

2025

Corporate
and
Business
Income Tax
Workshop

BY

Nick Preusch, CPA

COPYRIGHT ©2025
Don Farmer Tax
Education
4309 Cox Road
Glen Allen, VA 23060

**Don
Farmer**
Tax Education

**2025 CORPORATE AND BUSINESS
INCOME TAX WORKSHOP**

BY

NICK PREUSCH, CPA

PROPERTY OF

**COPYRIGHT ©2025 BY DON FARMER
P. O. BOX 1858
LENOIR, N. C. 28645**

PREFACE

This course is designed for the general practitioner and the CPA in industry. The purpose of the material is to review key corporate and business federal income tax provisions of importance to CPAs.

We have not attempted to cover all the provisions affecting corporations and other businesses. Therefore, many provisions of the internal revenue code have been omitted.

The material discussed in this manual provides general information. Before taking any action, the appropriate regulations, cases and rulings should be examined.

Note! Law changes in the form of statute changes, new regulations, IRS releases and court decisions are occurring at an unprecedented pace. Therefore, do not use these materials as reference material without researching new developments.

DISCLAIMER

This manual and the related lecture are designed to provide accurate and authoritative information about complex areas of tax law. The information contained in this manual may change as a result of new tax legislation, U.S. Treasury Department regulations, U.S. Internal Revenue Service (IRS) interpretations, or Judicial interpretations of existing tax law. This manual is not intended to provide legal, accounting, or other professional services, and is provided with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services.

This manual and related lecture should not be used as a substitute for professional advice. If legal advice or other expert assistance is required, the services of a competent tax advisor should be sought.

Note: The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

THIS MATERIAL WAS FINALIZED ON OCT. 1, 2025. PLEASE CONSULT THE PDF HANDOUT FOR SELECTED DEVELOPMENTS AFTER OCT. 1, 2025.

TABLE OF CONTENTS

INDEXED ITEMS, ETC.....	4
SELECTED PROVISIONS SCHEDULED TO EXPIRE OR BE REDUCED	13
DISASTER RELIEF	16
OTHER PRACTICE DEVELOPMENTS.....	21
ONE BIG BEAUTIFUL BILL: BUSINESS PROVISIONS	33
ONE BIG BEAUTIFUL BILL: INTERNATIONAL PROVISIONS	58
ONE BIG BEAUTIFUL BILL: PROVISIONS BY YEAR.....	61
ONE BIG BEAUTIFUL BILL: ENERGY CREDITS AND DEDUCTIONS.....	67
OTHER RECENT CHANGES.....	69
PROPERTY TRANSACTIONS (INCLUDING PURCHASE AND SALE OF CLOSELY-HELD BUSINESSES).....	75
TRAVEL, MEALS, AND ENTERTAINMENT	93
COMPARISONS OF §179 DEDUCTION AND 100% §168(k) BONUS DEPRECIATION	107
PARTNERSHIPS AND S CORPORATIONS ELECTING TO PAY STATE AND LOCAL TAXES AT ENTITY LEVEL	113
CHECK THE BOX RULES	116
§199A REFRESHER	122

INDEXED ITEMS, ETC.

Table 1 — Married Filing Jointly & Surviving Spouses (Section 1(j)(2)(A)):

Tax Rate Taxable Income (MFJ/Surviving Spouse)

10%	\$0 – \$23,850
12%	\$23,851 – \$96,950
22%	\$96,951 – \$206,700
24%	\$206,701 – \$394,600
32%	\$394,601 – \$501,050
35%	\$501,051 – \$751,600
37%	Over \$751,600

Table 2 — Heads of Household (Section 1(j)(2)(B)):

Tax Rate Taxable Income (Head of Household)

10%	\$0 – \$17,000
12%	\$17,001 – \$64,850
22%	\$64,851 – \$103,350
24%	\$103,351 – \$197,300
32%	\$197,301 – \$250,500
35%	\$250,501 – \$626,350
37%	Over \$626,350

Table 3 — Unmarried Individuals (Single) (Section 1(j)(2)(C)):

Tax Rate Taxable Income (Single)

10%	\$0 – \$11,925
12%	\$11,926 – \$48,475
22%	\$48,476 – \$103,350
24%	\$103,351 – \$197,300
32%	\$197,301 – \$250,525
35%	\$250,526 – \$626,350
37%	Over \$626,350

Table 4 — Married Filing Separately (Section 1(j)(2)(D)):

Tax Rate Taxable Income (Married Filing Separately)

10%	\$0 – \$11,925 (half of \$23,850)
12%	\$11,926 – \$48,475
22%	\$48,476 – \$103,350
24%	\$103,351 – \$197,300
32%	\$197,301 – \$250,525
35%	\$250,526 – \$375,800 (to top of 35% bracket)
37%	Over \$375,800

Note: All thresholds are half of the joint-filer amounts. Married-separate filers reach the 37% bracket at much lower income than singles (e.g. 37% begins at \$375,801 for MFS vs \$626,351 for single).

Table 5 — Estates & Trusts (Section 1(j)(2)€):

Tax Rate Taxable Income (Estates and Trusts)

10%	\$0 – \$ 3,250 (approx.)
24%	\$3,251 – \$ 10,450 (approx.)
35%	\$10,451 – \$ 15,650
37%	Over \$15,650

Note: Trusts and estates have only four brackets (10%, 24%, 35%, 37%). For 2025, 37% applies to fiduciary taxable income over **\$15,650**.

2025 Long-Term Capital Gains & Qualified Dividends Rates

Filing Status	0% Bracket (Income ≤)	15% Bracket (Income Between)	20% Bracket (Income >)
Single	\$48,350	\$48,351 – \$533,400	\$533,401+
Married Filing Jointly	\$96,700	\$96,701 – \$600,050	\$600,051+
Head of Household	\$64,750	\$64,751 – \$566,700	\$566,701+
Married Separately	Filing \$48,350	\$48,351 – \$300,000	\$300,001+

Net Investment Income Tax (NIIT) — IRC §1411

- Rate: 3.8%
- Base: Applies to the lesser of:
 1. Net Investment Income (NII), or
 2. The excess of Modified Adjusted Gross Income (MAGI) over the threshold amount.

Thresholds (Not Inflation-Adjusted):

- Married Filing Jointly & Surviving Spouse: \$250,000
- Married Filing Separately: \$125,000
- Single & Head of Household: \$200,000
- Qualifying Widow(er): Treated the same as Married Filing Jointly → \$250,000

Unlike ordinary tax brackets and capital gains/dividend thresholds, these NIIT thresholds never adjust for inflation — they've been the same since NIIT was enacted in 2013.

Additional Medicare Tax – IRC §3101(b)(2)

- **Rate: 0.9%**
- **Base:** Applies to **earned income** (wages or self-employment income) **above the threshold amount.**
- **Thresholds (Not Inflation-Adjusted):**
 - **Married Filing Jointly:** \$250,000
 - **Married Filing Separately:** \$125,000
 - **Single / Head of Household / Qualifying Widow(er):** \$200,000

Standard Deduction Amounts for 2025

- Married Filing Jointly / Surviving Spouse: \$31,500
- Head of Household: \$23,625
- Single or Married Filing Separately: \$15,750

Age-65+ Additional Standard Deduction

The additional standard deduction for seniors has been modestly increased for 2025:

- Single / Head of Household (age 65+): +\$2,000 (up from \$1,950 in 2024)
- Married Filing Jointly: \$1,600 per qualifying spouse (up from \$1,550)

New “Senior Bonus” Deduction (2025–2028)

A new, temporary provision provides further relief:

- Additional Deduction: Up to \$6,000 per senior (i.e., \$12,000 for couples where both spouses are 65+)
- Applies regardless of whether you itemize or not
- Phase-out thresholds:
 - Starts at \$75,000 MAGI for singles
 - Starts at \$150,000 MAGI for married filing jointly
 - Phases out fully by \$175,000 (single) / \$250,000 (joint)

Personal Exemption: Remains **\$0** — permanently repealed (except certain seniors’ provisions).

AMT Exemption Amounts for 2025

- Married Filing Jointly / Qualifying Surviving Spouse: \$137,000
- Single or Head of Household: \$88,100
- Married Filing Separately: \$68,650

AMT Exemption Phase-Out Details for 2025

Filing Status	Phase-out Begins at AMTI	Exemption Fully Phased Out at AMTI
Married Filing Jointly / QSS	\$1,252,700	\$1,800,700
Single / Head of Household	\$626,350	~\$978,750
Married Filing Separately	Same as Single (\$626,350)	~Same as Single (pro-rated)

AMT Tax Rates:

Filing Status	26% Bracket Range	28% Bracket Begins
MFJ, Single, HOH, QSS	AMTI ≤ \$220,700	> \$220,700
MFS	AMTI ≤ \$110,350	> \$110,350

Kiddie Tax:

First \$1,350 of a child’s unearned income (e.g., interest, dividends, capital gains) is **tax-free**—it qualifies as the child’s standard deduction.

The **next \$1,350** of unearned income is taxed at the **child’s own tax rate**.

Any amount over \$2,700 is taxed at the **parent’s tax rate**—the hallmark feature of the Kiddie Tax.

AMT Exemption for a Child Subject to Kiddie Tax

- When it comes to the AMT, a child subject to the Kiddie Tax is allowed a special exemption.
- That exemption is the lesser of:
 1. The regular AMT exemption for a single person (which is \$88,100 for 2025), or
 2. The child’s earned income plus \$9,550.

Deductions & Credits: Key 2025 Values

Long-Term Care Insurance Premiums (Deductible Medical Expense Limits, IRC §213(d))

Per-individual maximum deductible premiums by attained age at the close of the tax year:

- Age 40 or under: \$480
- Age 41–50: \$900
- Age 51–60: \$1,800
- Age 61–70: \$4,810
- Age 71 and older: \$6,020

U.S. Savings Bonds Interest Exclusion for Education (IRC §135)

Interest earned on Series EE or I U.S. savings bonds used for qualified higher education expenses may be excluded from taxable income, subject to MAGI phase-out thresholds in 2025:

- **Phase-out begins:**
 - \$149,250 for Married Filing Jointly
 - \$99,500 for Single, Head of Household (and others excluding MFS)
- **Fully phased out at:**
 - \$179,250 for Married Filing Jointly
 - \$114,500 for Single, HOH, and other non-joint filers

Note: Married Filing Separately filers are not eligible for this exclusion.

Student Loan Interest Deduction (§221): Maximum deductible interest = **\$2,500**. MAGI phase-out for deduction: **\$85,000 – \$100,000** (single) and **\$170,000 – \$200,000** (joint). (No deduction allowed above \$100k/\$200k MAGI.)

American Opportunity Tax Credit (AOTC): Maximum **\$2,500** per eligible student (40% refundable up to \$1,000). MAGI phase-out: **\$80,000 – \$90,000** (single) / **\$160,000 – \$180,000** (joint) – unchanged (not indexed).

Lifetime Learning Credit (LLC): Max **\$2,000** per return (20% of up to \$10k expenses). Same MAGI phase-out as AOTC: **\$80,000 – \$90,000** single / **\$160,000 – \$180,000** joint. (LLC remains nonrefundable.)

Educator “Above-the-Line” Deduction: \$300 for out-of-pocket classroom supplies (per eligible educator).

Qualified Transportation Fringe (Monthly Limits, §132(f))

- \$325 per month for transit passes or vanpooling (commuter transportation)
- \$325 per month for qualified parking

Child Tax Credit (CTC):

Credit Type	2025 Amount	Refundable	Phase-Out Threshold (MAGI)
Child Tax Credit (CTC)	\$2,200 per child	Up to \$1,700	Begins at \$200K (single/HOH), \$400K (joint)
Other Dependent Credit (ODC)	\$500 dependent	per No (nonrefundable)	Begins at same thresholds as CTC

Adoption Credit:

Parameter	2025 Details
Max Credit	\$17,280 per child
Refundable Portion	Up to \$5,000 (new for 2025 via OBBB)
Nonrefundable Portion	Remainder of credit; can carry forward 5 years
Phase-Out Begins (MAGI)	\$259,190
Phase-Out Ends (MAGI)	\$299,190

Individual Estimated Tax “Safe Harbor”: To avoid underpayment penalties, pay **100% of your 2024 tax liability** (or **110%** if 2024 AGI > \$150,000, or >\$75k MFS) **or at least 90% of your 2025 tax** by withholding/estimates.

Retirement & Savings Limits (2025)**Traditional IRA Contributions:**

Age	Contribution Limit Includes ...	
Under 50	\$7,000	Standard annual limit
Age 50 and over	\$8,000	\$7,000 + \$1,000 catch-up

(Catch-up contributions for IRAs remain \$1,000 and will be indexed in future years; 2025’s catch-up is \$1,000.)

Deductible IRA Income Phase-Outs: If taxpayer (or spouse) is an active participant in an employer plan, the traditional IRA deduction is phased out based on MAGI:

Scenario	Full Use if MAGI ≤	Partial Range	Phase-Out	No Benefit If MAGI >
Traditional IRA (Single/HOH, covered)	\$79,000	\$79k – \$89k		\$89,000
Traditional IRA (MFJ, participant)	\$126,000	\$126k – \$146k		\$146,000
Traditional IRA (MFJ, non-participant)	\$236,000	\$236k – \$246k		\$246,000
Roth IRA (Single/HOH)	\$150,000	\$150k – \$165k		\$165,000
Roth IRA (MFJ)	\$236,000	\$236k – \$246k		\$246,000

Annual Contribution Limit — Employer Plans:**401(k)/403(b)/457 Elective Deferrals**

Age Group	Employee Deferral	Catch-Up	Contribution Total (Max)
Under 50	\$23,500	—	\$23,500
Age 50–59 / 64+	\$23,500	\$7,500	\$31,000
Age 60–63	\$23,500	\$11,250	\$34,750

SIMPLE IRA Deferrals:

Age Group	Base Deferral	Catch-Up	Super Catch-Up	Total Limit
Under 50	\$16,500	—	—	\$16,500
Age 50–59 / 64+	\$16,500	\$3,500	—	\$20,000
Age 60–63	\$16,500	— (super applies instead)	\$5,250	\$21,750

Annual Addition Limit (Defined Contribution Plan §415(c)): \$70,000 total per participant (employee + employer contributions).

Annual Benefit Limit (Defined Benefit Plan §415(b)): \$280,000 of annual benefit can be funded (up from \$275k in 2024).

Compensation Cap for Plan Benefits (§401(a)(17)): \$350,000 – compensation above this cannot be counted for contributions/benefits (was \$345,000 in 2024).

“Highly Compensated Employee” Threshold (§414(q)): \$160,000 of prior-year compensation (up from \$155k) defines a highly compensated employee in 2025.

Health Accounts

Health Savings Accounts (2025):

Category	Self-Only Family	
HSA Contribution Limit	\$4,300	\$8,550
Age 55+ Catch-Up	+\$1,000	+\$1,000
Minimum HDHP Deductible	\$1,650	\$3,300
Max OOP (HDHP)	\$8,300	\$16,600

Archer Medical Savings Accounts (2025):

Coverage Type	Deductible Range	Out-of-Pocket Max
Self-Only	\$2,850 – \$4,300	\$5,700
Family	\$5,700 – \$8,550	\$10,500

Health FSAs (2025):

Feature	2025 Limit
Maximum Pre-Tax Contribution	\$3,300 per employee
Maximum Carryover to Next Year	\$660, if plan allows

QSEHRA (Small Employer HRA) Limits (2025):

For employers offering QSEHRA to employees in 2025:

- **Self-only coverage:** maximum \$6,350 per year (about \$529.16/month)
- **Family coverage:** maximum \$12,800 per year (about \$1,066.66/month)

Estate & Gift Tax Amounts (2025)

Estate and Gift Tax Rate: 40% top rate (unchanged).

Basic Exclusion Amount (Estate/Gift Unified Exemption): \$13,990,000 per individual. A married couple can shield \$27.98 million. (This is the unified credit *equivalent exclusion*, made permanent by the 2025 Act. It had been scheduled to drop after 2025.)

Unified Credit (Tax Value): This \$13.99M exclusion corresponds to roughly \$5.6 million of tax offset per person (i.e. the estate/gift tax credit that eliminates tax on \$13.99M at 40%).

Annual Gift Tax Exclusion: \$19,000 per donee (increased from \$17k in 2023, \$18k in 2024). Thus, a married couple can gift \$38,000 per recipient in 2025 with no gift tax filing.

Annual Exclusion for Gifts to Non-U.S.-Citizen Spouse: \$190,000 in 2025.

GST Tax Exemption: \$13,990,000 (same as estate exclusion; GST tax rate also 40%).

Special-Use Real Estate Valuation (2032A): \$1,420,000 — maximum reduction in estate value for qualified farm/business real property electing 2032A use-valuation.

Estate Tax Installment Payment (Sec. 6166) 2% Amount: \$1,900,000 — the limit on the taxable estate value eligible for the special 2% interest rate on installment payments.

Note: The estate/gift unified exclusion remains \$13.99M through 2025 and is indexed. Absent further law changes, it will revert to about ~\$7M in 2026.

Social Security & Payroll Taxes

Social Security Wage Base (OASDI 12.4% tax):

Category	2025 Amount
Social Security Wage Base	\$176,100
OASDI Tax Rate	12.4% (6.2% + 6.2%)
Max OASDI Tax per Person	\$10,918.20
Medicare Tax	1.45% on all earnings (no cap)

Medicare 2.9% tax has *no* wage limit (all earnings are subject to Medicare). Combined FICA rate = **15.3%** on earnings up to \$176,100 (then 2.9% Medicare thereafter). *High earners* also owe the 0.9% additional Medicare tax on wages/SE income over \$250k (joint) / \$200k (single), as noted above.

Depreciation & §280F Auto Limits

Tax Year	With Bonus Depreciation	Without Bonus Depreciation
1st Year	\$20,200	\$12,200
2nd Year	\$19,600	\$19,600
3rd Year	\$11,800	\$11,800
Later Years	\$7,060	\$7,060

§280F Lease Inclusion Amounts (2025 leases): If a passenger automobile is leased in 2025, the taxpayer must include a small amount in income each year to partially offset the lease deduction (instead of depreciation limits). The IRS provides a table (Rev. Proc. 2025-16, Table 3) of inclusion amounts based on the vehicle's FMV. (For example, a 2025 leased car with FMV ~\$60,000 has a first-year inclusion around \$10.)

Section 179 Expensing (Tax Years *Beginning* in 2025):

Feature	2025 Limit / Details
Section 179 Max Deduction	\$2,500,000
Phase-Out Begins	\$4,000,000 in total asset purchases
Phase-Out Completion	Fully phased out at \$6,500,000 in purchase volume
Heavy SUV Cap (6–14k lb)	\$31,300

Bonus Depreciation:

100% bonus depreciation is available for property placed in service in 2025, effective **1/20/25** with the signing of the 2025 Act.

Without this law change, the rate would have dropped to **40%** in 2025 under the TCJA schedule.

Standard Mileage Rates (2024–2025)

2024 vs 2025 Standard Mileage Rates

Category	2024 Rate	2025 Rate	Special Notes
Business Use	67¢ per mile (30¢ depreciation component)	70¢ per mile (33¢ depreciation component)	Standard mileage method allowed for ≤4 vehicles used simultaneously; if 5+ vehicles, must use actual expenses. Depreciation portion reduces basis and may be subject to recapture if switching methods or on sale.
Medical Moving (active-duty military)	22¢ per mile	21¢ per mile	Moving expenses deductible only for active-duty military relocating under orders.
Charitable Service	14¢ per mile	14¢ per mile (unchanged, statutory)	Rate fixed by statute; not indexed for inflation.

Failure to File Partnership or S-Corp Return (Forms 1065/1120-S):

Tax Year (Return Filed)	Penalty per Partner/Shareholder, per Month (or part of a month)
2024 returns (due in 2025)	\$245
2025 returns (filed in 2026)	\$255

Example: A 10-partner partnership 2 months late incurs $\$255 \times 10 \times 2 = \$5,100$ penalty.

Failure to File Information Returns (e.g. Forms 1099)

Penalty per Form/Statement 2024 Returns (filed 2025) 2025 Returns (filed 2026)

Up to 30 days late	\$60	\$60
31 days late through August 1	\$120	\$130
After August 1 or not filed	\$310	\$330
Intentional disregard	\$630	\$660

Maximum Annual Penalties (per IRS §6721/§6722)

Penalty Tier	Small Businesses (< \$5M gross receipts)	Large Businesses (≥ \$5M gross receipts)
Up to 30 Days Late	\$1,366,000	\$4,098,500
31 Days Late to Aug. 1	— (implicitly the same code)	— (implicitly the same code)
After Aug. 1 or Not Filed	Same caps as above (tier structure applies)	Same caps as above (tier structure applies)

Failure to File Individual Tax Return (Form 1040): The usual penalty is **5% of the tax due** per month late (to max 25%). The **failure-to-pay** penalty is 0.5% per month. These can stack, so a return filed over 5 months late with unpaid tax can incur up to $25\% + 2.5\% = 27.5\%$ in penalties, plus interest.

