any individual with respect to whom a deduction under §151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which such individual's taxable year begins.⁹⁴

Caution:

The limitation for any month with respect to an individual is **zero** for the first month such individual is entitled to benefits under Title XVIII of the Social Security Act and for each month thereafter.⁹⁵

- b. An “eligible individual” means, with respect to any month, any individual if such individual is covered under a high-deductible health plan as of the first day of such month, and such individual is not, while covered under a high-deductible health plan, covered under any health plan that is not a high-deductible health plan, and that provides coverage for any benefit that is covered under the high-deductible health plan.⁹⁶ The term “high-deductible health plan” means a health plan:⁹⁷ (i) that has an annual deductible that is not less than \$1,700⁹⁸ for self-only coverage, and twice that dollar amount for family coverage; and (ii) the sum of the annual deductible and the other annual out-of-pocket expenses required to be paid under the plan (other than for premiums) for covered benefits does not exceed \$8,500⁹⁹ for self-only coverage, and twice that dollar amount for family coverage. Such term **does not** include a health plan if substantially all of its coverage is permitted insurance or coverage (whether through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.¹⁰⁰ A plan does not fail to be treated as a high-deductible health plan by reason of failing to have a deductible for preventive care (within the meaning of §1871 of the Social Security Act).¹⁰¹
- c. Notice 2020-15 addressed the usage of High Deductible Health Plans (HDHPs) and HSAs in relation to COVID-19. An HSA-eligible HDHP will not lose its HDHP status under §223(c)(2)(A) if it covers costs for COVID-19 testing and treatment before plan deductibles are met. An individual with an HDHP that covers COVID-19 costs can

⁹² I.R.C. §223(b)(4)(B).

⁹³ I.R.C. §223(b)(5)(A).

⁹⁴ I.R.C. §223(b)(6).

⁹⁵ I.R.C. §223(b)(7).

⁹⁶ I.R.C. §223(c)(1)(A).

⁹⁷ I.R.C. §223(c)(2)(A).

⁹⁸ Rev. Proc. 2024-25.

⁹⁹ Rev. Proc. 2024-25.

¹⁰⁰ I.R.C. §223(c)(2)(B).

¹⁰¹ I.R.C. §223(c)(2)(C).

continue to contribute to an HSA. The intent of this notice is to eliminate financial and administrative barriers to COVID-19 testing and treatment.

The OBBBA introduced significant updates to HSAs, primarily focused on expanding eligibility and modernizing how funds can be used. Beginning January 1, 2026, all Bronze and Catastrophic health plans available through ACA Exchanges are officially classified as HSA-compatible HDHPs. This change makes more people eligible to contribute to an HSA, including individuals who previously could not because their plan did not meet the strict HDHP definition. Notice 2026-05 further clarifies that these plans do not necessarily have to be purchased through an Exchange to qualify.

Further, the OBBBA made permanent the ability for HDHPs to offer telehealth and remote care services before the deductible is met without disqualifying the user from HSA contributions. This change is effective for plan years beginning on or after January 1, 2025.

Additionally, beginning January 1, 2026, individuals enrolled in certain Direct Primary Care Service Arrangements (DPCSAs) can contribute to an HSA without it being considered disqualifying "other coverage." Under the OBBBA, monthly DPC fees are considered qualified medical expenses, allowing them to be paid or reimbursed tax-free from an HSA.

Q. Other

1. Tax benefits effective for individuals

- a. The deductible limit for health insurance premiums for self-employed taxpayers in 2026 is the lesser of 100 percent of the premium or the earned income derived by the taxpayer from the trade or business with respect to which the plan providing the medical-care coverage is established.
- b. The exclusion for foreign-earned income is \$132,900 in 2026.
 - (i) Under the new law, the base housing amount used in calculating the foreign housing cost exclusion in a taxable year is 16 percent of the amount (computed on a daily basis) of the foreign-earned-income exclusion limitation (instead of the present-law 16 percent of the grade GS-14, step 1 amount), multiplied by the number of days of foreign residence or presence (as previously described) in that year.
 - (ii) Reasonable foreign-housing expenses in excess of the base housing amount remain excluded from gross income (or, if paid by the taxpayer, are deductible), **but** the amount of the exclusion is limited to 30 percent of the maximum amount of a taxpayer's foreign-earned-income exclusion. Under the 30-percent rule, the maximum amount of the foreign-housing-cost exclusion in 2026 is (assuming foreign residence or presence on all days in the year) \$18,606 ($(\$132,900 \times 30 \text{ percent}) - (\$132,900 \times 16 \text{ percent})$).