199A Qualified Business Income Deduction (QBI) Thresholds (2025)

Filing Status	Threshold Deduction)	(Full Phase-In Range	SSTB Deduction Phase-Out
Married Jointly	Filing ≤ \$394,600	\$394,600 → \$494,600 (range: Fully \$100k)	disallowed above \$494,600
Single Filers / Other	≤ \$197,300	\$197,300 → \$247,300 (range: Fully \$50k)	disallowed above \$247,300

Small Business Gross Receipts Test

Many tax provisions (interest deduction limits, UNICAP inventory rules, use of cash accounting, etc.) exempt “small” businesses under §448(c). For **2025**, a business qualifies if average annual gross receipts for the prior 3 years ≤ **\$31,000,000**. (This threshold was \$29 million for 2024.) Businesses under this limit can use the cash method, avoid §163(j) interest caps, and are exempt from uniform capitalization rules, among other benefits.

SELECTED FEDERAL INCOME TAX PROVISIONS SCHEDULED TO EXPIRE AFTER 2025

(According to Joint Committee on Taxation, [JCX-1-25](#), Jan. 9, 2025)

1. Modification of individual income tax rates (§ 1(j)). **Made permanent and modified by P.L. 119-21.**
2. Child tax credit: Increased credit amount, increased refundable amount, reduced earned income threshold, and modification of identification requirements (§ 24(h)). **Made permanent and modified by P.L. 119-21.**
3. Premium assistance credit enhancements (§§ 36B(b)(3)(A)(iii) and (c)(1)(E)). **EXPIRES.**
4. New markets tax credit (§ 45D(f)(1)). **Made permanent and modified by P.L. 119-21.**
5. Employer credit for paid family and medical leave (§ 45S(i)). **Made permanent and modified by P.L. 119-21.**
6. Work opportunity credit (§ 51(c)(4)). **EXPIRES.**
7. Increase in exemption amount and phaseout threshold of individual AMT (§ 55(d)(4)). **Made permanent and modified by P.L. 119-21.**
8. Rate on modified taxable income and treatment of credits in the calculation of base erosion minimum tax amount (§ 59A(b)(2)). **Modified by P.L. 119-21.**
9. Increase in standard deduction of individuals (§ 63(c)(7)). **Made permanent and modified by P.L. 119-21.**
10. Suspension of deduction for miscellaneous itemized deductions in excess of 2% of AGI (§ 67(g)). **Made permanent and modified by P.L. 119-21.**
11. Suspension of limitation on itemized deductions (Pease limitation) (§ 68(f)). **Made permanent and modified by P.L. 119-21.**
12. Exclusion from gross income of discharge of indebtedness on principal residence (§ 108(a)(1)(E)). **EXPIRES.**
13. Special rule for certain discharges of student loans (§ 108(f)(5)). **Made permanent and modified by P.L. 119-21.**
14. Exclusion for certain employer payments of student loans (§ 127(c)(1)(B)). **Made permanent and modified by P.L. 119-21.**
15. Suspension of exclusion for employer reimbursement of bicycle commuting (§ 132(f)(8)). **Made permanent by P.L. 119-21.**
16. Suspension of exclusion for moving expense reimbursement (§ 132(g)(2)) and deduction for moving expenses (§ 217(k)). **Made permanent and modified by P.L. 119-21.**

17. Suspension of deduction for personal exemptions (§ 151(d)(5)). **Made permanent and modified by P.L. 119-21.**
18. Limitation on deduction for qualified residence interest and suspension of deduction for home equity interest (sec. 163(h)(3)(F)). **Made permanent by P.L. 119-21.**
19. Limitation on deduction for State, local, etc., taxes (§ 164(b)(6)). **Made permanent and modified by P.L. 119-21.**
20. Modification of rules relating to computation of wagering losses (§ 164(b)(6)). **Made permanent and modified by P.L. 119-21.**
21. Personal casualty losses limited to losses from a Federally declared disaster (§ 165(h)(5)). **Made permanent and modified by P.L. 119-21.**
22. Seven-year recovery period for motorsports entertainment complexes (§§ 168(e)(3)(C)(ii) and (i)(15)(D)). **EXPIRES.**
23. Increase in percentage limitation on cash contributions to public charities (§ 170(b)(1)(G)). **Made permanent and modified by P.L. 119-21.**
24. Special expensing rules for certain film, television, and live theatrical productions (§ 181). **Modified by P.L. 119-21 but expires 12/31/2025.**
25. Qualified business income deduction (§ 199A(i)). **Made permanent and modified by P.L. 119-21.**
26. Deduction percentages for foreign-derived intangible income and global intangible low-taxed income (§ 250(a)(3)). **Modified by P.L. 119-21.**
27. Deductibility of employer *de minimis* meals and related eating facility, and meals for the convenience of the employer (§ 274(o)). **EXPIRES. Modified by P.L. 119-21**
28. ABLE accounts (§ 529A):
29.
 - a. Contributions eligible for retirement saver's credit (§ 25B(d)(1)(D)). **Made permanent and modified by P.L. 119-21.**
 - b. Rollovers from qualified tuition programs permitted (§ 529(c)(3)(C)(i)(III)). **Made permanent by P.L. 119-21.**
 - c. Increase in contributions limit (§ 529A(b)(2)(B)). **Made permanent by P.L. 119-21.**
30. Look-through treatment of payments between related controlled foreign corporations under the foreign personal holding company rules (§ 954(c)(6)(C)). **Made permanent by P.L. 119-21.**
31. Empowerment zone tax incentives:
 - a. Designation of an empowerment zone and of additional empowerment zones (§ 1391(d)(1)(A)(i) and (h)(2)). **EXPIRES.**
 - b. Empowerment zone tax-exempt bonds (§§ 1394 and 1391(d)(1)(A)(i)). **EXPIRES.**
 - c. Empowerment zone employment credit (§§ 1396 and 1391(d)(1)(A)(i)). **EXPIRES.**
32. Increase in estate and gift tax exemption (§ 2010(c)(3)(C)). **Made permanent and modified by P.L. 119-21.**

33. Treatment of certain individuals performing services in the Sinai Peninsula of (Sec. 11026 of Public Law 115-97). **Made permanent and modified by P.L. 119-21.**

SELECTED FEDERAL INCOME TAX PROVISIONS SCHEDULED TO EXPIRE AFTER 2026

(According to Joint Committee on Taxation, [JCX-1-25](#), Jan. 9, 2025)

1. Elective deferrals and IRA contributions by certain individuals (§ 25B). **Made permanent and modified by P.L. 119-21.**
2. Credit for advanced manufacturing investment (§ 48D(e)). **Modified by P.L. 119-21 but expires for construction which begins after Dec. 31, 2026.**
3. Additional first-year depreciation with respect to qualified property (§§ 168(k)(2)(A)(iii) and 460(c)(6)(B)). **Made permanent and modified by P.L. 119-21.**
4. Election of additional depreciation for certain plants bearing fruits and nuts (§ 168(k)(5)(A)). **Made permanent and modified by P.L. 119-21.**
5. Election to invest capital gains in an opportunity zone (§ 1400Z-2(a)(2)(B)). **Made permanent and modified by P.L. 119-21.**

DISASTER RELIEF

WV-2025-04, [IRS announces tax relief for taxpayers impacted by severe storms, straight-line winds, flooding, landslides, and mudslides in West Virginia; various deadlines postponed to Feb 2, 2026](#)

The IRS announced tax relief for individuals and businesses in **Marion and Ohio counties, West Virginia**, affected by **storms, flooding, landslides, and mudslides** that began **June 14, 2025**. Affected taxpayers now have until **Feb. 2, 2026** to file returns and make payments originally due during the disaster period. This includes **individual, business, and exempt organization returns, quarterly estimated tax payments, and payroll/excise filings**. Casualty losses can be claimed on either 2024 or 2025 returns, and penalty relief is available. The IRS will automatically apply relief, but those outside the area with relevant records must contact the IRS.

NM-2025-03, [IRS announces tax relief for taxpayers impacted by severe storms, flooding, and landslides in New Mexico; various deadlines postponed to Feb 2, 2026](#)

IRS Notice NM-2025-03 (issued **July 16, 2025**) grants tax relief to individuals and businesses in parts of **New Mexico**, specifically **Chaves, Lincoln, Otero, and Valencia counties**, affected by **severe storms, flooding, and landslides** beginning **June 23, 2025**. Affected taxpayers now have until **Feb. 2, 2026**, to file various federal returns and make payments originally due during this period, including those for individuals, businesses, tax-exempt entities, and quarterly taxes. Filing extensions apply automatically; penalty relief and other assistance are available through IRS support for those outside the designated area.

TX-2025-04, [IRS announces tax relief for taxpayers impacted by severe storms, straight-line winds, and flooding in Texas; various deadlines postponed to Feb 2, 2026](#)

The IRS issued **Notice TX-2025-04** granting tax relief to taxpayers in designated Texas counties affected by **severe storms, straight-line winds, and flooding** beginning **July 2, 2025**. Affected individuals and businesses now have until **Feb. 2, 2026**, to file federal returns and make payments originally due during this period, including quarterly estimated taxes, payroll and excise filings, and returns on extension. The relief is applied automatically for those in the covered area, with penalty relief available for late filings connected to the disaster.

MO-2025-01, [IRS provides tax relief for taxpayers impacted by severe storms, straight-line winds, tornadoes, and flooding in Missouri; various deadlines postponed to Nov. 3](#)

The IRS issued **Notice MO-2025-01** on **June 25, 2025**, offering tax relief to individuals and businesses in parts of **Missouri**, including the **City of St. Louis, Scott County, and St. Louis County**, among others, affected by **severe storms, straight-line winds, tornadoes, and flooding** beginning **May 16, 2025**. Affected taxpayers now have until **Nov. 3, 2025**, to file various federal returns (individual, business, tax-exempt, estate/trust returns, etc.), make payments including estimated taxes, payroll/excise tax returns, and contributions to IRAs and HSAs originally due during the disaster period. Penalties on certain payroll and excise tax deposits within the affected window will be abated if paid by early June. The IRS automatically applies relief for those in designated areas, while taxpayers outside (but with relevant records in) these areas should contact the IRS to request relief.

MS-2025-01, [IRS announces tax relief for taxpayers impacted by severe storms, straight-line winds, tornadoes, and flooding in Mississippi; various deadlines postponed to Nov. 3](#)

The IRS issued **Notice MS-2025-01** on **June 11, 2025**, providing tax relief for individuals, businesses, and tax-exempt entities in select **Mississippi counties**—including Calhoun, Carroll, Covington, Davis, Grenada, Humphreys, Issaquena, Itawamba, Jefferson Davis, Lee, Leflore, Marion, Montgomery, Pike, Prentiss, Sharkey, Smith, Walthall, and Washington—that were affected by **severe storms, straight-line**

winds, tornadoes, and flooding beginning March 14, 2025. Affected taxpayers now have until **November 3, 2025**, to file federal returns (including individual, business, corporate, fiduciary, payroll, excise, and tax-exempt forms) and make tax payments that were originally due during the disaster period. Additionally, the deadline extension applies to 2024 contributions to IRAs and HSAs, as well as estimated tax payments due April 15, June 16, and September 15, 2025. Penalties on payroll and excise tax deposits due between March 14 and April 10, 2025, will be abated if the deposits were made by April 10. The relief is automatically applied for taxpayers in the covered areas; those outside with qualifying circumstances should contact IRS Special Services to request relief.

TX-2025-03, [IRS announces tax relief for taxpayers impacted by severe storms and flooding in Texas; various deadlines postponed to Nov. 3](#)

On **June 10, 2025**, the IRS issued **Notice TX-2025-03**, providing tax relief to individuals and businesses in parts of **Texas**, specifically **Cameron, Hidalgo, Starr, and Willacy counties**, affected by **severe storms and flooding beginning March 26, 2025**. Those eligible now have until **Nov. 3, 2025**, to file federal returns and make payments originally due during that period, including **individual income tax returns, 2024 IRA and Health Savings Account (HSA) contributions, estimated tax payments, quarterly payroll and excise filings, corporate and fiduciary returns, and tax-exempt organization filings**. Additionally, penalties on payroll and excise tax deposits due between March 26 and April 10, 2025, will be abated if received by April 10. The IRS will automatically apply this relief to those in covered areas; others who qualify but are outside should contact IRS Special Services to request it.

OK-2025-02, [IRS announces tax relief for taxpayers impacted by wildfires and straight-line winds in Oklahoma; various deadlines postponed to Nov.3](#)

On **June 9, 2025**, the IRS issued **Notice OK-2025-02**, granting tax relief to individuals, businesses, and tax-exempt entities in **Cleveland, Creek, Lincoln, Oklahoma, Pawnee, and Payne counties**, and any additional counties later added, affected by **wildfires and straight-line winds beginning March 14, 2025**. Affected taxpayers now have until **Nov. 3, 2025**, to file federal returns (e.g., individual, business, partnership, corporate, fiduciary, and tax-exempt filings) and make payments originally due during the covered period, including **2024 IRA and HSA contributions, estimated tax payments, and quarterly payroll and excise tax filings**. Penalties on payroll and excise tax deposits due between March 14 and March 31 are waived if deposited by March 31. Relief is applied automatically for those in designated areas; eligible taxpayers outside these areas may request relief by contacting IRS Special Services.

MO-2025-02, [IRS announces tax relief for taxpayers impacted by severe storms, straight-line winds, tornadoes, and wildfires in Missouri; various deadlines postponed to Nov. 3](#)

On **June 9, 2025**, the IRS issued **Notice MO-2025-02**, granting tax relief to individuals, businesses, and tax-exempt entities in numerous Missouri counties, including **Bollinger, Butler, Callaway, Camden, Carter, Dunklin, Franklin, Howell, Iron, Jefferson, Madison, New Madrid, Oregon, Ozark, Perry, Phelps, Reynolds, Ripley, Scott, Shannon, St. Louis, Stoddard, Wayne, Webster, and Wright**, who were affected by **severe storms, straight-line winds, tornadoes, and wildfires beginning March 14, 2025**. Those in the designated areas now have until **Nov. 3, 2025**, to file tax returns and make payments originally due during the relief period, which covers individual and business filings, 2024 IRA and HSA contributions, estimated tax payments due April 15, June 16, and Sept. 15, 2025, as well as quarterly payroll and excise tax deposits (with penalties abated for deposits due between March 14 and March 31, provided they're made by March 31). The relief is applied automatically for eligible taxpayers, while those outside the area but with ties to it may request assistance by contacting IRS Special Services.

VA-2025-03, [IRS announces tax relief for taxpayers impacted by severe winter storms and flooding in Virginia; various deadlines postponed to Nov. 3](#)

On **April 30, 2025**, the IRS issued **Notice VA-2025-03**, granting tax relief to individuals, businesses, and tax-exempt entities in numerous Virginia localities, such as Amelia, Appomattox, Bedford, Bland, and Botetourt counties, the City of Bristol, and more, impacted by **severe winter storms and flooding** that began on **Feb. 10, 2025**. Affected taxpayers now have until **Nov. 3, 2025**, to file federal returns (including individual income, business, partnership, estate, fiduciary, tax-exempt, and payroll/excise filings), make 2024 IRA and HSA contributions, and submit estimated tax payments originally due during the relief period. Penalties on employment and excise tax deposits due between Feb. 10 and Feb. 25, 2025, will be abated if paid by Feb. 25. Relief is applied automatically for those in designated areas; others with ties to the area should contact IRS Special Services to request assistance.

NC-2025-01, [IRS further postpones various tax deadlines to Sept. 25 for North Carolina storm victims](#)

On **April 17, 2025**, the IRS issued **Notice NC-2025-01**, extending and consolidating tax relief for **North Carolina** taxpayers affected by **Hurricane Helene**. Individuals, businesses, fiduciaries, and tax-exempt organizations located anywhere in North Carolina now have until **Sept. 25, 2025**, to file federal returns (including 2023 returns filed with extensions, along with 2024 individual, corporate, and exempt-entity filings), contribute to IRAs and HSAs for 2024, submit quarterly estimated tax payments (including both 2024 and 2025 installments), and file payroll and excise tax returns originally due during the relief period from **Sept. 25, 2024, through Sept. 25, 2025**. The extension applies automatically to those with a North Carolina address of record; others with ties to the area (such as records located there) should call IRS Special Services.

TN-2025-02, [IRS announces tax relief for Tennessee storm victims; various deadlines postponed to Nov. 3](#)

On **April 14, 2025**, the IRS issued **Notice TN-2025-02**, granting tax relief to **all individuals and businesses throughout Tennessee** affected by **severe storms, straight-line winds, tornadoes, and flooding** beginning **April 2, 2025**. Eligible taxpayers now have until **Nov. 3, 2025** to file federal tax returns (including individual, business, fiduciary, tax-exempt, employment, and certain excise filings) and make payments originally due during the relief period, covering deadlines such as the April 15 individual return, 2024 IRA/HSA contributions, estimated payments (April 15, June 16, Sept. 15), and calendar-year returns for corporations, fiduciaries, and tax-exempt organizations. Penalties on payroll and excise tax deposits due between April 2 and April 17 are waived so long as payment is made by April 17. The IRS automatically applies relief for those with an IRS address within Tennessee, while others with qualifying circumstances, such as those with records in the affected area, should contact IRS Special Services for assistance.

AR-2025-03, [IRS announces tax relief for Arkansas storm victims; various deadlines postponed to Nov. 3](#)

On **April 14, 2025**, the IRS issued **Notice AR-2025-03**, also published as **IR-2025-49**, granting comprehensive tax relief to all individuals, businesses, and tax-exempt entities across **all 75 counties of Arkansas** affected by **severe storms, tornadoes, and flooding** that began **April 2, 2025**. The IRS extended the due date for a wide range of federal filings and payments, such as individual income tax returns (normally due April 15), 2024 IRA and HSA contributions, estimated tax payments (due April 15, June 16, Sept. 15), payroll and excise tax returns (due April 30, July 31, Oct. 31), and calendar-year corporate, fiduciary, and tax-exempt organization returns (April 15 and May 15), to **Nov. 3, 2025**. Penalties on payroll and excise tax deposits owed between April 2 and April 17 will be waived if paid by April 17. Relief is automatically applied to taxpayers with an IRS address of record in Arkansas; those outside but with qualifying records in the state should contact IRS Special Services.

IR-2025-49, [IRS: All of Arkansas qualifies for disaster tax relief; various deadlines postponed to Nov. 3](#)

On **April 14, 2025**, the IRS issued **IR-2025-49**, confirming that **the entire state of Arkansas** — all **75 counties** — qualifies for federal tax relief following the **severe storms, tornadoes, and flooding** that began on **April 2, 2025**. Taxpayers including individuals, businesses, fiduciaries, and tax-exempt organizations now have until **Nov. 3, 2025**, to file various tax returns (e.g., individual, corporate, fiduciary, payroll/excise, tax-exempt) and make payments originally due during the April 2–Nov. 3 period. Additionally, 2024 IRA/HSA contributions and quarterly estimated tax payments (April 15, June 16, Sept. 15) are included in the extension. Penalties for payroll and excise tax deposits due between April 2 and April 17 will be abated if payments were made by April 17. Relief is applied automatically for Arkansas taxpayers based on IRS address records, though those outside the area or with special circumstances can contact IRS Special Services to request assistance.

IR-2025-47, [IRS: All of Tennessee qualifies for disaster tax relief; various deadlines postponed to Nov. 3](#)

On **April 14, 2025**, the IRS issued **IR-2025-47**, confirming that **the entire state of Tennessee** — all **95 counties** — qualifies for federal tax relief following severe storms, straight-line winds, tornadoes, and flooding that began on **April 2, 2025**. Taxpayers including individuals, businesses, fiduciaries, and tax-exempt organizations now have until **Nov. 3, 2025** to file various tax returns and make payments originally due between **April 2** and **Nov. 3**. This includes individual income tax filings, 2024 IRA and HSA contributions, estimated tax payments (April 15, June 16, Sept. 15), quarterly payroll and excise filings (April 30, July 31, Oct. 31), corporate, fiduciary, and tax-exempt organization returns. Penalties for payroll and excise tax deposits due between April 2 and April 17 will be waived if made by April 17. Relief is automatically applied based on IRS address records; those outside the area but with qualifying circumstances (such as records located in Tennessee) should contact IRS Special Services to request relief.

WV-2025-02, [IRS announces tax relief for West Virginia storm victims; various deadlines postponed to Nov. 3](#)

On **March 14, 2025**, the IRS issued **Notice WV-2025-02**, granting tax relief to individuals and businesses in parts of **West Virginia** affected by **severe storms, straight-line winds, flooding, landslides, and mudslides** beginning **Feb. 15, 2025**. Those in **Boone, Greenbrier, Lincoln, Logan, McDowell, Mercer, Mingo, Monroe, Raleigh, Summers, Wayne, and Wyoming** counties (and additional counties added later) now have until **Nov. 3, 2025** to file affected federal tax returns and make payments originally due during the relief period, including individual filings, IRA/HSA contributions for 2024, estimated payments, payroll/excise tax returns, partnership/S-corp returns, corporate/fiduciary returns, and tax-exempt organization filings. Penalties on payroll and excise tax deposits due between **Feb. 15 and March 3, 2025** are abated if deposits were made by **March 3**. Relief is automatically applied for eligible taxpayers based on IRS address records; those outside these areas, or whose records are located there, should contact IRS Special Services to request relief.

IR-2025-34, [IRS: West Virginia storm victims qualify for tax relief; various deadlines postponed to Nov. 3](#)

On **March 14, 2025**, the IRS issued **IR-2025-34**, announcing tax relief for individuals, businesses, and tax-exempt entities in **parts of West Virginia** affected by **severe storms, straight-line winds, flooding, landslides, and mudslides** beginning **Feb. 15, 2025**. Taxpayers residing or operating in **Logan, McDowell, Mercer, Mingo, Wayne, and Wyoming** counties (with additional counties eligible as designated) now have until **Nov. 3, 2025**, to file federal returns and make payments originally due during the relief window. The extension applies to individual income tax filings, 2024 IRA and HSA contributions, estimated tax installments (April 15, June 16, Sept. 15), payroll and excise tax returns (April 30, July 31, Oct. 31), partnership/S-corp returns, corporate/fiduciary filings, and tax-exempt organization returns. Furthermore, penalties for payroll and excise tax deposits due between Feb. 15 and March 3 are waived if

paid by March 3. Relief is automatically applied via IRS address records, and affected individuals outside these areas with ties (e.g., records) should reach out to IRS Special Services.

KY-2025-02 — [IRS announces tax relief for taxpayers impacted by severe storms, straight-line winds, flooding, and landslides in Kentucky; various deadlines postponed to Nov. 3](#)

On **Feb. 24, 2025**, the IRS issued **Notice KY-2025-02**, granting state-wide disaster tax relief in **Kentucky** for individuals, businesses, and tax-exempt entities affected by **severe storms, straight-line winds, flooding, and landslides** that began **Feb. 14, 2025**. Affected taxpayers now have until **Nov. 3, 2025** to file federal returns and make payments originally due between Feb. 14 and Nov. 3, including individual income tax, 2024 IRA and HSA contributions, estimated tax installments, payroll and excise filings, partnership/S-corp, corporate/fiduciary, and tax-exempt organization returns. Penalties on payroll and excise tax deposits due between Feb. 14 and March 3 are waived if paid by March 3. Relief is applied automatically for those with Kentucky addresses on file; affected taxpayers outside the area should contact IRS Special Services to request assistance.

CA-2025-01, [IRS announces tax relief for taxpayers impacted by wildfires in California; various deadlines postponed to Oct. 15](#)

On **Jan. 10, 2025**, the IRS issued **Notice CA-2025-01** (also published as **IR-2025-10**), granting tax relief to individuals and businesses in parts of **Southern California**, notably **Los Angeles County**, affected by **wildfires and straight-line winds** beginning **Jan. 7, 2025**. Affected taxpayers now have until **Oct. 15, 2025**, to file federal tax returns and make payments originally due during the postponement period, including individual income tax returns (normally due April 15), **2024 IRA and HSA contributions**, quarterly estimated tax payments, payroll and excise tax returns, partnership/S-corp filings, corporate/fiduciary filings, and tax-exempt organization returns. Penalties on payroll and excise tax deposits due between **Jan. 7 and Jan. 22, 2025**, are abated if paid by **Jan. 22**. The IRS will automatically apply relief for taxpayers with an IRS address of record in the designated disaster area; individuals outside but with relevant records in the area can request relief through the IRS disaster hotline.

IR-2025-10, [IRS: California wildfire victims qualify for tax relief; various deadlines postponed to Oct. 15](#)

On **Jan. 10, 2025**, the IRS issued **IR-2025-10**, confirming that taxpayers in **Los Angeles County** and any additional counties later designated by FEMA are eligible for tax relief due to **wildfires and straight-line winds** that began on **Jan. 7, 2025**. Filing and payment deadlines falling between **Jan. 7 and Oct. 15, 2025** are now extended through **Oct. 15, 2025**. This extension covers a wide range of obligations, including **individual income tax returns, 2024 IRA and HSA contributions, quarterly estimated tax payments, payroll and excise tax returns**, as well as **partnership/S-corp, corporate/fiduciary, and tax-exempt organization filings**. Penalty relief applies to payroll and excise tax deposits due between Jan. 7 and Jan. 22, if made by Jan. 22. The IRS applies this relief automatically for affected taxpayers, and those outside the designated area, but whose records or circumstances qualify, should contact the IRS to request relief

Claiming casualty losses. Taxpayers can claim casualty losses on their federal income tax return for either the year of loss (in this case, 2025) or the prior year (in this case, 2024). Taxpayers have up to six months after the due date of their income tax return (excluding extensions) for the year of the disaster to make this election. The loss is claimed on form 4684. Taxpayers must include the FEMA disaster declaration number (given above) on any return.

Practice Alert! Please see <https://www.irs.gov/newsroom/tax-relief-in-disaster-situations> for other areas provided disaster relief.

OTHER RECENT PRACTICE DEVELOPMENTS

Two U. S. Supreme Court Decisions Dealing With Challenges to IRS Regulations

1. Court Strikes Down Chevron Doctrine, Eliminating Courts' Deference to Federal Agency Regulations (*Loper Bright Enterprises et al., v. Raimondo, Secretary of Commerce, et al.*, Docket No. 22-451, June 28, 2024).

- a. **Background.** Since the 1984 Supreme Court decision in *Chevron U.S.A Inc. v. Natural Resources Defense Council, Inc.*, courts have generally been required to defer to certain Federal agency interpretations of statutes (including IRS regulations) that are silent or ambiguous, even if the court's reading of the law is different, provided the agency's interpretation was reasonable. The *Loper Bright* case concerns a pair of challenges to a regulation issued by the National Marine Fisheries Service (NMFS), the agency charged with administering the Magnuson Stevens Fishery Conservation and Management Act (MSA). The MSA incorporates the Administrative Procedure Act (APA), a 1946 federal law that governs the process by which federal agencies (including the IRS) develop and issue regulations. The APA also provides instructions for courts to review the actions of Federal agencies. The NMFS regulation required certain vessels to carry on board observers charged with collecting data "necessary for the conservation and management of the fishery." In 2020, the regulation was changed to require those vessels to bear the costs of carrying the observers if a government-paid observer is not available. NMFS estimated the cost of an observer would be up to \$710 per day.

The district court granted summary judgment to the Government citing *Chevron* and the D. C. Circuit Court of Appeals affirmed the decision. The courts found that while there was ambiguity in the statute regarding the responsibility to pay for the observers, the NMFS regulation was reasonable.

- b. **The decision.** In a 6-3 decision, the Supreme Court overruled *Chevron*. The court said,

Chevron is overruled. Courts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority, as the APA requires. Careful attention to the judgment of the Executive Branch may help inform that inquiry. And when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it. But courts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous.

Because the D. C. and First Circuits relied on Chevron in deciding whether to uphold the Rule, their judgments are vacated, and the cases are remanded for further proceedings consistent with this opinion.

- c. **Courts May Still Give "Due Respect" to IRS Interpretations.** While overruling automatic deference, the *Loper Bright* decision preserved the ability of courts to give "due respect" to agency interpretations under the standard established in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). In that decision, the Court held that agency rulings, interpretations, and opinions, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance."

Under *Skidmore*, the weight assigned to agency interpretations of statutory provisions depends on the agency's thoroughness, the validity of its reasoning, its consistency with earlier and later pronouncements, and its persuasiveness.

However, the *Loper Bright* majority also recognized that Congress can expressly delegate interpretive authority to agencies (such regulations are generally called legislative regulations). In those cases, the court ruled that a less stringent standard of judicial review applies, with the court stating **that a reviewing court's role under the APA is to independently identify the**

statutory delegation, determine its boundaries, and ensure the agency has engaged in reasoned decision-making within those boundaries.

- d. **Loper Bright Does Not Overrule Prior Decisions.** The Court makes it clear that this opinion does not apply to previous cases in which decisions relied on *Chevron*, stating “The holdings of those cases that specific agency actions are lawful ... are still subject to statutory *stare decisis* despite our change in interpretive methodology.”

Practice Alert! IRS regulations will now be subject to final interpretation by the courts. This may also affect the timing and content of new regulations as the IRS may no longer assume the courts will defer to its regulations. Expect more challenges to regulations issued by Treasury and the IRS and other Federal agencies.

2. **Supreme Court Changes the Start of the Six-Year Statute of Limitations for Suits Against the U.S. (*Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, Docket No. 22-1008, July 1, 2024).**

- a. **Background.** According to 28 U. S. C. §2401(a), suits against the United States (for example, a suit challenging a regulation) must be filed “within six years after the right of action first accrues.” In 2011, the Federal Reserve Board published Regulation II, which set the transaction fees charged to businesses for their acceptance of debit cards. The Board was sued, with the plaintiffs arguing that the costs in Regulation II did not appear in the statute. The D. C. Circuit ruled in 2014 that the rule rested on reasonable construction of the statute. Corner Post, a truck stop and convenience store, opened for business in 2018. In 2021, it joined a suit brought against the Board under the Administrative Procedure Act (APA) challenging Rule II. The case was dismissed in District Court and the Eighth Circuit affirmed the dismissal. The Eighth Circuit ruled that the six-year statute of limitations for filing a suit against the U.S. begins to run upon publication of the regulation (2011 in this case) and expires six years later (2017 in this case). Therefore, Corner Post filed its lawsuit four years too late (i.e., in 2021).
- b. **The decision.** In a vote of 6-3, the Supreme Court determined that the “right of action first accrues” (i.e., the statute for challenging a Federal regulation) begins to run, under the APA when “the plaintiff is injured by final agency action.” The majority opinion mentions that Congress could have included language to make it clear that the statute of limitations begins to run when the regulation is issued. In her dissent, Justice Jackson, joined by Justices Sotomayor and Kagan, argues “there is effectively no longer any limitations period for lawsuits that challenge agency regulations on their face.” The dissent urges Congress to amend the APA to clarify the start of the statute of limitations for challenges to government regulations.

Observation! Expect litigation challenging older IRS regulations to commence.

Practice Alert! Although, taxpayers are no longer required to challenge a government regulation, including an IRS regulation, within six years from the date the regulation is issued, if the challenge involves income taxes, any claim for refund must be filed before the statute of limitations on refunds expires.

Standards of Tax Practice

[Treasury Department Circular No. 230 \(31 U.S.C. §330\)](#). Circular 230 is a document containing the statute and regulations detailing a tax professional's duties and obligations while practicing before the IRS. It contains rules governing the recognition of attorneys, certified public accountants, enrolled agents, enrolled retirement plan agents, registered tax return preparers, and other persons representing taxpayers before the IRS.

In enacting §330, Congress contemplated that only individuals professionally and ethically fit to represent the interests of taxpayers, claimants, and others would be eligible to practice before the IRS. Those eligible

would be of good character, have a good reputation, have the necessary qualifications to provide valuable service to the client, and have the competence to advise and assist the client in presenting their cases. Attorneys, Certified Public Accountants (CPA), or Enrolled Agents (EA) not currently under suspension or disbarment from practice before the IRS are eligible without any additional qualifications to represent clients in proceedings before the IRS. Other practitioners are generally eligible to represent clients before the IRS only for returns they prepared. Representing clients includes all communication with the IRS regarding client matters without the client present.

Circular 230 and the regulations thereunder were last updated in June 2014. Several judicial decisions have affected the applicability of the Circular 230 provisions and in November 2020, the Department of the Treasury announced its intention to update them and solicited comments. The AICPA provided its comments in 2021, recommending revisions that encompass the judicial decisions as well as additional recommendations for new sections covering privacy, data protection, and record retention. Although the submitted comments are currently being reviewed, no date for the release of a revised Circular 230 has been announced.

Latest News on Proposed Regs Updating Circular 230 ([REG-116610-20](#))

Summary. The proposed update to Treasury Department Circular 230 (Circular 230), issued last December, [elicited more than 700 comments](#) from tax practitioners and others affected by the proposed changes. A March 6 public hearing held by the IRS and Treasury included 13 speakers representing the opinions of various stakeholders, including the AICPA, the National Taxpayers Union Foundation, the New York State Society of Enrolled Agents, and several appraiser groups, regarding the proposed regulations. Several issues were identified by the speakers as being troublesome.

Background. Circular 230 governs practice before the IRS and was last updated in 2014. The much-anticipated proposed regulations were published in the *Federal Register* on Dec. 26, 2024, with comments requested by Feb. 24, 2025. The major proposed changes, which were covered in the December newsletter, include tax return preparation, contingent fees, and knowledge of an error or omission. Also provided are rules related to appraisers.

Public comments. Some of the issues raised in the comments were:

- **The Texas Society of CPAs** is concerned that practitioners may be forced to advise their clients to waive their rights under the Fifth Amendment against self-incrimination under the “Knowledge of Error or Omission” section and asks for further clarification on the proposed rule to generally make contingent fees disreputable conduct.
- **The American Institute of CPAs (AICPA)** proposed several changes, including revisions about the practitioner’s duty to advise clients on the disclosure of errors to the IRS, revision or removal of the proposed sections regarding best practices, and the recommendation to focus on the qualifications of the appraisers rather than specific valuation standards.
- **The American Society of Appraisers, the Appraisal Institute, and others** criticized the proposed changes affecting appraisers and business valuation professionals. **The National Taxpayers Union Foundation** requested that the appraisal rules for private appraisers also apply to appraisals by the IRS.
- **The American Society of Tax Problem Solvers** urged the agency to continue to pursue legislative action to grant the IRS the authority to regulate return preparers, arguing that such oversight protects taxpayers. The group also recommended exceptions to the rule against contingent fees.
- **The National Association of State Boards of Accountancy** requested that the IRS rethink the best practice provision requiring a practitioner to evaluate any mental impairments of a client that could affect representation.
- **Reed Smith LLP**, a law firm, commented on the prohibition of contingency fees and its disreputable conduct designation, arguing that Treasury lacks the authority to apply the rule to lawyers. Removal of the applicable section regarding contingent fees was requested and if not removal, a revision to state that the ban on contingent fees does not apply to lawyers was requested.

Key issues identified in the March 6 hearing. Many of the issues identified in the public hearing were previously raised in the public comments. The key issues identified by the hearing participants are as follows:

- **Contingent fees.** Multiple speakers opposed the proposed prohibition on contingent fees, arguing it would limit access to competent tax representation, particularly for taxpayers with limited resources. They suggested that contingent fees should be allowed in most situations, except for original tax returns.
- **Appraisal standards, disqualification of appraisers.** Concerns were raised about the exclusive reference to Uniform Standards of Professional Appraisal Practice (USPAP) in the proposed regulations. Speakers argued that other appraisal standards should also be recognized to avoid confusion and ensure fairness. Concerns were also expressed about the broad authority granted to the IRS to disqualify appraisers. It was suggested that appraiser boards should handle disciplinary actions.
- **Limited practice rights.** The proposed expansion of practice rights for non-credentialed tax preparers was criticized for potentially compromising taxpayer service quality and undermining the enrolled agent credential.
- **Best practices.** New best practices related to data security, mental impairment, and practice continuity were discussed, with some speakers suggesting these should not be mandatory requirements under Circular 230.
- **Continuing education.** There were recommendations to expand allowable continuing education topics to include technology and practice management, and opposition to proposed user fees for CE providers.

Overall, the speakers urged the IRS and Treasury to reconsider certain aspects of the proposed regulations to ensure they do not negatively impact tax professionals and taxpayers.

Comment. It is unknown when the proposed regulations will be finalized. Keep in mind the Jan. 20 [executive order](#) which imposed a regulatory freeze on any new rules or those not yet published in the *Federal Register* until the rule is reviewed by a department or agency head designated by the President, unless the OMB Director exempts the rule.

AICPA Statements on Standards for Tax Services (SSTS). CPAs who are members of the AICPA are bound by the Code of Professional Conduct (“the Code”), the authority under which the SSTS were issued. CPAs who are not members of the AICPA may also be bound by the Code via membership in state CPA societies or by state law. In May 2023, the AICPA adopted the revised SSTS, effective Jan. 1, 2024. The previous seven SSTSs were reorganized into a practice-based framework, and three new standards were incorporated. This resulted in four SSTSs. The new standards are:

- **Data protection.** §1.3 of SSTS No. 1, *General Standards for Members Providing Tax Services*, contains the data protection standard. It requires the practitioner to make a reasonable effort to safeguard taxpayer data and to consider applicable privacy laws when collecting and storing taxpayer data. The standard references both the Gramm-Leach-Bliley Act (GLBA) and the Federal Trade Commission’s Safeguards Rule and compliments the confidentiality standards of the AICPA Code.
- **Reliance on tools.** Despite the increasing reliance on technology in providing tax services, there was no standard specifically addressing this. §1.4 of SSTS No. 1 addresses this oversight by providing guidance. Tools should be used to improve efficiency and to enhance the professional’s understanding of an issue; however, tools cannot supplant professional judgement. Reasonable steps must be taken to satisfy the professional that the results presented by the tool are reliable.
- **Tax representation.** SSTS No. 4 covers the entirely new standard of the representation of clients before any taxing authority. The task force was careful not to duplicate other existing standards, such as those provided in Circular 230, which only covers federal taxes. SSTS No. 4 does not

override those standards; rather, it supplements them and serves as a basic standard where a lower or no standard exists. SSTS No. 4 draws on the competency standard included in §1.300.010 of the AICPA Code and reminds tax professionals of the conflict-of-interest standards in §1.000.020 and the integrity and objectivity rules in §§1.100.001 and 2.100.001.

In addition to the new standards, the AICPA released two interpretations related to SSTS No. 1 and No. 2, *Standards for Members Providing Tax Compliance Services, Including Tax Return Positions*. There is also an FAQ document. These items are available on the AICPA website.

Written Information Security Plan (WISP). Tax professionals are required to have a security plan and must acknowledge the requirement when applying for or renewing their Preparer Tax Identification Number (PTIN) by checking the box on line 11 of Form W-12. The authority for this requirement stems from the GLBA, passed by Congress in 1999. The U.S. Federal Trade Commission (FTC) is charged with implementing the GLBA and issued its Standards for Safeguarding Customer Information, known as the Safeguards Rule. Tax and accounting professionals are included in the FTC's definition of "financial institutions" (§214.2(h)) and are, therefore, subject to this rule. The Safeguards Rule became effective in 2003 but was amended in 2021 to provide more concrete guidance. The Safeguards Rule includes nine specific elements of a written information security plan (WISP). Although the FTC and others have issued guides on creating and maintaining the plan, some have had difficulty developing it, prompting the IRS to issue [Publication 5708, Creating a Written Information Security Plan for your Tax & Accounting Practice](#), which incorporates the nine elements of the Safeguards Rule. Updated in Aug. 2024, Publication 5708 is a template designed to help tax professionals, especially those with smaller practices, meet the security plan requirement.

Caution! Tax professionals now need to report a security event (that is, personal identifying information has been stolen or lost) affecting 500 or more people to the FTC as soon as possible, but no later than 30 days from the date of discovery, using the FTC's online Safeguards Rule Security Event Reporting Form. This is in addition to the requirement to report the security event to others, including the IRS and state tax authorities, as outlined in Publication 5708.

Self-reporting of Circular 230 misconduct. In an Alert from the IRS Office of Personal Responsibility (OPR) (Issue 2025-12, Aug. 6, 2025, direct link not available on IRS [website](#) as of this writing), practitioners who self-report Circular 230 violations may benefit from doing so. Violations of Circular 230 can result in sanctions and suspensions, leading to the loss of the ability to practice before the IRS. Self-reporting of the violations may result in less harsh sanctions and favorable settlements.

Circular 230 does not require self-reporting of misconduct; however, as noted in the Alert, other requirements may effectively do so. OPR warns that it is often notified of violations from other sources, such as when state boards of accountancy discipline a CPA, or when a practitioner has been subjected to a criminal or civil judgment. The Alert identifies benefits from self-reporting, including the potential to serve a Circular 230 suspension simultaneously or concurrently with one imposed by state board of accountancy or state bar. The Alert states that practitioners who self-report, accept responsibility of their conduct, and express a genuine intention to reform their behavior are "prime potential candidates for a deferred discipline agreement or other settlement."

IRS to Start Verifying PTINs. According to a recent *Tax Notes* article, the IRS is planning to start verifying preparer identification numbers (PTIN). Thousands of preparers are not renewing the numbers, and some are using fake numbers. In addition, Form 14157, *Return Preparer Complaint*, [has been digitized](#), which the IRS hopes will make it easier for tax professionals to report bad actors. Previously, the form had to be mailed to the IRS.