Caution:

In a major change in calculating income tax, if an individual excludes an amount from income under §911, any income in excess of the exclusion amount determined under §911 is taxed (under the regular tax and alternative minimum tax) by applying to that income the tax rates that would have been applicable had the individual not elected the §911 exclusion.

The Service has issued a notice that uses a higher daily rate for certain higher-priced foreign localities that is taken into account in determining the 30-percent multiplier.¹⁰²

Example: An individual with \$132,900 of foreign-earned income that is excluded under §911 and with \$20,000 in other taxable income (after deductions) would be subject to tax on that \$20,000 at the rate or rates applicable to taxable income in the range of \$132,900 to \$152,900.

- c. In order for taxpayers in 2026 having adjusted gross income in excess of \$150,000 in 2025 to avoid estimated tax penalties, estimated tax payments must be at least 110 percent of the 2024 tax liability.
- d. The Disaster Act, passed on December 20, 2019 as part of the 2020 year-end spending package, amends IRC §213(f) and provides for a reduction in the medical expense deduction floor from 10% to 7.5%. Individuals were eligible to claim an itemized deduction for unreimbursed medical expenses to the extent that the expenses exceeded 7.5% of AGI for tax years beginning after December 31, 2018 and before January 1, 2021. The Consolidated Appropriations Act of 2021 makes the 7.5-percent-of-AGI threshold for the medical expense deduction floor permanent for itemizers claiming unreimbursed medical expenses. This provision is applicable for tax years beginning after December 31, 2020.

2. Interest rates for second quarter of 2026

The IRS has announced that the interest rates for the quarter beginning April 1, 2026, are 6 percent for overpayments (5 percent for a corporation), 6 percent for underpayments (noncorporate taxpayers and corporations), 8 percent for large corporate underpayments, and 3.5 percent for the portion of a corporate overpayment exceeding \$10,000.¹⁰³

Note:

For taxpayers other than corporations, the overpayment and underpayment rate is the federal short-term rate plus 3 percentage points. Generally, in the case of a corporation, the underpayment rate is the federal short-term rate plus 3 percentage points and the overpayment rate is the federal short-term rate plus 2 percentage points. The rate for large corporate underpayments is the federal short-term rate plus 5 percentage points. The rate on the portion of a corporate overpayment of tax exceeding \$10,000 for a taxable period is the federal short-term rate plus one-half of a percentage point.

¹⁰² Notice 2007-77; 2007-40 I.R.B. 1.

¹⁰³ <https://www.irs.gov/payments/quarterly-interest-rates>.

3. FUTA surtax reduced

Unemployment insurance (UI) is financed by a combination of state and federal taxes on employers based on the wages of each employee. The Federal Unemployment Tax Act (FUTA) had imposed a federal payroll tax on employers of 6.2 percent of the first \$7,000 paid annually to each employee. The tax funds a portion of the federal/state unemployment benefits system. This 6.2-percent rate included a temporary (set in 1985 and extended thereafter) surtax of 0.2 percent. Employers in states that meet certain federal requirements were allowed a credit for state unemployment taxes of up to 5.4 percent, making the minimum net federal tax rate 0.8 percent. The surtax has expired, and the minimum net federal tax rate is now 0.6 percent.

4. Section 448(c)(1) gross receipts limitation

The gross receipts limitation of §448(c)(1) increases to \$32,000,000 in 2026. Section 448(c)'s primary purpose has been to limit the ability of C corporations to use the cash method of accounting.

C corporations may use the cash method of accounting if their average gross receipts for the prior three years do not exceed the §448(c)(1) amount. However, the TCJA and OBBBA references the §448(c) limit for other purposes. Some impacted code sections include:

- a. **Section 163(j) business interest limitation:** Businesses are not subject to the business interest limitation if they meet the gross receipts test of §448(c).¹⁰⁴
- b. **Section 263A capitalization rules:** A business is exempt from the §263A Unicap rules if it meets the gross receipts test of §448(c).¹⁰⁵
- c. **Section 460 accounting for long-term contracts:** A contractor that meets the gross receipts test of §448(c) may use the completed contract method to account for contracts if the taxpayer and contracts qualify under the provisions of §460.¹⁰⁶
- d. **Section 471 inventory requirement:** A business is not required to follow the inventory rules of §471 if they meet the gross receipts test of §448(c). They may instead treat inventories in a manner consistent with applicable financial statements or as non-essential materials and supplies. This means that businesses who were required to use the accrual method of accounting in the past because they had inventories and their gross receipts exceeded \$1,000,000 may now use the cash method of accounting and change their inventory method.¹⁰⁷