Updated Offer in Compromise Form 656-B (Rev. 4-2024). The IRS updated its [Form 656 Booklet, Offer in Compromise](#), in April 2024. To make an offer in compromise (OIC), you must use this latest booklet, which includes the instructions and forms necessary to make the offer.

- **What is an OIC?** An offer in compromise allows taxpayers to settle their tax debt for less than the full amount owed. The IRS will consider the taxpayer's ability to pay, income, expenses and equity in assets, based on the taxpayer's unique facts and circumstances, to determine approval. Offers can be for a lump sum amount or for periodic payments. The IRS states that it generally accepts an OIC when the amount "represents the most we can expect to collect in a reasonable period of time."
- **Who is eligible for an OIC?** The IRS has a tool (available at irs.gov/OICtool) for individual taxpayers to use to determine their eligibility. To be eligible, the taxpayer must have filed all required returns and made all required estimated payments, have received a bill for at least one tax period included in the offer, and are not in an open bankruptcy proceeding. If the taxpayer is an employer, they must have made tax deposits for the current and past two quarters. If the taxpayer applies but is not eligible, the application fee (\$205, unless the taxpayer meets the low-income certification guidelines) and any offer payment included with the application to their balance due is not returned.
- **More information.** [IRS Tax Tip 2024-37](#) (April 24, 2024) contains additional information on an OIC, including a warning to be aware of promoters who mislead taxpayers and charge often excessive fees. There is also an [FAQ](#) on OIC.

Practice pointer! An OIC may not be appropriate for a taxpayer, even if they are eligible. For some, the offer terms (included in §7 of Form 656 in the booklet) may be onerous, such as the filing of a federal tax lien against the taxpayer's property.

Updated list of automatic changes in accounting methods ([Rev. Proc. 2025-23](#)). The IRS has updated the list of automatic changes in accounting methods for which the procedures in Rev. Proc. 2015-13, as modified, apply. The new Rev. Proc. also supersedes, in part, Rev. Proc. 2024-23. Listed are 18 significant changes, including 10 that remove obsolescent language and five that are clarifications. Automatic accounting method changes are generally made by attaching Form 3115, "[Application for Change in Accounting Method](#)," to the income tax return and filing a duplicate.

Delay in electronic payment processing. The IRS [announced](#) that there has been a delay in processing some electronic payments. This may result in notices being sent to affected taxpayers, which the IRS urges taxpayers to ignore if the tax owed was paid in full and on time.

Digital asset reporting relief ([Notice 2025-33](#)). The IRS is providing an additional year of relief from backup withholding and related penalties for brokers who fail to report the sale and exchange of certain digital assets on Form 1099-DA, "Digital Asset Proceeds From Broker Transactions." An earlier notice (Notice 2024-56) extended relief for transactions effected in calendar year 2025. The latest notice extends the relief to transactions effected in calendar year 2026.

Interim final regulations and proposed regulations for user fee on estate closing letter ([T.D.10031, REG-107459-24](#)). The user fee imposed on a request for the issuance of an estate closing letter is to be reduced from \$67 to \$56. The interim final regulations and the proposed regulations contain identical text. Comments are requested on the proposed regulations by July 21.

Some scam victims can deduct theft loss ([CCA 202511015](#), released March 14, 2025). A CCA memorandum provides guidance on five taxpayers who are the victims of various scams and determines that some of them are deductible under § 165.

Background. Section 165 permits the deduction of losses to the extent not reimbursed by insurance or otherwise. The deduction for individual losses under § 165(c) are limited to (1) losses incurred in a trade or business; (2) non-trade or business losses incurred in a transaction entered into for profit; and (3) other losses of property arising from fire, storm, shipwreck, or other casualty, or from theft. Unless there are casualty gains, the TCJA limited the last category of losses to those in a Federally declared disaster area. This provision was made permanent and beginning in 2026, losses incurred in state declared disasters also qualify (§ 165(h)(5)).

Deductible theft losses. The CCA concluded that in each scenario, the taxpayer sustained a theft loss due to an illegal taking of property that is considered criminal theft under applicable state law. If deductible, § 165(e) permits deduction of the theft loss in the taxable year of discovery, unless there is a reasonable prospect of recovery.

In none of the scenarios was the taxpayer eligible to use the Ponzi loss safe harbor provided in Rev. Proc. 2009-20 as modified by Rev. Proc. 2011-58 because the requirements were not met.

The CCA provides this background to the discussion of the five taxpayers:

Scammer A perpetrated scams against Taxpayers 1 through 5 through fraud and deceit that constituted criminal fraud, larceny or embezzlement under the law of the state where the victims reside. In addition, Scammer A's true identity was unknown, the transfers of funds were irreversible, the losses were not covered by insurance, the victims had no legal recourse against any third party, and law enforcement stated that there was little to no prospect of any recovery. Accordingly, as of December 31, 2024, Taxpayers 1 through 5 had no reasonable prospect of recovery and sustained an actual theft loss under § 165. [...] Taxpayers 1 through 5 invested funds in IRA and non-IRA brokerage type accounts that generally invest in securities, and other financial products, the purchase of which is considered prima facie evidence of a profit motive.

In all cases, then, the year of loss is 2024. The IRA accounts are presumed to be traditional IRA accounts in which the taxpayer has no basis.

Taxpayer 1 — Compromised Account Scam, Taxpayer 2 — Pig Butchering Scam, and Taxpayer 3 — Phishing Scam. Scammer A contacted Taxpayer 1, claiming to be a fraud specialist at the taxpayer's financial institution. Scammer A stated that Taxpayer 1's computer and bank accounts had been compromised and induced Taxpayer 1 to authorize distributions from IRA and non-IRA accounts and to transfer the distributions to new investment accounts created by Scammer A. Once the transfers were completed, Scammer A emptied the accounts.

Scammer A sent an unsolicited email to Taxpayer 2 advertising an investment opportunity in cryptocurrency and promising large profits. Taxpayer 2, via a website provided by Scammer A, invested a small sum, saw it increase in value, and withdrew the money. This happened several times, with Taxpayer 2 investing increasing amounts of money taken from IRA and non-IRA accounts. A last attempt to liquidate the account was met with an error message on the website and no response from customer support.

Taxpayer 3 also received an unsolicited email from Scammer A, this one claiming that Taxpayer 3's accounts had been comprised. The email looked official and contained a phone number to call. Taxpayer 3 called the number and was directed to click on the link in the email and log into their tax-deferred and non-IRA accounts. By clicking on the link, Taxpayer 3 gave Scammer A access to Taxpayer 3's computer and Scammer A was able to obtain Taxpayer 3's login information and used this information to distribute the funds to an overseas account.

In all three cases, the CCA concluded that the theft losses incurred are deductible theft losses under § 165(c)(2) and that the amount of the loss is the taxpayer's basis under § 165(b). The taxpayers will be liable for tax on the IRA account distributions and recognize gain or loss from the disposition of the assets in the non-IRA accounts. The CCA indicates that basis for determining the theft loss will be increased by any gain recognized on the IRA distributions and increased or decreased by any gain or loss recognized on the disposition of assets in non-IRA accounts. A theft loss from a transaction entered into for profit is reported on [Form 4684](#), Section B — Business and Income-Producing Property.

Taxpayer 4 — Romance Scam and Taxpayer 5 — Kidnapping Scam. Taxpayer 4 received an unsolicited text message from Scammer A and the two developed a virtual romantic relationship. Scammer A convinced Taxpayer 4 to take distributions from IRA and non-IRA accounts to help pay the medical bills of a relative of Scammer A. The distributed money was transferred to an overseas account, after which Scammer A stopped responding to messages.

Scammer A contacted Taxpayer 5 by text and phone, claiming to have kidnapped Taxpayer 5's grandson for ransom. Scammer A used artificial intelligence to clone the grandson's voice, with him begging for help, which Taxpayer 5 heard over the phone. Taxpayer 5 authorized distributions from IRA and non-IRA accounts and transferred the funds to an overseas account provided by Scammer A. Shortly after, Taxpayer A was able to contact the grandson and determined that no kidnapping had taken place.

The CCA concluded that there was no profit motive in these two cases, as the losses were not incurred in a transaction entered into for profit. Therefore, the losses are personal casualty losses under § 165(c)(3). As there were no casualty gains and the losses were not attributable to a Federally declared disaster, the theft losses are not deductible. The taxpayers will be liable for any tax on the IRA account distributions and will recognize gain or loss from the disposition of the assets in the non-IRA accounts.

IRS Revenue Agent Indicted for Filing False Tax Returns (*United States v. Ndeye Amy Thioub*, Docket No. 1:24-cr-10098, United States District Court, District of Massachusetts, April 16, 2024)

Background. Ndeye Amy Thioub was hired in 2006 as a Revenue Agent (RA) in the IRS Large Business and International Division, working in the Boston office. As an RA, Thioub received training related to her duties, including annual training on employee tax compliance. In addition to a master's degree in accounting and a master's degree in business administration in financial management, she obtained her Massachusetts CPA license in 2010. In addition to her IRS position, Thioub worked as a Visiting Instructor at Salem State University, teaching college-level classes that included instruction on the verification of records; valuation and analysis of accounts; the importance of financial accounting and financial statements; professional standards; and **ethics**, professional responsibilities and legal liabilities issues facing auditors

An IRS Criminal Investigation Division Investigative Analyst (IA) began to review information related to taxpayers with large Schedule C losses over several consecutive years, concerned that they may have exceeded the presumption contained in IRC §183(d) that an activity is engaged in for profit if it is profitable for three years in five consecutive tax years. During the review, the IA noticed that one taxpayer had such losses for tax years 2010 through 2017. The taxpayer also had an IRS W-2 and was identified as Thioub. The review expanded to include tax years through 2019.

- **The indictment.** Barred by the statute of limitations for tax years 2010 through 2016, Thioub was arrested in March 2024 for allegedly filing false personal returns for tax years 2017, 2018, and 2019. She was subsequently indicted on April 16, 2024, for three counts each of filing false tax returns and filing false tax returns as an employee of the United States. She is alleged to have understated her income by \$90,192 over the three years resulting in additional tax owed of \$20,511.
- If convicted, Thioub is facing prison time, fines, and being fired. The charge of filing a false tax return carries a sentence of up to three years in prison, followed by one year of supervised release and a fine of \$100,000. The charge of filing a false return by a U.S. employee provides for discharge from employment, a sentence of up to five years in prison followed by one year of supervised release, and a \$10,000 fine.

Observation. The potential penalties for this conduct far outweigh the taxes saved by Thioub by claiming these losses.

IRS Increases Security Measures for Obtaining Client Transcripts by Phone to Protect Against Identity Theft (IR-2024-136, May 9, 2024)

The IRS has taken new security steps to change how tax professionals can order transcripts by phone through the Transcript Delivery System (TDS). IR-2024-136 says that beginning April 8, 2024, tax professionals need to call the Practitioner Priority Service (PPS) line at 866-860-4259 to request transcripts

to be deposited into their Secure Object Repository (SOR) mailbox. IRS employees on other phone lines may not be authorized to provide transcripts through the SOR delivery method. The information release says tax professionals will need to pass enhanced authentication which requires them to verify their Short ID. A Short ID is an 8 to 10 alphanumeric code assigned when an IRS e-Services account is established. If the identity of the caller cannot be verified, transcripts will not be delivered using the SOR delivery method but will instead be mailed to the taxpayer's address of record. For additional information, please see [Practitioner Priority Service ® | Internal Revenue Service](#).

Practice Alert! There are other ways to obtain transcripts other than by phone. Please see [Practitioner Priority Service ® | Internal Revenue Service](#) for other ways to receive a taxpayer's transcript.

IRS Warns of Scams Targeting Tax Professionals

EFIN Scam. The IRS is warning tax professionals about a scam email that tries to steal electronic filing identification numbers (EFINs) to gain access to client data and a tax preparers' identities. The IRS says the scheme creates the potential for scammers to file fraudulent tax returns for refunds. The scammers impersonate software companies and say in the email that they need EFIN documents for a required verification to transmit tax returns.

The IRS says it has received dozens of reports of the scam targeting tax professionals and says professionals should be alert for a scam email that includes a U.S.-based area code for faxing EFIN documents and provides instructions on obtaining EFIN documentation from the IRS e-Services site. Scam variations seen by the IRS use different fax numbers for software vendors. Other warning signs of a scam include inconsistencies in the email wording and a German footer in the email. The IRS says tax professionals who receive these emails should not respond to the email and should not proceed with any of the steps displayed in the email. **IRS says the body of the fraudulent email states:**

Dear [recipient_email_address],

Help us protect you.

Because many Electronic Filing Identification Numbers (EFINs) are stolen each year and used to file fraudulent tax returns, the IRS has asked software vendors, such as Software A, to verify who the EFIN owner is by getting a copy of the IRS issued EFIN document(s). Our records show that we do not have a document for one or more of the EFINs that you transmit with.

What this means for you: Until your EFIN is verified, you will be unable to transmit returns. Please provide a copy of your EFIN Account Summary from IRS e-Services, with a status of 'Completed', to Software B for verification.

To send us your EFIN Summary document:

1. Fax to Software B at 631-995-5984

PLEASE NOTE THAT YOUR PREPARER TAX IDENTIFICATION NUMBER (PTIN) APPLICATION CANNOT BE USED AS DOCUMENTATION FOR YOUR EFIN.

If you do not have the above documentation you can get a copy of your IRS Application Summary from IRS e-Services by following the below steps or call the IRS e-Services helpline at 866-255-0654.

- 2. Sign in to your IRS e-Services account*
- 3. Choose your organization from the list provided and click Submit*
- 4. Click the Application link to access your existing application*
- 5. Click the e-File Application link*
- 6. Select the existing application link that applies to your organization*
- 7. Click the Application Summary link for the area of the application you wish to enter*
- 8. Click the Print Summary link at the bottom of the summary presented on the screen*

If you have any questions please contact the Compliance Department at xxx-xx-xxxx for assistance.

Thank you for your business. We look forward to serving you this coming season. Software B (edited) for verification.”

IRS Commissioner Danny Werfel said in a statement, "This scam serves as a powerful reminder that tax professionals should ensure strong security at their practices, including reminding employees to be careful with any emails coming in that could be posing as an official communication."

The IRS says that tax professionals who receive the scam email should report it to the [Treasury Inspector General for Tax Administration](#) (TIGTA). The professional should also send the email as an attachment to phishing@irs.gov. The IRS says that tax professionals who suspect data theft has occurred should report it to their local [IRS stakeholder liaison](#).

New Client Scam. As part of its “Dirty Dozen” tax scams, the IRS warns tax professionals about a “New Client Scam”. In this scam the tax preparer receives an email that seems to be from a new potential client. The preparer responds to the email and the scammer sends a malicious attachment or URL usually pretending to be the potential client’s tax information that, if opened, enables the scammer to gain access to sensitive client information on the preparer’s computer systems. The IRS says to never click suspicious links, double check the requests with the original sender, and to be vigilant year-round, not just during filing season.

BOI Reporting Not Required for Domestic Entities and Owners

Summary. All entities created in the United States and their U.S. beneficial owners are no longer required to file Beneficial Ownership Information (BOI) reports. Existing foreign companies have at least 30 days from March 21 to file.

Background. The Financial Crimes Enforcement Network (FinCEN) is a bureau of the U.S. Department of the Treasury (Treasury) and is responsible for implementing the Corporate Transparency Act (CTA), which includes BOI reporting. After numerous court challenges, some still ongoing, FinCEN [announced](#) on Feb. 18 a filing deadline of March 21, 2025, for most reporting companies established prior to Jan. 1, 2024, to file initial, updated, and/or corrected BOI reports. Its Feb. 18 notice indicated that it would be revising the BOI reporting requirements and that a further delay in the requirement may be forthcoming.

In a Feb. 27 [release](#), FinCEN announced that it would not take any enforcement actions, including fines or penalties, against any reporting companies that failed to comply with the BOI reporting requirements by the current deadlines. The release stated that an interim final rule to extend the BOI reporting deadlines would be issued by March 21.

On March 2, Treasury [released](#) a statement that it will not enforce any penalties or fines associated with the BOI reporting requirements under the existing deadlines and that no penalties or fines will be enforced against U.S. citizens, domestic reporting companies, or their beneficial owners after rule changes take effect. Further, Treasury will be issuing a rule “that will narrow the scope” of the BOI reporting rule “to foreign reporting companies only.”

The Treasury release elicited some pushback from the bipartisan FACT Coalition and other groups concerned that the exclusion of domestic reporting companies made it possible for [dirty money](#) to flow into the U.S. and may be unconstitutional. In a March 6 briefing, the groups stated that as many as 99.8 percent of all covered entities would be exempt, effectively gutting the anti-money laundering law.

BOI reporting requirements eliminated for U.S. companies and U.S. persons. In a March 21 [release](#), FinCEN announced the issuance of an [interim final rule](#) (IFR) that eliminated the requirement for U.S. companies and U.S. persons to report beneficial ownership information. Entities formed under the law of a foreign country and have registered to do business in the United States will have to report their foreign

beneficial owners only. Those foreign entities who registered to do business in the United States before the publication of the IFR must file BOI reports within 30 calendar days of publication. Those who register to do business after the publication of the IFR have 30 calendar days after receiving notification that their registration is effective to file their initial reports.

Comment. It was previously estimated that 71,000 foreign entities would have to file BOI reports in 2024, and about 11,000 new foreign entities would have to file each year after 2024. This pales in comparison to the estimated 36 million domestic entities required to file in 2024 and an additional 5 million each year after that. During the March 6 briefing, one concern voiced was that the distinction between shell companies formed in the U.S. and those formed in foreign companies fails to consider the underlying risk. Transparency International's Scott Greytak stated in the briefing that "The problem here is anonymous shell companies, regardless of where they are formed." It is reasonable to expect litigation on this.

New ID.me PTIN registration sign-in process. On June 26, the Director of the IRS Return Preparer Office sent an email announcing that tax preparers with a Social Security number would soon be required to sign into the [Tax Professional PTIN System](#) with ID.me. A subsequent email on July 15 announced that the sign-in process has been updated, allowing access to those with an ID.me account. The email notes that the existing sign-in method (Username and Password) for tax return preparers with a SSN will no longer be supported in the near future. Those with an ID.me account from a state government or another federal agency can sign in without re-verifying their identity. Those without an ID.me account will have to create one. To do so, users will need a government-issued photo ID, an email address, and a camera-enabled computer or mobile device. Additional information about ID.me can be found on the [IRS website](#). The ID.me credential enables access to various IRS online services, including the [Tax Pro Account](#), [e-Services](#), and others.

IRS, Security Summit Protect Your Clients, Protect Yourself campaign (IR-2025-73). The IRS and Security Summit partners announced a five-week campaign to help tax professionals protect themselves against tax-related identity theft threats. Week one of the series covered new and evolving scams targeting tax pros, including the "new client" scheme, phishing attempts to obtain the tax pro's EFIN, PTIN, and CAF numbers, and various phone, text, and correspondence scheme. In week two (IR-2025-75), phishing scams are highlighted and information on the six essential steps needed to address the attacks. The third week focuses on the details of the Written Information Security Plan, which all tax pros are required to have. The fourth week will cover the tools to help protect the tax pro and clients. The final week will address identify theft — how to recognize the signs of it and how to report it.

Chatbot available for e-Services. The IRS recently announced that its chatbot technology has been expanded to e-Services. The new feature provides answers to frequently asked questions and is available via the Chat icon on the [e-Services page](#). Note that the chatbot will not answer account-specific questions.

Privacy Concerns. Via another [executive order](#), the Department of Government Efficiency (DOGE) was established in the Executive Office of the President. The order renamed the United States Digital Service to the United States DOGE Service (USDS) and a temporary organization, the U.S. DODGE Service Temporary Organization, was established within the USDS. Further, the order stated that the USDS was to be led by an Administrator. Each agency was directed to establish a DOGE Team of at least four employees, and the team could include Special Government Employees. The order also required agency heads to ensure USDS access to "all unclassified agency records, software systems, and IT systems."

DOGE's access to various IT systems has been the subject of many news articles but its [attempt to access IRS's systems](#) has privacy advocates concerned. As noted above, the Administrator of USDS is unknown but the Feb. 17 court filings show it is not Elon Musk; rather, Musk is a Special Government Employee and is, therefore, eligible to be a member of an agency's DOGE team.

Nineteen state attorneys general obtained a temporary restraining order (TRO) ([State of New York, et al., v. Trump, et al.](#), No. 1:25-cv-01144), preventing Treasury from giving any political appointees or special government employees (which would include DOGE) access to the payment systems of the Bureau of the

Fiscal Service (BFS). The TRO was [modified](#) to allow the Secretary and Deputy Secretary of the Treasury to have access.

Several other lawsuits have been filed by taxpayer advocacy groups, nonprofits, unions, and others seeking to deny DOGE access. Part of the arguments being made point to IRC §6103. This Code section declares that tax returns and tax return information is confidential and cannot be disclosed except in certain circumstances and only with the permission of the Treasury Secretary. One of the lawsuits notes that the protection of tax return information in §6103 came in response to Watergate and the Nixon administration's attempts to audit its opponents. In conjunction with §6103, §7431 provides for civil damages for the unauthorized inspection or disclosure of returns and return information, §7213A provides for criminal penalties for the unauthorized inspection of returns or return information (the section under which former IRS contractor Charles Littlejohn, who shared tax return information with the New York Times and Pro Publica, pled guilty and was sentenced to 5 years in prison), and §7217 prohibit executive branch interference with audits or investigations of a taxpayer's tax liability.

Meanwhile, former Treasury officials are speaking out. Ten former officials, including former IRS Commissioner Danny Werfel, filed [a brief](#) in support of the 19 state attorneys general, arguing that DOGE access to BFS systems poses serious risks to the integrity of the payment system. In a *Tax Notes* article, former IRS Commissioner John Koskinen said, "As a general matter, political appointees never, as in never, have access to individual taxpayer files."

Finally, both the Treasury Inspector General and the GAO [have opened investigations](#) into DOGE's "unprecedented access to the federal government's payment systems."

Business Provisions

Extension and Enhancement of Deduction for Qualified Business Income

After 2025, this provision permanently extends and enhances the Qualified Business Income (QBI) deduction under IRC §199A. Under section 199A certain individuals, trusts, and estates may deduct (with limitations) 20 percent of qualified business income from a partnership, S corporation, or sole proprietorship, as well as 20 percent of aggregate qualified real estate investment trust (“REIT”) dividends and qualified publicly traded partnership income. The provision was scheduled to expire for tax years beginning after 2025.

Expanded Phase-In Thresholds:

The taxable income thresholds for fully applying the wage and capital limitations and for completely phasing out the QBI for specified service trade or businesses (SSTBs) are increased:

- **Single filers:** From \$50,000 to \$75,000
- **Joint filers:** \$100,000 to \$150,000

Therefore, for 2026 the wage and capital limitations and the SSTB disallowance provisions should phase in as taxable income increases from:

- **Single filers:** \$197,300 to \$272,300 (prior to the Act \$197,300 to \$247,300)
- **Joint filers:** \$394,600 to \$544,600 (prior to the Act \$394,600 to \$494,600)

Minimum Deduction for Active Businesses: Introduces a new minimum deduction of \$400 for taxpayers with at least \$1,000 in active qualified business income. Applies only to businesses in which the taxpayer materially participates (as defined under §469(h)).

Inflation Adjustments: Both the \$400 minimum deduction and the \$1,000 income threshold will be adjusted for inflation starting in 2027, using 2025 as the base year.

Effective Date: The amendments apply to taxable years beginning **after Dec. 31, 2025**.

Full Expensing for Certain Business Property

The OBBB revives and makes permanent the 100% bonus depreciation (full expensing) for qualified business property under IRC §168(k), **for qualifying property acquired after Jan. 19, 2025**.

Permanent 100% Expensing: The provision amends IRC §168(k) to allow a 100% first-year deduction for the cost of qualified property. This applies to most tangible depreciable property with a recovery period of 20 years or less, including machinery, equipment, and certain improvements.

Specified Plants: The 100% expensing also applies to certain plants bearing fruits and nuts, with special rules for those planted or grafted after Jan. 19, 2025.

Transitional Election: Taxpayers may elect a reduced bonus depreciation percentage (e.g., 40% or 60% [for long production period property or noncommercial aircraft]) for property placed in service in the first taxable year ending after Jan. 19, 2025.

Effective Date: **Applies to property acquired after Jan. 19, 2025.** Property subject to a binding written contract entered into before Jan. 20, 2025, is not eligible for the 100-percent rate and is subject to a 40% rate if placed in service in 2025 (60% in the case of long production period property and noncommercial

aircraft), a 20% rate if placed in service in 2026 (40% in the case of long production period property and noncommercial aircraft), and a 0% or 20% rate if placed in service in 2027.

Full Expensing of Domestic Research and Experimental Expenditures

For amounts paid or incurred after 2024, this provision restores and enhances the immediate deductibility of *domestic* research and experimental (R&E) expenditures, reversing the amortization requirement introduced by the 2017 Tax Cuts and Jobs Act (TCJA).

Immediate Deduction for Domestic R&E: Taxpayers may fully deduct domestic research or experimental expenditures in the year they are paid or incurred. Applies only to expenditures connected with a trade or business and **excludes foreign research costs**.

Optional Amortization Election: Taxpayers may elect to amortize domestic R&E expenditures over a period of not less than 60 months, beginning in the month benefits are first realized. Once elected, the method and period must be consistently applied unless changed with IRS approval.

Coordination With Research Credit: For expenditures paid or incurred in tax years beginning after 2024, the research credit is limited to domestic research and experimental costs only. A taxpayer claiming the research credit must reduce the deduction for research and experimental expenditures by the amount of the research credit.

Small Business Taxpayers May Elect to Apply This Change to Tax Years Beginning After 2021: Small business taxpayers (other than a tax shelter) with average annual gross receipts of \$31 million or less may retroactively elect to apply this change to tax years beginning after Dec. 31, 2021. The election must be made by July 4, 2026 (within one year of the date of enactment) and requires amended returns for tax years impacted by the election.

Acceleration provisions. Taxpayers that capitalized domestic research or experimental expenditures after Dec. 31, 2021, and before Jan. 1, 2025, may elect to accelerate the remaining unamortized deductions for such expenditures over a one-year period or ratably over a two-year period beginning with the first tax year beginning after 2024.

Exclusions: The provision does not apply to:

- Land acquisition or improvement costs,
- Property subject to depreciation or depletion,
- Mineral exploration expenditures,
- Foreign research expenditures.

Software Development: Software development costs are explicitly treated as domestic R&E expenditures and are eligible for full expensing.

Coordination with Other Provisions: Updates are made to integrate the new rules with the research credit (§41), AMT adjustments (§56), and other related sections (e.g., §280C, §59(e), §1202).

Effective Date: Generally, applies to amounts paid or incurred in taxable years beginning after December 31, 2024.

Modification of Limitation on Business Interest

The Act modifies the business interest expense limitation under IRC §163(j).

Depreciation, Amortization, & Depreciation Added Back In Determining ATI: **For tax years beginning after 2024**, businesses subject to the §163(j) interest deduction limitation can deduct more interest. The business interest deduction is limited under §163(j) to: (1) business interest income; (2) 30% of adjusted taxable income (ATI); and (3) floor plan financing interest. Prior to the Act., depreciation, amortization and depletion were deducted in determining ATI.. **For tax years beginning after 2024**, depreciation, amortization and depletion are added back to taxable income in determining ATI.

Foreign Items Included In Determining ATI For Tax Years Beginning After 2025: The definition of ATI is amended to include the following additional income items:

- Subpart F income under §951(a),
- Global intangible low-taxed income (GILTI) under §951A(a),
- Section 78 gross-up amounts,

And the corresponding deductions allowed under:

- §245A(a) (by reason of §964(e)(4)), and
- §250(a)(1)(B) (by reason of such inclusions).

Purpose: These changes ensure that foreign income inclusions and related deductions are properly reflected in the calculation of ATI, which may increase the amount of interest expense a taxpayer can deduct.

Broadening Floor Plan Interest Definition: **For tax years beginning after 2024**, interest on floor plan financing interest now includes floor plan interest for any trailer or camper which is designed to provide temporary living quarters for recreational, camping, or seasonal use and is designed to be towed by, or affixed to, a motor vehicle.

Coordination with Capitalization Rules: **For tax years beginning after 2025**, the §163(j) limitation on business interest applies regardless of whether the interest would otherwise be deducted or capitalized.

Priority of Allowable Interest: Any allowable interest under the §163(j) limitation must be:

- First applied to interest that would otherwise be capitalized, and
- Then to interest that would be deducted.
- Business interest carried forward is not subject to capitalization rules in future years.

Exclusion of Certain Capitalized Interest: **For tax years beginning after 2025**, Interest capitalized under §263(g) (relating to interest on debt used to carry tax-exempt obligations) or §263A(f) (relating to self-constructed assets) is excluded from the definition of “business interest.”

Regulatory Authority: The Secretary of the Treasury is granted authority to issue regulations or guidance to implement these changes, including coordination with the Base Erosion and Anti-Abuse Tax (BEAT) under §59A(c)(3).

Extension and Enhancement of Paid Family and Medical Leave Credit

For taxable years beginning after 2025, this provision extends and significantly enhances the employer tax credit for providing paid family and medical leave under IRC §45S, offering employers more flexibility and incentives to support employee leave programs. The credit was slated to expire after 2025.

Expanded Credit Options: Employers may now elect between two credit calculation methods-

- A percentage of wages paid to qualifying employees during leave, or
- A percentage of premiums paid for an insurance policy covering paid family and medical leave. The credit for insurance premiums is available whether or not leave is actually taken.

Clarified Aggregation Rules: Entities treated as a single employer under §414(b) and (c) are generally aggregated, unless a substantial and legitimate business reason is demonstrated.

Treatment of State-Mandated Leave: Leave paid or required by state or local governments -

- Counts toward the employer's leave offering,
- But it is excluded from the federal credit calculation.

Eligibility Enhancements: An employer may elect for an eligible employee to be a person who has been employed by the employer for not less than six months, rather than one year. Part-time employees are eligible employees if they work at least 20 hours per week on average.

No Double Benefit: Act clarifies that employers cannot deduct the portion of premiums or wages for which they claim the credit.

Section 414 Aggregation Provision. The Act amends the aggregation rule to provide that all persons treated as a single employer under §414(a) or §414(b) are generally treated as a single employer for purposes of the family and medical leave credit. All members of the controlled group must have a written paid FMLA policy and meet all the requirements for the credit, unless the employer has a substantial and legitimate business reason (other than line of business, wage rate, or job category) for treating some employees differently.

Effective Date: Applies to taxable years beginning **after Dec. 31, 2025**

Exceptions from Limitations on Deduction for Business Meals

The Tax Cuts and Jobs Act (TCJA) provided that business deductions paid or incurred for certain meals were not deductible **after 2025**. This includes amounts paid or incurred for: 1) meals excludable from an employee's income under §119(a) provided to employees and their spouses and dependents for the employer's convenience and on the employer's business premises; or 2) food, beverage, and facility expenses for meals qualifying as a *de minimis* fringe benefit under §132(e).

OBBB retains the disallowance of deductions for the above meal expenses for amounts paid or incurred after 2025.

Act Clarifies Following Costs Remain Fully Deductible:

Costs of Food and Beverages Sold (§274(e)(8)): Employers may deduct the entire amounts incurred for the purchase and preparation of food and beverages sold to customers for adequate and full consideration.

Food and Beverages Provided to Crew Members of Commercial Vessels or Drilling Rigs (§274(o)): Meals remain fully deductible if provided to the crews of commercial vessels that employers are required to provide under federal law and the crews of offshore drilling rigs that meet certain requirements (Code Sec. 274(o)).

Act Modifies Rules under §274 to Allow Broader Deductibility of Following business Meal Expenses:

Food and Beverages Provided to Crews of Fishing Vessels §274(n)(2)(C): Employers may deduct 100 percent (50% prior to the Act) of the cost of food and beverages provided to the crews of fishing vessels, as defined by Sec. 2101 of Title 46 of the U.S.C., and fish processing facilities. Fishing processing facilities

only qualify if they are located in the United States north of the 50 degrees north latitude and are not situated in a metropolitan area, as defined by §143(k)

Effective Date: Applies to taxable years beginning **after Dec. 31, 2025**

Increased §179 Dollar Limitations for Expensing of Certain Depreciable Business Assets

This provision enhances the expensing limits under IRC §179, allowing businesses to immediately deduct a greater amount of the cost of qualifying depreciable property, rather than recovering it through depreciation over time.

Increased Expensing Limits: The **maximum amount** a taxpayer may expense under §179 is increased from \$1,250,000 as indexed to \$2,500,000 for 2025.

The phase-out threshold is increased from \$3,130,000 as indexed to \$4,000,000.

Inflation Adjustments: The new dollar amounts will be adjusted for inflation beginning in 2026, using calendar year 2024 as the base year.

Effective Date: Applies to property placed in service in taxable years beginning **after Dec. 31, 2024**

Special 100% Depreciation Allowance for Qualified Production Property

For property placed in service after July 4, 2025, OBBB provides a new §168(n) 100% depreciation deduction for certain nonresidential real property used in qualified production activities, aimed at incentivizing domestic manufacturing and industrial investment.

100% First-Year Deduction: Taxpayers may elect to deduct 100% of the adjusted basis of qualified production property in the year it is placed in service.

The basis of the property is reduced by the amount of the deduction before calculating future depreciation.

Definition of Qualified Production Property: Must be nonresidential real property:

- Used as an integral part of a qualified production activity
- Located in the U.S. or its possessions
- Original use begins with the taxpayer
- Construction begins after Jan. 19, 2025 and before Jan. 1, 2029
- Placed in service before Jan. 1, 2031
- Designated by the taxpayer in election to take deduction

Exclusions: Office space, administrative services, lodging, parking, sales, research, software development, and engineering functions are excluded. Property subject to the alternative depreciation system is not eligible.

Qualified Production Activity: Defined as manufacturing, production, or refining of tangible personal property. Must result in a substantial transformation of the property. Excludes food/beverages prepared in the same building as a retail establishment.

Used Property Exception: Property must generally be new property. However, allows previously owned property (except property previously owned by the taxpayer) to qualify if not used in production since Jan. 1, 2021 and meets acquisition criteria. Recapture rules apply if the property is used for non-qualified purposes within 10 years. Deduction is allowed for alternative minimum tax purposes.

Recapture Rules: Qualified production property is subject to the recapture rules under §1245, not §1250. If a change in use occurs within ten years after qualified production property is placed in service, the recapture rules under §1245(a) apply. For recapture purposes, the production property will be treated as though taxpayer disposed of the property on the date taxpayer stops using the property in a qualified production activity.

Election Rules: Must be made on the taxpayer's return and is irrevocable without IRS consent (except in extraordinary circumstances).

Effective Date: Applies to property placed in service **after July 4, 2025**

Enhancement of Advanced Manufacturing Investment Credit

Effective for property placed in service after 2025, the advanced manufacturing investment credit percentage under §48D is increased from 25% to 35%. The credit applies to investments in a manufacturing facility built before 2027 with the primary purpose of manufacturing semiconductors or semiconductor manufacturing equipment.

Spaceports are Treated Like Airports under Exempt Facility Bond Rules

For obligations issued after July 4, 2025, this provision amends §142 to treat spaceports similarly to airports for purposes of the tax-exempt facility bond rules, thereby expanding financing opportunities for space infrastructure.

Inclusion in Exempt Facility Bond Rules: Amends §142(a)(1) to include "airports and spaceports" as eligible facilities for tax-exempt private activity bonds.

Treatment of Ground Leases: Spaceport property on land leased by a governmental unit from the U.S. government will be treated as owned by a governmental unit, provided lease requirements are met.

Definition of Spaceport: A "spaceport" includes facilities located at or near launch or reentry sites used for:

- Manufacturing, assembling, or repairing spacecraft or space cargo
- Flight control operations
- Launch and reentry services
- Transferring crew, participants, or cargo to/from spacecraft

Clarified Terms: Definitions for "spacecraft," "space cargo," "launch site," "reentry site," and related terms are aligned with those in 51 U.S.C. §50902.

Public Use Not Required: Spaceports do not need to be available for general public use to qualify.

Industrial Parks Exception: The usual exclusion for industrial parks under §142(c)(2)(E) does not apply to spaceport property used for manufacturing or assembly.

Exception from Federally Guaranteed Bond Prohibition: Bonds are not disqualified as tax-exempt merely because the U.S. government pays rent or fees to use the spaceport.

Effective Date: Applies to obligations issued **after July 4, 2025**

Enhancement of Employer-Provided Child Care Credit

For amounts paid or incurred after 2025, this provision expands and strengthens the employer-provided child care credit under §45F, increasing the financial incentive for businesses to support child care services for their employees.

Increased Credit Percentage: The credit rate for qualified child care expenditures is increased from 25% to 40%. The credit percentage is 50% for an eligible small business. The credit for resource and referral expenditures remains 10%.

Higher Dollar Limitations: The annual credit cap is raised to:

- \$500,000 for most businesses
- \$600,000 for eligible small businesses

Inflation Adjustments: Beginning in 2027, both the \$500,000 and \$600,000 limits will be adjusted for inflation using 2025 as the base year.

Definition of Eligible Small Business: A business that meets the gross receipts test under §448(c), modified to use a five-year lookback period instead of three years. The maximum inflation-adjusted gross receipts amount for 2025 is \$31 million.

Expanded Eligibility for Contracted Services: The credit now applies to child care services provided:

- Directly by the employer, or
- Through a contract with an intermediate entity that partners with qualified child care facilities.

Joint Ownership Allowed: A child care facility jointly owned or operated by the taxpayer and others still qualifies for the credit.

Regulatory Guidance: The Secretary of the Treasury is directed to issue regulations to implement these changes, including guidance on the new third-party and joint ownership provisions.

Effective Date: Applies to amounts paid or incurred **after Dec. 31, 2025**

Permanent Renewal and Enhancement of Opportunity Zones

This provision permanently renews and significantly enhances the Opportunity Zone (OZ) program under §§1400Z-1 and 1400Z-2, expanding its reach, improving transparency, and introducing new incentives, particularly for rural development.

Permanent Decennial Designation Process: Establishes a recurring 10-year cycle for designating Opportunity Zones, beginning July 1, 2026, and every 10 years thereafter. Repeals the special designation rule for Puerto Rico effective Dec. 31, 2026.

Updated Eligibility Criteria: Redefines “low-income community” to include census tracts with:

- Median family income $\leq 70\%$ of state/metropolitan median, or
- Poverty rate $\geq 20\%$ and median income $\leq 125\%$ of state/metropolitan median.

Eliminates the rule allowing contiguous tracts to qualify automatically.

Sunset Repeal and Basis Step-Up: Repeals the sunset on deferral elections, allowing indefinite deferral for reinvested capital gains.

For investments held:

- Five years: 10% basis step-up (30% for rural OZ funds),
- 10 years: basis equals fair market value at sale or after 30 years.

Qualified Rural Opportunity Funds (QROFs): Introduces QROFs, which must hold ≥90% of assets in rural OZ property. Rural areas are defined as areas outside cities/towns with >50,000 people and adjacent urbanized areas.

Special Rules for Rural Improvements: Allows 50% of adjusted basis in existing rural structures to count toward substantial improvement tests.

Enhanced Reporting and Transparency: Requires annual IRS reporting by OZ funds and investors, including:

- Asset values, business types (NAICS), employment data, and investment locations.
- Disclosure of investor-level data (e.g., acquisition/disposition dates and amounts).

Treasury must publish annual reports on OZ activity, including:

- Investment totals, job creation, housing units, and economic indicators
- Comparative data for census tracts over time (e.g., poverty, income, business starts)

Effective Dates: Most provisions apply to investments made **after Dec. 31, 2026**. Some reporting and structural changes take effect on **July 4, 2025**.

Scenario:

- **Investor**: Individual
- **Date of investment**: March 1, 2027
- **Capital gain realized**: \$500,000 from sale of stock
- **Capital gain reinvested into**: Qualified Rural Opportunity Fund (QROF) investing in a rural OZ housing project
- **Holding period**: Investor holds the investment for 10 years
- **OZ designation**: Extended permanently, next cycle begins July 1, 2026
- **Rural designation applies**: Yes (rural tract outside a metro area)

New OZ Benefits Applied:

Deferral of Capital Gain

- The \$500,000 capital gain is **deferred indefinitely** (no sunset clause anymore).
- It will not be taxed until the earlier of:
 - The sale of the OZ investment, or
 - December 31, 2032 – 5 years after the investment in the O Zone (the 2026 cliff is repealed).

Basis Step-Ups for Holding Period

- **At 5 years** → 10% step-up in basis
- $\$500,000 \times 10\% = \$50,000$ **excluded**
- **At 10 years (QROF)** → 100% of gain from OZ investment is excluded
- So, if the OZ investment grows from \$500,000 → \$900,000:
 - **\$400,000 gain is tax-free**
 - Only the **original deferred gain** (minus \$50,000 basis step-up) = \$450,000 would be taxed when recognized

Rural Boost

- Because the investment is in a QROF:
 - **Step-up at 5 years is 30%**, not 10%
 - $\$500,000 \times 30\% = \mathbf{\$150,000}$ excluded from deferred gain
 - **Remaining deferred gain = \$350,000**, taxed when triggered

Permanent Enhancement of Low-Income Housing Tax Credit

This provision permanently increases the state housing credit ceiling and modifies bond financing rules to expand access to the Low-Income Housing Tax Credit (LIHTC) under IRC §42, supporting the development of affordable housing.

Permanent Increase in State Credit Ceiling: The temporary 12.5% increase in the state housing credit ceiling, originally enacted for 2018–2021, is changed to 12% and made permanent. This applies to calendar years beginning after Dec. 31, 2025.