5. Educator expense deduction

The Educator Expense deduction was originally enacted in 2002, allowing teachers and other eligible educators to deduct up to \$250 of out-of-pocket classroom expenses (\$500 if married filing jointly and both spouses are eligible educators, but not more than \$250 each). An individual is considered an eligible educator if, for the tax year, he or she is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide for at least 900 hours a school year in a school that provides elementary or secondary education as determined under state law. Qualified expenses for purposes of the Educator Expense deduction include amounts paid or incurred for participation in professional development courses, books, supplies, computer equipment, and supplementary materials used in the classroom. Additionally, qualified expenses include amounts spent on PPE, disinfectant, or supplies used to prevent the spread of the COVID-19 virus. In order to be eligible for the Educator Expense deduction, the expenses must be paid or incurred during the tax year.

¹⁰⁴ I.R.C. §163(j)(3).

¹⁰⁵ I.R.C. §263A(i).

¹⁰⁶ I.R.C. §460(e)(1)(B)(ii).

¹⁰⁷ I.R.C. §471(c)(1).

For the first time since 2002, the IRS increased the maximum Educator Expense deduction from \$250 to \$300 in 2022, remaining at this level through 2025. In 2026, the amount further increased to \$350. As a result, in 2026, an eligible educator can deduct up to \$350 of qualifying expenses (\$700 if married filing jointly and both spouses are eligible educators, but not more than \$350 each). The limit will rise in \$50 increments in future years based on inflation adjustments.

6. Excess Business Loss Threshold

For taxable years beginning in 2026, the excess business loss thresholds are as follows:

Filing Status	2026 Threshold Amount
Joint filers	\$512,000
Other returns	\$256,000

As discussed, the OBBBA makes the excess business loss limitation permanent. Previously scheduled to expire, as a result of the OBBBA, this limitation is now a permanent fixture of the tax code. As shown in the table above, beginning in tax year 2026, the OBBBA changes the "indexing year" used to calculate inflation adjustments. This results in lower threshold amounts for 2026 compared to 2025.

R. Retirement plan 2026 numbers¹⁰⁸

1. Maximum annual benefit

The maximum single-life annuity for a defined-benefit plan in 2026 is \$290,000, increased from \$280,000 in 2025.

2. Maximum annual addition

The maximum annual addition to a defined-contribution plan in 2026 is \$72,000, increased from \$70,000 in 2025.

3. Maximum compensation considered

The maximum amount of compensation that can be taken into account under any qualified plan allocation or benefit formula in 2026 is \$360,000, increased from \$350,000 in 2025.

¹⁰⁸ Retirement plan numbers updated by IRS Notice 2025-67.

Note:

Generalizations with respect to a defined-benefit plan are more difficult, as the contributions not only depend on compensation level but also the age of the participant and the number of years before the normal retirement age under the plan when the benefits must be fully funded. If the benefit formula is a fixed amount (\$3,000 per month), the change in the limit has no effect. If the formula is a unit benefit type, where the benefit that is earned each year is based solely on the compensation for that year, the change in the maximum will require marginally more funding in all succeeding years for the highly compensated employee. The most interesting and potentially most expensive case is where the benefit formula is based on some percentage of a career-high average. As the higher compensation is taken into account, it not only increases the funding requirement for the current year, but generates in effect liabilities in respect of past years. Quantifying the effect for budgeting purposes requires the services of an actuary. Again, while the effect may be to require a higher funding level for the highly compensated to the extent there is an increased benefit, now is the time to have the additional costs determined so as to choose whether to continue the plan as is, or reduce, in respect of future years, the benefit formula.

Note:

Qualified retirement-planning services provided to an employee and his or her spouse by an employer maintaining a qualified plan after December 31, 2001 are excludable from income and wages without regard to the requirements of an education-assistance program or fringe benefit. "Qualified retirement-planning services" are retirement-planning advice and information. The exclusion is not limited to information regarding the qualified plan, and thus, for example, applies to advice and information regarding retirement-income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement-income plan.

Caution:

On the other hand, the exclusion does not apply to services that may be related to retirement planning, such as tax-preparation, accounting, legal, or brokerage services.

The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees that is normally provided education and information regarding the employer's qualified plan. It is intended that the treatment of retirement advice will be provided in a nondiscriminatory manner. It is intended that, in determining the application of the exclusion to highly compensated employees, the Service may permit employers to take into consideration employee circumstances other than compensation and position in providing advice to classifications of employees. Thus, for example, the Secretary may permit employers to limit certain advice to individuals nearing retirement age under the plan.

4. SIMPLE deferral maximum

The maximum amount of deferral in a SIMPLE plan in 2026 is \$17,000, increased from \$16,500 in 2025.

Table 1 -- SIMPLE Deferral Limits

For year beginning in calendar year:	The applicable dollar amount:
2026	\$17,000

Table 2 -- Catch-Up Elective Deferrals for SIMPLE and SIMPLE-401(k) Plans

For taxable years beginning in:	The applicable dollar amount is:
2026	\$4,000

Under a SIMPLE plan, an employer is generally required to make a contribution on behalf of each eligible employee in an amount equal to the employee's salary-reduction contributions, up to a limit of three percent of the employee's compensation for the entire calendar year.¹⁰⁹

Note:

For the business owner concerned about the maximum tax-shelter potential of the SIMPLE, note that the maximum matching contribution for an individual with \$550,000 of compensation or more is \$17,000. A \$17,000 salary deferral, plus the \$17,000 match, results in a maximum contribution of \$34,000. Above \$550,000 in compensation, the match cannot exceed \$17,000. If the participant earns less than \$550,000, the maximum contribution is less. For example, a person with compensation of \$150,000 is eligible for the matching contribution of \$4,500 (three percent of \$150,000). The table below identifies the maximum contribution for individuals at various salary levels.

In 2025:

Maximum SIMPLE IRA Contribution			
Salary	Maximum salary deferral	Matching contribution	Total contribution
\$50,000	\$17,000	\$1,500	\$18,500
\$75,000	\$17,000	\$2,250	\$19,250
\$100,000	\$17,000	\$3,000	\$20,000
\$125,000	\$17,000	\$3,750	\$20,750
\$150,000	\$17,000	\$4,500	\$21,500
\$160,000	\$17,000	\$4,800	\$21,800
\$175,000	\$17,000	\$5,250	\$22,250
\$566,667 or more	\$17,000	\$17,000	\$34,000

5. SEP minimum compensation

The threshold level of compensation at which an employer must cover an employee in a SEP in 2026 increases to \$800.

- a. If an employer establishes and maintains an individual retirement account or annuity that qualifies as a SEP, the maximum amount that the employer may contribute is the lesser of \$72,000 in 2026 or 25 percent of the employee's compensation.¹¹⁰ An employee for whom an employer contributes under a SEP is allowed a deduction for the employee's contributions to an IRA subject to the phaseout rule for active participants.
- b. Generally, any employee is protected from current tax only if the employer's contribution does not exceed the lesser of 25 percent of the employee's compensation from that employer or \$72,000 in 2026.

Example: Corporation Q has established a SEP arrangement for the benefit of its eligible employees. Employee A earns \$100,000 in compensation from Q in 2026. For 2026, the most Q can contribute to the SEP of A (without causing tax to A) is \$25,000 (25 percent of \$100,000). Twenty-five percent of A's compensation is less than \$70,000, so this is the applicable prong of the two-part limitation. Note that for purposes of calculating 25 percent of the employee's compensation, the employer's contribution to the employee's SEP is ignored. Thus, the limitation for Q is 25 percent of \$100,000, not 25 percent of \$125,000.

¹⁰⁹ I.R.C. §§408(p)(2)(A)(iii) and (C)(ii)(I). See Notice 98-4, 1998-2 I.R.B. 25, Q&A, D-4.

¹¹⁰ For the self-employed person, compensation means earned income as reduced for other contributions. I.R.C. §408(k)(7)(B). This is further reduced by the deduction for self-employment taxes.