Modified Tax-Exempt Bond Financing Requirement: Revises the rule for when a building qualifies for the 4% LIHTC without needing to compete for state credit ceiling allocations.

A building qualifies if:

- $\geq 50\%$ of the aggregate basis of the building and land is financed by tax-exempt bonds, or
- $\geq 25\%$ is financed by such bonds issued after Dec. 31, 2025, and those bonds finance $\geq 5\%$ of the aggregate basis.

Effective Dates: The state ceiling increase applies to calendar years beginning after December 31, 2025. The bond financing rule changes apply to buildings placed in service in taxable years beginning **after Dec. 31, 2025**

Permanent Extension of New Markets Tax Credit

This provision permanently extends the New Markets Tax Credit (NMTC) under §45D which was set to expire on Dec. 31, 2025. The credit incentivizes private investment in low-income communities through tax credits for qualified equity investments in community development entities (CDE).

Permanent Extension: Amends §45D(f)(1)(H) to strike the previous expiration (2020–2025) and authorize allocations for each calendar year after 2019, making the NMTC a permanent part of the tax code.

Carryover of Unused Limitation: Revises §45D(f)(3) to:

- Allow unused credit allocation authority to be carried forward for up to five years.
- Treat any excess from pre-2026 calendar years as occurring in 2025, aligning carryover treatment with the new permanent structure.

Effective Date: Applies to calendar years beginning after **Dec. 31, 2025**

1% Floor on Deduction of Charitable Contributions Made by Corporations

For tax years beginning after 2025, this provision introduces a new limitation on the deductibility of charitable contributions made by corporations, establishing a minimum threshold that must be exceeded before deductions are allowed.

1% Floor and 10% Cap: A corporation's charitable contributions are deductible only to the extent that the total contributions:

- Exceed 1% of the corporation's taxable income, and
- Do not exceed 10% of the corporation's taxable income.

Carryforward Rules: Contributions disallowed due to the 10% cap may be carried forward for up to five years. Contributions disallowed solely due to the 1% floor may only be carried forward from years in which the 10% cap was exceeded. Contributions carried forward must be used on a first-in, first-out basis. If a corporation also has NOL carryovers, the charitable contribution carryover is reduced by the amount by which it would have reduced taxable income but for the NOL carryover, and the NOL carryover to succeeding years is correspondingly increased.

Scenario (Tax Year 2026):

- **Entity:** C Corporation
- **Taxable income (before charitable deductions):** \$1,000,000
- **Charitable contributions made:**
 - \$5,000 cash to a public charity
 - \$12,000 of inventory to a food bank
 - \$4,000 of equipment to a school

Total charitable contributions: \$21,000

Step 1: Apply the 1% Floor

- 1% of taxable income = $1\% \times \$1,000,000 = \$10,000$
- Contributions are only deductible to the extent they **exceed this floor**

\$21,000 – \$10,000 = \$11,000 deductible

Step 2: Apply the 10% Cap

- 10% of taxable income = **\$100,000**
- The \$11,000 deductible amount is **below this cap**, so no further limitation applies

Step 3: Carryforward

- The **\$10,000 disallowed under the 1% floor** may be **carried forward**, but **only** if the total contributions for the year exceeded the 1% floor 10% cap — which they did in this case.
- That \$10,000 can be carried forward for up to **five years**, subject to the 10% cap and 1% floor in future years

Effective Date: Applies to taxable years beginning **after Dec. 31, 2025**

Permanent Increase in Limitation on Cover Over of Tax on Distilled Spirits

This provision amends the Internal Revenue Code to permanently increase the amount of federal excise tax on distilled spirits that is "covered over" (i.e., transferred) to the treasuries of Puerto Rico and the U.S. Virgin Islands.

Increased Cover Over Rate: The cover over amount is permanently set at \$13.25 per proof gallon, replacing the previous temporary rate that was subject to expiration.

Effective Date: Applies to distilled spirits brought into the United States **after Dec. 31, 2025**

Nonprofit Community Development Activities in Remote Native Villages

This provision clarifies and expands the tax-exempt treatment of certain nonprofit activities related to fisheries in remote Alaska Native villages, specifically within the Bering Sea and Aleutian Islands regions.

Recognition of Fisheries-Related Activities as Tax-Exempt: Activities substantially related to participation or investment in fisheries in the Bering Sea and Aleutian Islands are deemed to be substantially related to the exempt purpose of certain nonprofit entities under §501(a).

Applies to entities identified in §305(i)(1)(D) of the Magnuson-Stevens Fishery Conservation and Management Act.

Qualifying activities include: Harvesting, processing, transportation, sales, and marketing of fish and fish products from the designated statistical and reporting areas.

Treatment of Wholly Owned Subsidiaries: If a qualifying nonprofit entity owns a subsidiary engaged in such fisheries activities, and the subsidiary's assets are transferred to the parent entity within 18 months of enactment:

- No gain or income is recognized by either party.
- All income from the transferred business is exempt from taxation.

Effective Date: Effective July 4, 2025 and remains in effect for the duration of the Western Alaska Community Development Quota (CDQ) Program under §305(i)(1) of the Magnuson-Stevens Act

Adjustment of Charitable Deduction for Certain Expenses Incurred in Support of Native Alaskan Subsistence Whaling

This provision increases the allowable charitable deduction for certain out-of-pocket expenses incurred by individuals who participate in Native Alaskan subsistence whaling activities, recognizing the cultural and subsistence importance of these practices.

Increased Deduction Limit: Amends IRC §170(n)(1) to raise the maximum deduction for qualified whaling-related expenses from \$10,000 to \$50,000 per year.

Effective Date: Applies to taxable years beginning **after Dec. 31, 2025**

Exception to Percentage of Completion Method of Accounting for Certain Residential Construction Contracts

This provision provides an exception to the requirement that certain long-term construction contracts use the percentage-of-completion method (PCM) of accounting, specifically for qualified residential construction contracts.

Exception from use of PCM for Residential Construction Contracts: Amends IRC §460(e)(1)(B) to exclude from the PCM requirement any residential construction contract entered into in a tax year beginning after July 4, 2025:

Exemption From UNICAP: A residential construction contract is not subject to the UNICAP rules:

- If the taxpayer estimates at the time the contract is entered into that the contract will be completed within the three-year period (instead of the general two-year period) beginning on the contract commencement date; and
- The contract is entered into by a taxpayer whose average annual gross receipts for the prior three years do not exceed \$31 million (indexed for inflation based on IRC 448(c)).

Residential Construction Contract. The term “residential construction contract” means any contract if 80 percent or more of the estimated total contract costs (as of the close of the taxable year in which the contract was entered into) are reasonably expected to be attributable to the building, construction, reconstruction, or rehabilitation of, or the installation of any integral component to, or improvements of a house or apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel, or other establishment more than one-half of the units in which are used on a transient basis. A “residential construction contract” also includes any improvements to real property directly related to such dwelling units and located on the site of such dwelling units.

AMT: Residential construction contracts entered into in a tax year beginning after July 4, 2025 are exempt from the requirement to use the percentage of completion method for AMT according to amended §56(a)(3).

Effective Date: Applies to contracts entered into in taxable years beginning **after July 4, 2025**

Expansion of Qualified Small Business Stock Gain Exclusion

This provision amends IRC §1202 to expand the capital gains exclusion for Qualified Small Business Stock (QSBS), reducing the holding period and increasing the exclusion percentage for stock acquired after the enactment date.

Phased Exclusion Based on Holding Period:

For stock acquired after Sept. 27, 2010 and on or before July 4, 2025, a 100% exclusion applies if the stock is held more than five years. No exclusion is allowed if not held more than five years. For QSBS **acquired after July 4, 2025**, the exclusion percentage is a graduated exclusion based on how long the stock is held.

- Three years: 50% exclusion
- Four years: 75% exclusion
- Five years or more: 100% exclusion

Clarified Acquisition Date Rules: The “acquisition date” for purposes of §1202 is the first day the stock is held by the taxpayer, determined after applying §1223 (relating to holding periods in certain transfers).

Issuer’s Asset Limitation: Prior to the Act, the aggregate gross assets of the issuing corporation (cash and the adjusted basis of its assets) generally must not have exceeded \$50 million at any point before and immediately after the stock issuance (including amounts received in the issuance). The Act increases this gross asset limitation to \$75 million for stock issued after July 4, 2025.

Alternative Minimum Tax (AMT) Treatment: Gain from qualified small business stock acquired after September 27, 2010, including stock acquired after July 4, 2025, is not subject to AMT.

Conforming Amendments: Updates various subsections of §1202 to reflect the new three-year minimum holding period and the phased exclusion structure.

Increased Per-Issuer Limitation: For QSBS acquired after July 4, 2025, the per-issuer gain exclusion cap is increased. Specifically, eligible gain from stock from any one issuer in any given tax year that a taxpayer

may exclude is limited to the greater of (i) the applicable dollar limit for the tax year, or (ii) 10 times the taxpayer's basis in the stock.

For this purpose, the applicable dollar limit for any tax year with respect to eligible gain from one or more dispositions of QSBS of a corporation by a taxpayer is:

- *For stock acquired on or before July 4, 2025:* \$10 million, reduced by the aggregate amount of eligible gain taken into account by the taxpayer under the gain exclusion rule for prior tax years and attributable to dispositions of stock issued by the corporation and acquired by the taxpayer before, on, or after July 4, 2025.
- *For stock acquired after July 4, 2025:* \$15 million, reduced by the sum of:
 - the aggregate amount of eligible gain taken into account by the taxpayer under the gain exclusion rules for prior tax years and attributable to dispositions of stock issued by the corporation and acquired by the taxpayer before, on, or after July 4, 2025, plus
 - the aggregate amount of eligible gain taken into account by the taxpayer under the gain exclusion rule for the tax year and attributable to dispositions of stock issued by the corporation and acquired by the taxpayer on or before July 4, 2025.

For tax years beginning after 2026, the \$15 million per-issuer limit is adjusted for inflation.

Scenario:

- **Investor:** Jane
- **QSBS acquired:** Aug. 1, 2026 (after enactment date)
- **QSBS holding period:**
 - Sold three years later → Aug. 1, 2029
 - Sold five years later → Aug. 1, 2031
- **Gain on sale:** \$2,000,000
- **Jane meets all §1202 QSBS eligibility rules** (e.g., stock was issued by a C corporation with ≤ 75M in assets, held original issue, active business, etc.)
- **No prior QSBS sales** by Jane

New Exclusion Tiers:

For QSBS acquired **after the new law's enactment**, exclusion percentages are:

- **Three years:** 50% exclusion
- **Four years:** 75% exclusion
- **Five-plus years:** 100% exclusion

Outcome 1: Sale After Three Years

- Holding period = Three years
- Exclusion = 50%
- **Excludable gain = \$1,000,000**
- **Taxable gain = \$1,000,000**
 - Subject to 28% capital gain rate under §1202
 - Plus 3.8% Net Investment Income Tax (NIIT), if applicable
- **\$1,000,000 taxed**

Outcome 2: Sale After Five Years

- Holding period = Five years
- Exclusion = 100%
- **Excludable gain = \$2,000,000**
- **Taxable gain = \$0**

Jane pays **no federal tax** on the \$2,000,000 gain if held for at least five years

Key Additions Under the New Law:

- **New phased-in exclusion levels** based on holding period
- **Per-issuer cap increase:** The \$10M lifetime or 10× basis cap is increased to 15M as adjusted for inflation.
- **Effective Date:** Applies to taxable years beginning after July 4, 2025.

Repeal of Revision to De Minimis Rules for Third Party Network Transactions

This provision repeals the lower reporting threshold for third-party network transactions introduced by the American Rescue Plan Act of 2021 and restores the prior *de minimis* exception under IRC §6050W.

Restoration of Prior Thresholds: A third-party settlement organization is only required to report transactions if:

- The aggregate amount exceeds \$20,000, and
- The number of transactions exceeds 200.

Effective Date: Applies to returns for calendar years beginning **after 2021**

Backup Withholding Coordination: Amends IRC §3406 to ensure that backup withholding applies only if both the \$20,000 and 200 transaction thresholds are met.

Exception: If a payee had reportable transactions under the backup withholding rules in the prior year, the backup withholding rules apply regardless of current-year thresholds.

Effective Date for Backup Withholding Rule: Applies to calendar years beginning **after Dec. 31, 2024**

Increase in Threshold for Requiring Information Reporting with Respect to Certain Payees

After 2025, this provision raises the reporting threshold for payments made to non-employees, easing compliance burdens for businesses and aligning the threshold with inflationary trends.

Increased Reporting Threshold: Amends IRC §6041(a) to increase the threshold for information reporting from \$600 to \$2,000.

Inflation Adjustment: Introduces a new subsection §6041(h) to provide for annual inflation adjustments to the \$2,000 threshold beginning in calendar year 2027. The adjustment is based on the cost-of-living index, rounded to the nearest multiple of \$10,000.

Effective Date: Applies to taxable years beginning after **Dec. 31, 2025**

Treatment of Certain Qualified Sound Recording Productions

This provision expands the scope of IRC §181 to include qualified sound recording productions, allowing producers to expense production costs and benefit from bonus depreciation, similar to film, television, and live theatrical productions.

Election to Expense Costs: Amends §181(a)(1) to allow taxpayers to elect to treat costs of a qualified sound recording production as deductible expenses in the year incurred.

Dollar Limitation: A cap of \$150,000 applies to:

- The cost of any single qualified sound recording production, and
- The cumulative cost of all such productions in a taxable year.

No Double Deduction: No other deduction or amortization is allowed for costs expensed under this provision.

Definition of Qualified Sound Recording Production: Defined as a sound recording (per 17 U.S.C. §101) that is produced and recorded in the United States.

Bonus Depreciation Eligibility: Qualified sound recording productions are added to the list of property eligible for 100% bonus depreciation under §168(k), treated as placed in service at the time of initial release or broadcast.

Conforming Amendments: Updates are made throughout §181 and §168 to reflect the inclusion of sound recordings alongside film, television, and live theatrical productions.

Observation: The Code Sec. 181 deduction expires for productions commencing after Dec. 31, 2025 and was not extended by the new law. If a §181 election is made, production costs are expensed in the tax year paid or incurred. If the production does not commence until after the Dec. 31, 2025, expiration date, costs expensed under §181 are subject to recapture. Under the bonus depreciation rule, production costs will be expensed in the tax year the production is placed in service and without regard to the \$150,000 limit for sound recordings.

Effective Date: Applies to productions commencing in taxable years ending **after July 4, 2025**

Exclusion of Interest on Loans Secured by Rural or Agricultural Real Property

This provision introduces a partial exclusion from gross income for interest earned on certain loans secured by rural or agricultural real estate, aiming to incentivize lending in underserved rural areas.

25% Interest Exclusion: Allows a 25% exclusion from gross income for interest received by a qualified lender on a qualified real estate loan.

Qualified Lender Definition: Includes:

- FDIC-insured banks and savings associations,
- State- or federally regulated insurance companies,
- Certain U.S.-based bank holding company subsidiaries,
- Federally chartered instrumentalities under the Farm Credit Act of 1971

Qualified Real Estate Loan Criteria: Must be: Secured by rural or agricultural real estate, or a leasehold mortgage on such property, Made to a non-foreign entity, Originated after July 4, 2025 (refinancings of pre-enactment loans are excluded).

Definition of Rural or Agricultural Real Estate: Includes:

- Property substantially used for agricultural production
- Property used in fishing or seafood processing
- Aquaculture facilities (e.g., hatcheries, rearing ponds)

The property must be located in a U.S. state or territory.

Coordination With Section 265:

For tax-exempt interest purposes: Only 25% of interest on indebtedness is disallowed, 25% of loan basis is treated as tax-exempt obligation basis, Adjustments apply to prevent full disallowance of deductions tied to tax-exempt income.

Effective Date: Applies to loans made **after July 4, 2025**

Restoration of Taxable REIT Subsidiary Asset Test

This provision amends IRC §856(c)(4)(B)(ii) to: Increase the allowable percentage of a REIT's assets that may be held in taxable REIT subsidiaries (TRSs) from 20% to 25%.

Effective Date: Applies to taxable years beginning **after Dec. 31, 2025**

Termination of Qualified Commercial Clean Vehicles Credit

This provision eliminates the tax credit for businesses that purchase qualified commercial clean vehicles under Section 45W of the Internal Revenue Code.

Termination Date: The credit, originally set to expire on Dec. 31, 2032, will now terminate on Sept. 30, 2025.

Effect: Businesses will no longer be eligible to claim the credit for vehicles acquired after this date.

Effective Date: Applies to vehicles acquired after **Sept. 30, 2025**

Termination of Energy Efficient Commercial Buildings Deduction

This provision eliminates the deduction under Section 179D of the Internal Revenue Code for energy-efficient commercial building property.

Termination Rule: The deduction will no longer apply to property the construction of which begins after June 30, 2026.

Effective Date: Applies to property whose construction begins **after June 30, 2026**

Termination of Cost Recovery for Energy Property

This provision eliminates the accelerated cost recovery for certain energy property under Section 168 of the Internal Revenue Code.

Repealed Provision: Subclause (I) of Section 168(e)(3)(B)(vi), which allowed a five-year recover period for solar or wind energy property, is repealed.

Effective Date: Applies to property the construction of which begins after **Dec. 31, 2024**

Modifications of Zero-Emission Nuclear Power Production Credit

This provision amends Section 45U of the Internal Revenue Code to impose new restrictions on eligibility for the zero-emission nuclear power production credit.

Foreign Entity Restrictions: No credit is allowed for any taxable year beginning after July 4, 2025, if the taxpayer is a *specified foreign entity*, or for any taxable year beginning after July 4, 2027, if the taxpayer is a *foreign-influenced entity* (as defined in IRC §7701(a)(51)).

Termination of Clean Hydrogen Production Credit

This provision shortens the availability of the clean hydrogen production credit under Section 45V of the Internal Revenue Code.

Termination Date: The credit, originally set to expire for production facilities where construction began after Dec. 31, 2032, will now terminate if a production facility begins construction after Dec. 31, 2027.

Termination and Restrictions on Clean Electricity Production Credit

This provision modifies Section 45Y of the Internal Revenue Code to both terminate the clean electricity production credit for certain facilities and impose new restrictions on eligibility.

Termination for Wind and Solar Facilities: The credit will no longer apply to wind or solar facilities (“applicable facilities”) placed in service after Dec. 31, 2027 where construction of the facility begins after July 4, 2026.

“Applicable facility” includes those using wind or solar energy to produce electricity, as defined in IRC §45(d)(1) and §45(d)(4), respectively, without regard to construction start date requirements.

Restrictions on Foreign Influence: No credit is allowed for facilities whose construction begins after Dec. 31, 2025, if the construction receives material assistance from a prohibited foreign entity (as defined in IRC §7701(a)(52)). Additionally, no credit is allowed for any tax year beginning after July 4, 2025 for any taxpayer that is a specified foreign entity or a foreign-influenced entity (as defined in IRC §7701(a)(51)(B) and (D)).

Termination and Restrictions on Clean Electricity Investment Credit

This provision modifies Section 48E of the U.S. Internal Revenue Code to terminate the clean electricity investment credit for certain facilities and impose new restrictions on eligibility.

Termination for Wind and Solar Facilities: The credit will no longer apply to wind or solar facilities placed in service after Dec. 31, 2027, if they are part of an “applicable facility” using wind or solar energy to produce electricity and construction of the “applicable facility” begins after July 4, 2026.

Exception: This termination does not apply to energy storage technology placed in service at such facilities.

Restrictions on Foreign Influence: No credit is allowed for facilities or energy storage technology whose construction begins after Dec. 31, 2025, if they receive material assistance from a prohibited foreign entity (as defined in IRC §7701(a)(52)).

No credit is allowed for any tax year beginning after July 4, 2025 for any taxpayer that is a specified foreign entity or a foreign-influenced entity (as defined in IRC §7701(a)(51)(B) and (D)).

Recapture Rule: If a taxpayer that received the credit makes a payment to a prohibited foreign entity within 10 years of placing the property in service, the tax for that year will be increased by the full amount of the prior credits claimed.

Other Changes: Denial of credit for wind and solar leasing arrangements where the property is rented to a third party.

Adjustments to domestic content thresholds for projects beginning construction after June 16, 2025.

Elimination of the energy credit for certain energy property.

Application of the credit to qualified fuel cell property with a fixed 30% rate.

Effective Dates: General provisions apply to taxable years beginning after the date of enactment.

Foreign entity restrictions apply to construction beginning after Dec. 31, 2025. Termination for wind and solar facilities applies to construction beginning after July 4, 2026

Phase-out and Restrictions on Advanced Manufacturing Production Credit

This provision modifies Section 45X of the Internal Revenue Code to phase out and restrict the advanced manufacturing production credit.