- c. If an employer contributes more than the lesser of 25 percent of compensation or \$72,000 in 2026 to the SEP of an employee, the amount in excess of that limitation is treated as an excess contribution by the employee to an IRA. On or before the due date for filing the employee's tax return (including extensions), the employee should withdraw the amount of the excess and any income on that amount. The employee thus would avoid a six-percent excise tax on the excess contribution, but must pay tax on the amount of the contribution that exceeds the limitation.

6. Maximum elective deferral

The maximum amount of deferral in a §401(k) plan or §403(b) plan in 2026 is \$24,500, increased from \$23,500 in 2025.

Elective deferrals increase to the applicable amount in accordance with the following schedule.

Table 3 -- Elective-Deferral Limits

For taxable years beginning in calendar year:	The applicable dollar amount is:
2026	\$24,500

A qualified plan may now allow additional elective deferrals to be made to the plan by a participant who attains the age of 50 before the end of the plan year.

Table 4 -- Catch-Up Elective Deferrals for §401(k) and Other Qualified Plans

For taxable years beginning in:	The applicable dollar amount is:
2026	\$8,000

The additional elective deferrals are generally not taken into account under the actual deferral percentage (ADP) or other limitations on such contributions. The applicable dollar amount increases in the cost of living at the same time and in the same manner as adjustments for annual benefits and additions, except that the base period taken into account is the calendar quarter beginning July 1, 2005, and any increase that is not a multiple of \$500 is rounded to the next lower multiple of \$500.

Note:

Since elective deferrals generally represent amounts the employer would have deducted under §162 for reasonable compensation but for the preemptive effect of §404 with respect to amounts contributed to a qualified plan, the elective-deferral component of the contribution is deducted as compensation rather than as a contribution.

Planning point:

Elective deferrals remain an annual addition, but the amount subject to the 25-percent-of-compensation limitation does not include them, but only the matching and any other nonelective employer contributions. Subject to any other limitations (such as the annual-additions limitation), an employee may defer 100 percent of current salary **and** the employer may deduct not only the amount so deferred by the employee but also up to 25 percent of the total participant compensation for the year for other contributions.

Planning point:

One of the major motivations for the use of a money-purchase pension plan rather than a profit-sharing plan lay in the enhanced deductibility of contributions up to 25 percent of total compensation to “fully fund” the annual additions. The disadvantage of a money-purchase pension plan is that as a pension plan, the formula for contributions is fixed and creates an annual liability much as a defined-benefit plan does. The change in the deductibility of contributions to a profit-sharing plan puts the future of the money-purchase plan in some doubt, as the enhanced deductibility and the annual-additions limitation can now be met by a profit-sharing plan that does not commit the employer to any specific level of contributions annually.

7. Highly compensated employee

The minimum compensation of an employee owning less than five percent of the stock of the employer to be treated as a highly compensated employee is \$160,000 in 2026, remaining the same as \$160,000 in 2025.

8. Self-employed persons

- a. The §401(k) plan is essentially a profit-sharing plan with elective deferrals. The following worksheet assumes that the employer’s contributions are allocated to each participant’s account in accordance with compensation, i.e., the plan is not age-weighted or otherwise cross-tested.
- b. Since the base of contributions to a SEP is earned income, the following worksheet is necessary to determine the contribution to a SEP on behalf of that self-employed person.

In 2026:

1. Nominal plan stated rate	
2. Add “1” to Step (1)	
3. Self-employed rate Step 1/Step 2	
4. Net earnings (Line 31, Sch. C; Line 34, Sch. F; Box 14, code A, Schedule K-1)	
5. Self-employment income Step (4) x 0.9235)	
6. Taxable wage base	
7. Lesser of Step (5) or Step (6)	
8. Step (7) x 0.124	
9. Step (5) x 0.029	
10. Total self-employment tax Step (8) plus Step (9)	
11. Self-employment tax deduction Step (8) x 0.5 + .5 x Step (9)	
12. Earned income Step (4) – Step (11)	
13. Nominal contribution Step (12) x Step (3)	
14. \$366,667 x Step (3)	
15. Maximum dollar annual addition	
16. Lesser of Step (14) and Step (15)	
17. Maximum deductible contribution lesser of Step (13) and Step (16)	
18. Elective deferral	
19. Catch-up contribution†	
20. Total maximum contribution (Step (17) + Step (18) + Step (19)	

† Only available to SARSEPS in place as of December 31, 1996. All other SEPS stop at line 17.

- c. The contribution level for self-employed persons in a SIMPLE plan depends on the net earnings from self-employment. Remember, neither the §415 nor the compensation limitations generally apply.

1. Net earnings (Line 31, Schedule C; Line 34, Sch. F; Box 14, code A, Schedule K-1)	
2. Self-employment income Step (1) x 0.9235)	
3. Contribution rate	
4. Contribution Step (2) x Step (3)	
5. Elective deferral	
6. Total contribution sum of Step (4) and Step (5)	
7. Catch-up contribution	
8. Total contributions Step (6) and Step (7)	

To obtain the maximum contribution to a SIMPLE, the self-employed person must have bottom-line Schedule C income of at least \$613,608.

1. Net earnings (Line 31, Schedule C; Line 34, Sch. F; Box 14, code A, Schedule K-1)	\$613,608
2. Self-employment income Step (1) x 0.9235)	\$566,667
3. Contribution rate	0.03
4. Contribution Step (2) x Step (3)	\$17,000
5. Elective deferral	\$17,000
6. Total contribution Sum of Step (4) and Step (5)	\$34,000
7. Catch-up contribution	\$4,000
8. Total contributions Step (6) and Step (7)	\$38,000

Representative Table of Maximum SIMPLE contributions

Schedule C	Employer contribution	Elective deferral	Under-50 Maximum	Catch-up (Over-50)	Over-50 Maximum	Catch-up (Age 60–63)	Age 60-63 Maximum
\$50,000	\$1,500	\$17,000	\$18,500	\$4,000	\$22,500	\$5,250	\$23,750
\$100,000	\$3,000	\$17,000	\$20,000	\$4,000	\$24,000	\$5,250	\$25,250
\$150,000	\$4,500	\$17,000	\$21,500	\$4,000	\$25,500	\$5,250	\$26,750
\$200,000	\$6,000	\$17,000	\$23,000	\$4,000	\$27,000	\$5,250	\$28,250
\$250,000	\$7,500	\$17,000	\$24,500	\$4,000	\$28,500	\$5,250	\$29,750

9. IRAs

An IRA (other than SEP or SIMPLE) cannot accept more than \$7,500 (\$8,600 if age 50 or older) in contributions for any taxable year (not including rollover amounts) in 2026 (increasing from same as \$7,500, or \$8,500, if age 50 or older in 2025).¹¹¹ This limit applies to both regular and Roth IRAs, but the annual contribution limit may be divided between such IRAs as the owner may determine. In certain circumstances, a married individual may make IRA contributions of more than \$7,500 (\$8,600 if age 50 or older) per taxable year. The contributions must be made to a combination of the married individual's own IRA and the nonworking spouse's IRA, because neither IRA is permitted to receive more than \$7,500 (\$8,600 if age 50 or older) in contributions per taxable year (excluding rollover contributions).

- a. An IRA owner may never deduct more than the lesser of \$7,500 (\$8,600 if age 50 or older) or taxable compensation.¹¹² This amount may be further limited if the IRA owner or the owner's spouse is an "active participant" in an employer-sponsored retirement plan.
- b. In 2026, the deductibility of contributions to regular IRAs for active participants is phased out in a pro rata fashion over the applicable phaseout range of AGI. For example, if the applicable phaseout range of AGI is \$81,000 to \$91,000, a taxpayer with AGI of \$86,000 who actively participates in a qualified plan would be permitted to contribute \$7,500 to an

¹¹¹ I.R.C. §408(o)(2); Notice 2024-80.

¹¹² I.R.C. §219(b)(1).

IRA, but would only be permitted to deduct \$3,750 of that 7,500 contribution. The remaining \$3,750 (0.5 of \$7,500) would be a nondeductible contribution.

- c. **AGI phaseout ranges** -- The phaseout range depends upon filing status and the year in which the contribution is made.

Taxable years beginning in:	Joint returns phaseout range	Single taxpayers phaseout range
2026	\$129,000 - \$149,000	\$81,000 - \$91,000

- d. The maximum deductible IRA contribution for an individual who is not an active participant, but whose spouse is, is phased out for taxpayers with AGI between \$242,000 and \$252,000 in 2026.
- e. For 2026, the dollar amount an individual who is not married may contribute to a Roth IRA is phased out ratably between modified AGI of \$153,000 and \$168,000; for a married individual filing a joint return, between modified AGI of \$242,000 and \$252,000 and for a married individual filing separately, between modified AGI of \$0 and \$10,000.