Phase-Out for Critical Minerals: For applicable critical minerals (excluding metallurgical coal), the credit phases out as follows:

- 75% of the full credit for minerals produced in 2031
- 50% in 2032
- 25% in 2033
- 0% after Dec. 31, 2033

Termination Dates:

- No credit for wind energy components produced and sold after Dec. 31, 2027
- No credit for metallurgical coal produced after Dec. 31, 2029

Restrictions on Foreign Influence: No credit is allowed for any taxable year beginning after July 4, 2025:

For any property that includes material assistance from a prohibited foreign entity (as defined in IRC §7701(a)(52)).

If the taxpayer is a specified foreign entity or a foreign-influenced entity (as defined in IRC §7701(a)(51)(B) and (D)).

Other Key Changes: Clarifies treatment of integrated components sold within the same facility.

Adds metallurgical coal to the list of applicable critical minerals.

Expands the definition of battery modules to include essential energy collection equipment.

Effective Date: Applies to taxable years beginning **after July 4, 2025**

Restriction on the Extension of Advanced Energy Project Credit Program

Beginning on July 4, 2025, any allocations of the §48C advanced energy project credit revoked by the IRS because the taxpayer failed to place the project in service within 2 years may not be added to the amount of credits that may be allocated.

Extension and Modification of Clean Fuel Production Credit

This provision extends and modifies the clean fuel production credit under Section 45Z of the Internal Revenue Code, with new eligibility rules and restrictions.

Extension of Credit: The credit is extended by two years, from its original expiration date of Dec. 31, 2027, to Dec. 31, 2029.

Prohibition on Foreign Feedstocks: For fuel produced after December 31, 2025, to qualify for the credit, fuel must be exclusively derived from feedstocks produced or grown in the United States, Mexico, or Canada.

Prohibition on Negative Emission Rates: Effective for emission rates published for fuel produced after 2025, the emissions rate for any transportation fuel, resulting from rounding, may not be less than zero, except for fuels derived from animal manure, which may receive a negative emissions rate.

Exclusion of Indirect Land Use Changes: Effective for emission rates published for fuel produced after 2025, rates must be adjusted to exclude emissions attributed to indirect land use changes, based on regulations issued by the Secretary.

Special Treatment for Animal Manure: Effective for emission rates published for fuel produced after 2025, the Secretary is to provide distinct emissions rates for fuels derived from specific types of animal manure (e.g., dairy, swine, poultry), and these may include negative emissions rates.

Foreign Entity Restrictions. Restrictions apply to clean fuel production credits related to foreign entities. The credit is not allowed for:

- Any tax year beginning after July 4, 2025, if the taxpayer is a specified foreign entity as defined in §7701(a)(51)(B), or
- Any tax year begins after July 4, 2027, if the taxpayer is a foreign-influenced entity as defined in §7701(a)(51)(D).

Restrictions on Carbon Oxide Sequestration Credit

This provision modifies Section 45Q of the IRC to impose new restrictions and adjustments on the carbon oxide *sequestration credit*.

Foreign Entity Restrictions: No credit is allowed for any taxable year beginning after July 4, 2025 if the taxpayer is:

- A specified foreign entity (as defined in IRC §7701(a)(51)(B)), or
- A foreign-influenced entity (as defined in IRC §7701(a)(51)(D), without regard to clause (i)(II)).

Parity for Carbon Oxide Uses: Effective for facilities or equipment placed in service after July 4, 2025, the provision restructures the treatment of carbon oxide to ensure consistent credit eligibility across:

- Secure geological storage,
- Use as a tertiary injectant in enhanced oil or gas recovery, and
- Other qualified utilization methods.

Credit Amount Adjustments: For years beginning after 2024 and before 2027: \$17 per metric ton

For years after 2026: \$17 adjusted for inflation (using 2025 as the base year)

For enhanced oil and gas recovery: \$36 per metric ton

Intangible Drilling and Development Costs Taken into Account for Purposes of Computing Adjusted Financial Statement Income

This provision modifies the treatment of intangible drilling and development costs (IDCs) for purposes of calculating adjusted financial statement income (AFSI) under the corporate alternative minimum tax (CAMT).

Inclusion of IDCs in AFSI: Deductions for IDCs under Section 263(c), including those amortized under Sections 59(e) or 291(b)(2), must now be included in AFSI to the extent they are deducted in computing taxable income for the year.

Depreciation and Depletion Adjustments: The provision also adjusts how depreciation and depletion expenses related to such property are treated in AFSI calculations.

Effective Date: Applies to taxable years beginning **after Dec. 31, 2025**

Income from Hydrogen Storage, Carbon Capture, Advanced Nuclear, Hydropower, and Geothermal Energy Added to Qualifying Income of Certain Publicly Traded Partnerships

This provision expands the definition of “qualifying income” for publicly traded partnerships (PTPs) under Section 7704(d)(1)(E) of the Internal Revenue Code.

Expanded Qualifying Activities: Income from the following activities are now considered qualifying income for PTPs:

Transportation or storage of:

- Liquefied or compressed hydrogen
- Fuels described in IRC §6426 (e.g., biodiesel, alcohol fuels, sustainable aviation fuel)

Generation, availability, or storage of electric power at qualified carbon capture facilities (as defined in IRC §45Q(d)) or the capture of carbon dioxide by such facilities

Production of electricity from advanced nuclear facilities (as defined in IRC §45J(d)(2))

Production of electricity or thermal energy using hydropower or geothermal energy (as defined in IRC §45(c)(1)(D) or (H))

Operation of certain energy property (as defined in IRC §48(a)(3)(A)(iii) or (vii))

Effective Date: Applies to taxable years beginning **after Dec. 31, 2025**

Modifications to De Minimis Entry Privilege for Commercial Shipments

This provision tightens the rules under Section 321 of the Tariff Act of 1930 regarding the de minimis entry privilege for low-value imports.

Civil Penalty Introduced: A new civil penalty is imposed for misuse of the de minimis entry privilege:

- Up to \$5,000 for the first violation
- Up to \$10,000 for each subsequent violation

Applies when a person uses the de minimis privilege to import goods that violate other U.S. customs laws.

Repeal of Commercial Shipment Exception: The provision repeals the exception that previously allowed certain commercial shipments to qualify for de minimis treatment.

Effective Dates: Civil penalty provision takes effect 30 days after July 4, 2025. Repeal of the commercial shipment exception takes effect on July 1, 2027.

Modification and Extension of Limitation on Excess Business Losses of Noncorporate Taxpayers

This provision makes permanent and modifies the limitation on excess business losses for noncorporate taxpayers under Section 461(l) of the IRC.

Permanent Rule: The temporary limitation on excess business losses, previously set to expire after 2028, is made permanent.

Adjustment of Thresholds: **For tax years beginning after 2025**, the base year for calculating the inflation-adjusted threshold amounts (i.e., \$250,000 or \$500,000 for those filing a joint return) is updated from 2017 to 2024, and the reference date for the inflation adjustment is changed from Dec. 31, 2018 to Dec. 31, 2025. For 2025, the threshold amounts are \$313,000 (626,000 for those filing joint returns). The threshold amounts should be significantly lower for 2026.

Scenario (Tax Year 2026):

- **Filer:** Single individual (non-corporate taxpayer)
- **Business income:** \$200,000
- **Business deductions:** \$1,000,000
- **Net business loss:** \$800,000
- **Other income (e.g., wages, dividends):** \$50,000

Resulting total income before limitation = \$50,000 – \$800,000 = \$750,000

Step 1: Understand the Excess Business Loss (EBL) Threshold

- For 2026, assume the **inflation-adjusted EBL threshold** is **\$260,000** (actual amount will be indexed from \$250,000 base using 2025 as reference year)
- This means: **Only \$260,000** of business loss can offset nonbusiness income

Step 2: Apply the Limitation

- **Claimable business loss in 2026:** \$260,000
- **Excess business loss disallowed:** \$800,000 – \$260,000 = **\$540,000**

The **\$540,000** excess becomes a **Net Operating Loss (NOL) carryforward** under §172 in 2027

Final Taxable Income (2026):

- **Other income:** \$50,000
- **Business loss allowed:** –\$260,000
- **Taxable income = –\$210,000 → NOL**

The taxpayer effectively gets to use only \$260,000 of their \$800,000 business loss in the current year. The rest carries forward.

Effective Dates: The permanent extension applies to taxable years beginning after Dec. 31, 2026. The adjusted calculation thresholds apply to taxable years beginning after Dec. 31, 2025.

Treatment of Payments from Partnerships to Partners for Property or Services

This provision amends Section 707(a)(2) of the Internal Revenue Code to clarify the treatment of payments made by partnerships to partners in exchange for property or services.

Clarification of Statutory Language: Section 702 provides rules for recharacterizing certain payments to a partner from a partnership for property or services as a transaction between the partnership and someone who is not a partner. The introductory statutory language under section 702 is revised by the OBBB to read "Except as provided" in place of "Under regulations prescribed". Replacing the phrase "Under regulations prescribed" with "Except as provided," signals a shift in how such payments are to be interpreted under the statute, potentially limiting reliance on regulatory discretion.

This affects "disguised sales" and "guaranteed payments" — two common ways partnerships compensate partners.

It may narrow the IRS's ability to recharacterize payments unless explicitly allowed by the statute.

It could also impact planning strategies involving property contributions or service arrangements between partners and partnerships.

Example:

Scenario:

- **Partnership:** ABC Partners, LLC
- **Partner:** John owns a 30% interest in profits and capital
- **Situation:** ABC agrees to pay John \$200,000 in exchange for:
 1. **\$100,000 of consulting services** related to an upcoming acquisition, and
 2. **\$100,000 worth of real estate property** John owns and contributes to the partnership
- The payments are structured **outside of John's distributive share** and made on specific dates

Prior Law (Pre-Amendment):

- Under §707(a)(2)(A) and (B), the IRS could **recharacterize** these transactions as:
 - **Disguised payments** for services or property
 - Potentially treat them as **non-partner transactions** if structured to avoid tax or shift income
- The IRS had **broad regulatory authority** to determine when recharacterization was appropriate

New Law (Post-Amendment):

- The language "**Under regulations prescribed...**" is replaced with "**Except as provided...**"
- This restricts the IRS from issuing new regulations that **recharacterize valid partner transactions unless the statute explicitly provides for it.**

Tax Treatment in This Example (Post-Amendment):

1. **\$100,000 for consulting services**
 - Treated as **§707(a) payment** (like a payment to a non-partner)
 - **Taxable ordinary income** to John
 - **Deductible business expense** to ABC Partners
2. **\$100,000 for real estate contribution**
 - If treated under §707(a), this is a **taxable sale**, not a capital contribution
 - John recognizes **gain or loss** on the transfer
 - Partnership takes **stepped-up basis** in the property

These payments are not part of John's distributive share and are **not treated under §704(b)**. The partnership and John must **report these separately** (e.g., on Schedule K-1, Box 4 or 5 for guaranteed payments and §707(a) transactions)

Effective Date: Applies to services performed and property transferred after July 4, 2025

Excessive Employee Remuneration from Controlled Group Members and Allocation of Deduction

This provision amends Section 162(m) of the Internal Revenue Code to address how excessive employee compensation is treated when paid by members of a controlled group of corporations.

Aggregation of Compensation: If a publicly held corporation is part of a controlled group, and any member of that group pays more than \$1 million in compensation to a “specified covered employee,” the deduction limitation under Section 162(m) applies to all members of the group.

Allocation of Deduction Limit: The \$1 million deduction cap is allocated among the group members based on the proportion of compensation each member pays to the specified covered employee.

Specified Covered Employee Definition: Includes employees who would be considered covered employees under Section 162(m)(3) if all members of the controlled group were considered together.

Effective Date: Applies to taxable years beginning after December 31, 2025

Excise Tax on Certain Remittance Transfers

This provision imposes a new excise tax on specific types of outbound remittance transfers (generally electronic transfers to recipients abroad) under newly created Section 4475 of the Internal Revenue Code.

Tax Rate: A 1% excise tax is imposed on the amount of any qualifying remittance transfer.

Who Pays: The sender of the remittance is responsible for the tax.

The remittance transfer provider must collect the tax from the sender and remit it quarterly to the IRS. If the tax is not collected at the time of transfer, the provider becomes secondarily liable for the unpaid tax.

Scope of Tax: Applies only to remittance transfers funded with cash, money orders, cashier’s checks, or other similar physical instruments.

Exemptions: Transfers funded by:

Withdrawals from U.S. financial institution accounts, or

U.S.-issued debit or credit cards, are not subject to the tax.

Definitions: Terms like “remittance transfer,” “remittance transfer provider,” and “sender” are defined by reference to the Electronic Fund Transfer Act (15 U.S.C. §1693o–1(g)).

Effective Date: Applies to transfers made after December 31, 2025

Enforcement Provisions with Respect to COVID-Related Employee Retention Credits

This provision introduces new enforcement rules and limitations related to the COVID-era Employee Retention Credit (ERC) under Section 3134 of the Internal Revenue Code. The ERC is also called the ERTC.

Due Diligence Penalty: A penalty of \$1,000 per failure is imposed on any “COVID–ERTC promoter” who provides aid, assistance, or advice related to ERC claims and fails to meet due diligence requirements similar to those under IRC §6695(g).

Definition of COVID–ERTC Promoter: A person qualifies as a promoter if:

- They charge a fee based on the refund or credit amount and derive more than 20% of gross receipts from ERC-related services, or
- They derive over 50% of gross receipts from ERC-related services, or
- They meet a hybrid threshold of 20% gross receipts and over \$500,000 in ERC-related revenue.

Limitation on Claims: No ERC claims or refunds will be allowed after July 4, 2025, unless the claim was filed on or before January 31, 2024.

Extended Assessment Period: The limitations period for assessment of any amount attributable to an ERC claimed under Code Sec. 3134 will not expire before the latest of 6 years from:

The original return filing date,

The deemed filing date under §6501(b)(2), or

The date the claim for credit or refund was made.

Coordination with Wage Deductions: If an ERC is disallowed, the period for claiming a credit or refund of any amount attributable to a deduction for improperly claimed ERC wages does not expire before the time period for such assessment expires.

Penalty Expansion: The 20% penalty for erroneous refund claims under §6676 is expanded to include employment taxes, not just income taxes.

Effective Dates:

Penalties and enforcement provisions apply to aid or advice provided **after July 4, 2025**.

The claim limitation and assessment extension apply to credits and assessments **after July 4, 2025**.

Non-Profit and Miscellaneous Provisions

Modification of Excise Tax on Investment Income of Certain Private Colleges and Universities

This provision revises the excise tax under IRC §4968 on the net investment income of certain private colleges and universities by introducing a tiered rate structure and expanding the definition of taxable income.

New Tiered Excise Tax Rates:

- 1.4% for institutions with a student-adjusted endowment between \$500,000 and \$750,000
- 4% for institutions with a student-adjusted endowment between \$750,000 and \$2 million
- 8% for institutions with a student-adjusted endowment exceeding \$2 million

Applicable Institutions:

- Must have at least 3,000 tuition-paying students
- More than 50% of students must be located in the United States
- Must not be a state college or university
- Must have a student-adjusted endowment of at least \$500,000

Student-Adjusted Endowment: Defined as the fair market value of assets (excluding those used directly for exempt purposes) divided by the number of full-time equivalent students.

Expanded Definition of Net Investment Income: Includes interest income from student loans made by the institution or related organizations. Includes federally subsidized royalty income from intellectual property developed with federal funds, even if previously exempt.

Related Organizations: Assets and income of related organizations are included unless the organization is not controlled by the institution or the assets are not intended for the institution's benefit.

Reporting Requirements: Institutions must report the number of tuition-paying students and total students used in the calculation of the student-adjusted endowment.

Effective Date: Applies to taxable years beginning after December 31, 2025

Expanding Application of Tax on Excess Compensation within Tax-Exempt Organizations

The provision Section 70416 of the Senate-passed bill expands the application of the excise tax on excess compensation within tax-exempt organizations under §4960 by broadening the definition of a “covered employee.”

Expanded Definition: A “covered employee” now includes:

Any current employee of a tax-exempt organization (or its predecessor),

Any former employee who was employed during any taxable year beginning after December 31, 2016.

Purpose: This change ensures that the excise tax under IRC Section 496, which imposes a 21% tax on compensation exceeding \$1 million paid by certain tax-exempt organizations, applies more broadly, including to former employees retroactively.

Effective Date: The amendment applies to taxable years beginning **after Dec. 31, 2025**

Task Force on the Replacement of Direct File

This provision establishes a task force to evaluate and propose a replacement for the IRS Direct File program. Here's a summary of its key provisions:

Purpose: The Department of the Treasury is directed to deliver a report to Congress within 90 days after July 4, 2025. The report must address:

Cost analysis of enhancing and establishing public-private partnerships that offer free tax filing for up to 70% of taxpayers (based on AGI), as a replacement for IRS-run Direct File.

Taxpayer preferences regarding a government-run versus private-sector-provided free filing service.

Feasibility assessment of a new approach, including:

- Consistency and simplicity across providers
- Features that meet taxpayer needs

Cost estimates for developing and operating a free direct e-file system, including options based on income and return complexity.

Funding: \$15 million is appropriated for fiscal year 2026, available until Sept. 30, 2026, to support this initiative.

SELECT INTERNATIONAL PROVISIONS OF TITLE VII OF P.L. 119-21

Provisions Related to the Foreign Tax Credit

Modifications to foreign tax credit limitation (70311). For taxable years beginning after Dec. 31, 2025, the rules for the allocation and apportionment of deductions to income in the NCTI (formerly GILTI — see B.3. below) category are modified for purposes of determining the FTC limitation (new § 904(b)(5)).

- Deductions treated as allocable and apportionable to NCTI category. No interest expense or R&E are allocable or apportionable. Only two types of deductions are permitted.
- The deduction under § 250(a)(1)(B) (the 40% deduction for NCTI amounts included in gross income under § 951A and the § 78 gross-up) less applicable taxes imposed on these under § 164(a)(3), and
- Any other deduction directly allocable to NCTI.

Other amounts or deductions. Any other amounts or deductions that would have been allocated or apportioned to the NCTI category but for the rules in a. above are allocated or apportioned to U.S. sources income.

Modifications to Determination of Deemed Paid Credit for Taxes Properly Attributable to NCTI (70312)

For taxable years beginning after Dec. 31, 2025, the legislation increases the deemed paid credit from 80% to 90% related to the NCTI included in a domestic corporation's gross income (amended § 960(d)(1)) with a corresponding increase in the § 78 gross up (amended § 78). Section 951A(a) requires U.S. shareholders of CFCs to include in gross income the shareholder's NCTI for the year. Section 959(a) provides for an exclusion from gross income for distributions of previously taxed NCTI. For such distributions made after June 28, 2025, no FTC is allowed for 10% of any foreign taxes paid or accrued (or deemed paid) (new paragraph § 960(d)(4)).

Sourcing of Income From Sale of Inventory Produced in the U.S. (70313). Currently, income for the sale of inventory produced by the taxpayer within the U.S. and sold outside the U.S. is allocated and apportioned on the basis of production activities, i.e., inventory produced entirely in the U.S. is 100% U.S.-source income. For taxable years beginning after Dec. 31, 2025, for U.S. persons who maintain an office or other fixed place of business in a foreign country, the portion of income from the sale of inventory produced in the U.S. for use outside the U.S., to which the third sentence of § 863(b) applies (related to the source on income partly from within and partly from without the U.S.), and is attributable to the foreign office or other fixed place business is treated as foreign source income, not to exceed 50% of the total income from the sale or exchange of inventory (new § 904(b)(6)).

Provisions Related to FDDEI (Formerly FDII) and NCTI (Formerly GILTI)

Modification of Deduction for FDDEI and NCTI (70321). The deductions allowed to domestic corporations for FDDEI and NCTI under § 250(a) have been made permanent (§ 250(a)(3) is stricken) and are reduced in comparison to 2025 levels (but are higher than those that were to be in effect for post-2025 tax years that were contained in the now stricken § 250(a)(3)). For taxable years beginning after Dec. 31, 2025, the FDDEI deduction is reduced from 37.5% to 33.34% and the NCTI is reduced from 50% to 40% (amended §§ 250(a)(1)(A) and (B)). The effective tax rate for the FDDEI deduction is 14%. After considering

the 10% haircut in the new § 960(d)(4) (item A.2. above), the combined effective tax rate to eliminate U.S. residual tax on NCTI is 14%.

Determination of deduction eligible income (70322). New § 250(b)(3)(A)(i)(VII) modifies the definition of deduction eligible income (DEI) by excluding any income or gain from the sale or other disposition (including a deemed sale or other disposition, or a transaction subject to the special rules relating to transfers of intangibles under § 367(d)) of intangible property (as defined in § 367(d)(4)) and other property that is subject to depreciation, amortization, or depletion for transactions occurring after Jun. 16, 2025. In addition, amended § 250(b)(3)(A)(ii) modifies the deductions (including taxes) that reduce DEI to exclude interest expense and R&E expenditures from the expenses and deductions (including taxes) properly allocable to DEI. This modification applies to taxable years beginning after Dec. 31, 2025.

Rules Related to Deemed Intangible Income (70323). For taxable years beginning after Dec. 31, 2025, this provision eliminates the deduction for a domestic corporation's deemed tangible income, which is used to determine its FDII, and a shareholder's net deemed tangible income return, which is used to determine the shareholder's GILTI, by removing §§ 951A(b) and (d). In the removal of these, the terms DII and FDII are unnecessary and are stricken from the IRC. Thus, the legislation renames Foreign-Derived Intangible Income (FDII) to Foreign-Derived Deduction Eligible Income (FDDEI) and renames Global Intangible Low-Taxed Income (GILTI) to Net CFC Tested Income (NCTI) in the appropriate places in §§ 250 and 951A.

Other Provisions

Base Erosion Minimum Tax Amount (70331). The base erosion and anti-abuse tax (BEAT) is an additional tax imposed on certain U.S. corporations that are part of multinational groups. The tax is a fixed percentage of modified taxable income to the extent that it exceeds the taxpayer's adjusted regular tax liability (i.e., regular tax liability reduced by certain credits). For taxable years beginning after Dec. 31, 2025, the rate was scheduled to increase, and the regular tax liability was to be reduced by generally all credits. The legislation sets the rate at 10.5% (instead of the scheduled increase to 12.5% from the current 10% - amended § 59A(b)(1)(A) and stricken § 59A(b)(2)) and eliminates the modification to the calculation of allowable credits (stricken § 59A(b)(2)) for tax years beginning after Dec. 31, 2025.

Definition of ATI for Business Interest Limitation (70342). New § 163(j)(8)(A)(vi) excludes from ATI certain foreign amounts of income and deductions, specifically, the Subpart F (§ 951(a)) and GILTI (§ 951A(a)) inclusions and the associated § 78 gross-up amounts (and the portion of the deductions for foreign source dividends received from certain 10%-owned foreign corporations under § 245A(a) for taxable years beginning after Dec. 31, 2025. The amounts determined under § 956 (related to investment earnings in U.S. property of CFCs) will continue to be excluded from a taxpayer's ATI.

Permanent Extension of Look-Thru Rule for Related Cfcs (70351). The look-thru rule for foreign corporations in § 954(c)(6), scheduled to expire Dec. 31, 2025, is permanent (amended § 954(c)(6)(C)).

Repeal of One-Month Deferral Election for Specified Foreign Corporations (70352). Section 898 contains the rules for determining the required taxable year of a specified foreign corporation, which is one treated as a CFC in which a U.S. shareholder owns more than 50% of a) the total voting power or all classes of voting stock or b) the total value of all classes of stock (§ 898(b)). The required tax year is either that of the majority U.S. shareholder, or if no majority U.S. shareholder, the tax year prescribed under the regulations. The Code included an election to adopt a tax year beginning one month earlier than that of the majority U.S. shareholder. The legislation repealed the election (§ 898(c)(2) is stricken) for taxable years of specified foreign corporations beginning after Nov. 30, 2025. A transition rule requires that a specified foreign corporation's first taxable year beginning after Nov. 30, 2025, must end at the same time as its required year (i.e., a short taxable year) and that the change in year end is treated as initiated by the corporation with the consent of the Secretary of the Treasury.

Constructive Ownership Rules — Restoration of Limitation on Downward Attribution of Stock Ownership (70353). Section 958 applies the constructive ownership rules of § 318(a) with modifications. Previous § 958(b)(4), repealed by the TCJA, held that stock owned by a foreign person was not attributed downward to a U.S. person. Because of this, attribution of stock owned by a foreign person to a related U.S. person was required to determine whether the U.S. person is a U.S. shareholder (actual or constructive ownership of 10% or more of a) the total combined voting power of all classes of voting stock or b) the total value of all shares of all classes of stock (§ 951(b)) and, therefore, whether the foreign corporation is a CFC (U.S. shareholders own more than 50% of a) the total voting power or all classes of voting stock or b) the total value of all classes of stock (§ 957(a)). The legislation restores the language of the repealed § 958(b)(4) (new § 958(b)(4)). The legislation also adds new § 951B to permit downward attribution from a foreign person in certain circumstances, i.e., to a foreign controlled U.S. shareholder, defined as one who owns more than 50% of a) the total combined voting power of all classes of voting stock or b) the total value of all shares of all classes of stock. Both changes apply to taxable years of foreign corporations beginning after Dec. 31, 2025.

Modification of Pro Rata Share Rules (70354). For tax years of foreign corporations beginning before Jan. 1, 2026, a U.S. shareholder owning stock *on the last day* of the tax year of a foreign corporation that is a CFC at any time during the tax year must include in gross income the shareholder's pro rata share of the foreign corporation's subpart F income and, generally, the amounts determined under § 956 (related to investment earnings in U.S. property of CFCs). Effective for taxable years of foreign corporations beginning after Dec. 31, 2025, the legislation modifies the rules so that a U.S. shareholder owning stock on *any day* of the tax year of the CFC is subject to the gross income inclusion (amended § 951(a)). A transition rule is provided for certain dividends paid (or deemed paid) by a CFC on or before Jun. 28, 2025, or if paid (or deemed paid) after Jun. 28, 2025, and before the CFC's first taxable year beginning after Dec. 31, 2025. Such dividends are not treated as dividends for purposes of applying § 951(a)(2)(B) (as in effect before the amendments made by this provision).

SELECT BUSINESS PROVISIONS OF TITLE VII OF P.L. 119-21

Items affecting businesses in 2025. Except as otherwise noted, the provisions below apply to tax years beginning after Dec. 31, 2024.

Tips (70201) and overtime (70202) reporting. Qualified tips and qualified overtime are to be reported on W-2s or 1099s; however, a transition rule for 2025 permits employers to provide a “separate accounting” of the tips or overtime and the IRS has announced ([IR-2025-82](#), Aug. 7, 2025) that there will be no changes to these information returns for 2025. The format for the separate accounting will come in subsequent guidance from the IRS. For tips, the recipient’s occupation must be reported.

- a. **Qualified tips.** See the discussion of the tips deduction under “Items affecting individuals in 2025” earlier, including the limitations for SSTB employers. Whether SSTB employers will be required to report tips will be addressed in the forthcoming IRS guidance.
- b. **Withholding tables adjustment for qualified tips.** The legislation directed the IRS to update the withholding tables; however, in IR-2025-82, the IRS announced that there will be no changes to the withholding tables for 2025.
- c. **Qualified overtime.** See the discussion of the overtime deduction under “Items affecting individuals in 2025” earlier. Overtime paid for reasons other than the FLSA requirement, such as under contractual agreements or under state law that do not satisfy the FLSA requirements, is not “qualified overtime” and would not be reported.

Tips credit (70201). The credit for the portion of employer Social Security taxes paid with respect to employee cash tips under § 45B has been expanded to include those in beauty services, provided such tipping is customary (amended § 45B(b)(2)). The beauty services include barbering and hair care, nail care, esthetics, and body and spa treatments.

Car loan interest reporting (70203). New § 6050AA requires businesses that receive interest from individuals of \$600 or more in a calendar year on a specified passenger vehicle loan file a return with the IRS and furnish a written statement to the individual reporting the interest received by Jan. 31 of the next year. See the discussion of the car loan interest deduction under “Items affecting individuals in 2025” earlier, for what interest and vehicles qualify.

- a. **Reporting content.** The return and statement must include the name and address of the individual from whom the interest was received; the amount of interest received; the outstanding principal on the loan as of the beginning of the calendar year; the date of the original loan; the year, make, model, and VIN of the vehicle that secures the loan; and any other information that the IRS may require. The penalties for failure to comply with the reporting requirements apply.
- b. **Reporting format.** Guidance from the IRS will be forthcoming, likely a new 1098 series form.

1099-K reporting threshold and backup withholding (70432). The reporting threshold for third party network transactions is reverted to more than \$20,000 and more than 200 transactions. This provision is effective as if it were included in the American Rescue Plan Act of 2021, so it applies to returns for calendar years beginning after Dec. 31, 2021 (amended § 6050W(e)). The increased threshold also applies to the backup withholding requirements, unless the third-party network transactions made in the prior year were reportable. This backup withholding provision is effective for calendar years beginning after Dec. 31, 2024 (new § 3406(b)(8)).

Qualified small business stock (QSBS) (70431). The limit on gains excludable gain from a single issuer under § 1202(b) is increased from \$10 million to \$15 million for stock acquired after July 4, 2025. The cap

continues to be subject to reduction by certain prior year excluded gains, as well as the greater of the cap (as reduced) or 10 times the taxpayer's adjusted basis in the stock requirement. In addition, for stock issued after July 4, 2025, the limit on the corporation's aggregate gross assets for the stock to qualify as QSBS is increased from \$50 million (before and immediately after issuance) to \$75 million. Both the per-issuer and gross asset caps will be adjusted for inflation beginning in 2027.

Bonus depreciation (70301). The 100% deduction is permanently reinstated for qualified property acquired after Jan. 19, 2025 (amended §§ 168(k)(2)(A), (B), (E), (5)(A)), and 460(c)(6)(B)).

- a. Limitation. Property acquired under a written binding contract entered into before Jan. 20, 2025, is **not** eligible for the 100% deduction and is subject to the lower rates previously prescribed (for 2025, 40% or 60% for long production period property and noncommercial aircraft, with the subsequent reductions thereafter).
- b. Transitional election. For qualified property placed in service during the first taxable year ending after Jan. 19, 2025, taxpayers may elect to use the lower rates previously prescribed for 2025.

Bonus depreciation for sound recording productions (70434). Qualified sound recording productions are eligible for bonus depreciation for taxable years ending after July 4, 2025 (new § 168(k)(2)(A)(i)(VI)). A qualified sound recording production is one defined in section 101 of title 17, United States Code that is produced and recorded in the United States (new § 181(f)). For purposes of the bonus depreciation deduction, a sound recording production is considered placed in service at the time of initial release or broadcast (new § 168(k)(2)(H)(iii)).

NOTE: This same section of the new law added sound recording productions to the deduction available under § 181, limited to \$150,000 per year, for taxable years ending after July 4, 2025; however, § 181 terminates Dec. 31, 2025.

Special depreciation allowance for qualified production property (70307). New § 168(n) permits taxpayers to elect to take a deduction of 100% of the adjusted basis of qualified production property placed in service after July 4, 2025. The election is irrevocable without the consent of the Treasury Secretary, who can only consent in extraordinary circumstances.

- a. Qualified production property. Qualified production property is new, nonresidential real property used as an integral part of a qualified production activity for which construction begins after Jan. 19, 2025, and before Jan. 1, 2029, and which is placed in service in the U.S. or its possession before Jan. 1, 2031. (The Jan. 1, 2031, date may be extended by the Treasury Secretary if an act of God prevents the taxpayer from placing the property in service by that date.) An exception exists for used property not previously owned by the taxpayer if such property was not used in a qualified production activity at any time between Jan. 1, 2021, and May 12, 2025. There is also a special rule for acquisitions under written binding contracts. **Excluded** from the definition of qualified production property are the portions of nonresidential real property used for offices, administrative services, lodging, parking, sales activities, research activities, software development or engineering activities, or other functions unrelated to the manufacturing, production, or refining of tangible personal property.
- b. Qualified production activity. This is the manufacturing, production or refining of a qualified product which result in a substantial transformation of the property comprising the product. The term "production" only includes agricultural and chemical production. A "qualified product" is any tangible property other than a food or beverage prepared in the same building as a retail establishment in which such property is sold.
- c. Recapture. If, within 10 years after it is placed in service, the property ceases to be used as an integral part of a qualified production activity, the recapture rules under § 1245 are applied.

- d. Regulations. Forthcoming regulations will address what constitutes “substantial transformation of property” and how the recapture rules regarding a change in use apply in a fully or partially tax-free transfer.

Section 179 expensing (70306). The maximum deduction is \$2.5 million, reduced dollar-for-dollar for assets placed in service in excess of \$4 million (amended §§ 179(b)(1) and (2)). Both the deduction amount and threshold will be adjusted for inflation after 2025 (amended § 179(b)(6)(A)).

Business interest expense (70303). The calculation of ATI for purposes of the business interest expense limitation is permanently restored to EBITDA (amended § 163(j)(8)(A)(v)). In addition, for purposes of floor plan financing, the definition of motor vehicle is expanded to include trailers or campers designed to provide temporary living quarters for recreation, camping, or season use and is designed to be towed by, or affixed to, a motor vehicle (amended § 163(j)(9)(C)). The legislation authorizes additional guidance by the IRS, if necessary or appropriate, for short taxable years that begin after Dec. 31, 2024, and end before July 4, 2025.

Domestic research and experimental (R&E) expenditures (70302). New § 174A provides a permanent expense deduction for domestic R&E expenditures paid or incurred in taxable years beginning after Dec. 31, 2024. In lieu of expensing, taxpayers may elect to capitalize and amortize such expenditures over not less than 60 months. Forthcoming regulations, as necessary, will be issued, including those allowing for the deduction in the case of taxpayers with taxable years beginning after Dec. 31, 2024, and ending before July 4, 2025. The legislation provides for transition rules, as follows.

- a. Elective retroactive application by small businesses. Taxpayers who meet the gross receipts test in § 448(c) for the first taxable year beginning after Dec. 31, 2024 (average annual gross receipts for the three previous tax years not exceeding \$31 million in 2025) may elect to expense domestic R&E paid or incurred after Dec. 31, 2021. The election is treated as a change in accounting method under § 481 and must be made on an amended return filed prior to July 4, 2026.
- b. Election to deduct unamortized amounts. Taxpayers not eligible for the retroactive small business election or who chose not to elect it may elect to deduct unamortized domestic R&E paid or incurred in taxable years beginning after Dec. 31, 2021, and before Jan. 1, 2025, in the first taxable year beginning after Dec. 31, 2024, or over a two-year period beginning with the first taxable year beginning after Dec. 31, 2024. The election is treated as a change in accounting method under § 481 initiated by the taxpayer and as made with the consent of the Treasury Secretary.

Energy credits (70503). The qualified commercial clean vehicles credit (§ 45W(g)) is eliminated for vehicles acquired after Sep. 30, 2025. Numerous other credits have been terminated early (see “Select Energy Credits Summary” and “Select Energy-Related Deductions Summary” later).

Payments to partners for property or services (70602). An amendment to § 707(a)(2) removes “Under regulations prescribed” and replaces it with “Except as provided”. This change clarifies that regulations are not required to apply the rules of the statute and applies to services performed, or property transferred, after July 4, 2025.

Employee retention credits (ERC or ERTC) (70605). As of July 4, 2025, the IRS is barred from paying out refunds for any claims for the last two quarters of 2021 filed after Jan. 31, 2024.

- a. Statute of limitations extended, penalties. For ERC claims filed for the last two quarters of 2021, the statute of limitations on assessment is extended to six years after the latest of (1) the date on which the original return is filed, (2) the date on which the return is treated as filed under § 6501(b)(2), or (3) the date on which the claim for credit or refund is made (amended § 3134(l)(1)). The statute of limitations on the deduction for wages related to the ERC is similarly extended (amended § 3134(l)(2)). (For information on how to correct income tax

returns for ERC-related wages, see "Income tax and ERC" section of the [IRS ERC FAQ](#).) Finally, the 20% penalty for an erroneous claim for refund or credit has been extended to employment tax returns (amended § 6676(a)).

- b. ERTC promoters. Any COVID-ERTC promoter which provides aid, assistance, or advice with respect to any COVID-ERTC document and fails to comply with the due diligence requirements similar to those in § 6695(g) will be charged a penalty of \$1,000 for each failure. The penalty is imposed under § 6695(g) and assessed under § 6201. "Document" is one which constitutes, or relates to, a return or claim for refund under § 3134. A COVID-ERTC promoter is one who either (1) charges a fee based on the refund or credit amount and the fees for aid, assistance and advice with respect to all COVID-ERTC documents exceed 20% of their gross receipts for the year, or (2) the gross receipts for aid, assistance and advice with respect to all COVID-ERTC documents exceed 50% of their gross receipts for the year, or (3) the COVID-ERTC-related gross receipts are greater than 20% of their gross receipts and greater than \$500,000.

Percentage of completion method not required for residential construction contracts (70430). Long-term residential construction contracts entered into in taxable years beginning after July 4, 2025, are not required to use the percentage of completion method of accounting (amended § 460(e)). The provision extends the eligibility to use the completed contract method for both regular tax and AMT purposes (amended § 56(a)(3)) beyond the previous "home construction contracts" and requires that, at the time the contract is entered into to, it is estimated to be completed within three years. (For home construction contracts, the two-year estimated completion period remains.) A "residential construction contract" is one in which 80% or more of the estimated total contract costs (as of the close of the taxable year in which the contract is entered into) are reasonably expected to be attributable to the building, construction, reconstruction, or rehabilitation of, or the installation of any integral component to, or improvements of "a house or apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel or other establishment, more than one-half of the units in which are used on a transient basis" (i.e. "dwelling units" as defined in § 168(e)(2)(A)(ii)).

Items affecting businesses after 2025. Except as otherwise noted, the provisions apply to tax years beginning after Dec. 31, 2025.

1. 1099 reporting threshold (70433). For payments made after Dec. 31, 2025, the reporting threshold for Forms 1099-MISC and 1099-NEC is \$2,000 (§ 6041(a)). New § 6041(h) provides for the \$2,000 to be adjusted for inflation after 2026. The same threshold, including the inflation adjustment, applies to the backup withholding requirements in § 3406(b)(6).
2. Trump savings accounts (70204). New § 128 permits employers to make contributions of up to \$2,500 to the Trump accounts of its employees or their dependents. Such amounts are excluded from the gross income of the employee (or the account beneficiary under new § 139J). The \$2,500 limit will be adjusted for inflation for taxable years beginning after 2027.
3. Business interest expense (70341). New § 163(j)(10) provides for the coordination of the business interest expense limitation with the interest capitalization provisions, including those in § 263 and § 266. The new section provides that the § 163(j) limitation is calculated prior to the application of any interest capitalization provision under which interest is required to be capitalized or under which interest may be deducted or capitalized.
4. Corporate charitable contributions (70426). Corporate charitable contributions are subject to a 1% floor before the application of the 10% of taxable income limitation (amended § 170(b)(2)(A)). Contributions disallowed due to the 1% floor are only included in the carryforward if contributions for the year exceed the 10% limit. The 5-year carryforward period, the first-in, first out application

of carryforwards, and the reduction in the contributions carryforward when there are also NOL carryforwards are unchanged (amended § 170(d)(2)).

5. Business meals expenses (70305). Section 274(o) was added to the Code by P.L. 115-97 (TCJA) to prohibit after 2025 deductions for certain meals provided at the convenience of the employer, specifically the expenses for the operation of a facility described in § 132(e)(2) and food or beverages associated with the facility, and any expense for meals described in § 119(a) relating to meals furnished on the business premises of the employer. This prohibition remains in effect; however, the section was amended to exclude from the prohibition those described in §§ 274(e)(8) and (n)(2)(C).
 - a. Section 274(e)(8). Expenses for goods or services (including the use of facilities) sold to the taxpayer for adequate consideration are permitted the full 100% deduction. This includes the cost of food and beverages purchased by a restaurant or catering business for purposes of providing meals to consumers that may also be consumed by employees.
 - b. Section 274(n)(2)(C). As amended this, section permits a 100% deduction for meals provided on certain fishing boats (fishing vessel, fish processing vessel, or fish tender vessel as defined in section 2101 of title 46, United States Code) or certain fish processing facilities (those processing fish for commercial use or consumption located in the U.S. north of 50 degrees north latitude (i.e., Alaska) and not located in a metropolitan statistical area (§ 143(k)(2)(B))).
6. Qualified business income (QBI) deduction (70105). The deduction, which was scheduled to expire after 2025, is permanent and remains at 20%. The provision for specified agricultural or horticultural cooperatives (or certain of their patrons), which are not eligible for the general QBI deduction but are entitled to an alternative deduction under § 199A(g), is also permanent (via amended § 199A(i)).
 - a. Increased phase-in range. The phase-in range for the W-2 wages and capital investment limitation (§ 199A(b)(2)(B)) as well as the SSTB limitation (§ 199A(d)(1)(A)) is increased from \$50,000 (\$100,000 MFJ) to \$75,000 (\$150,000 MFJ) (amended §§ 199A(b)(3)(B) and (d)(3)). These amounts will not be adjusted for inflation.
 - b. Minimum deduction. The rewrite of § 199A(i) establishes a minimum deduction for active qualified business income. The deduction is \$400 if the aggregate QBI of all the taxpayer's active qualified trades or businesses is at least \$1,000. Both the \$400 and \$1,000 amounts will be adjusted for inflation after 2026.
7. Energy credits (70504, 70508). The alternative fuel vehicle refueling property credit (§ 30C) is terminated for property placed in service after June 30, 2026. The new energy efficient home credit (§ 45L) is terminated for homes acquired after June 30, 2026.
8. New markets tax credit (70423). The credit is permanent (amended § 45D(f)(1)(H)). The carryover is modified from its scheduled end in 2030 to five years. Carryovers from any calendar years prior to 2026 are treated as occurring in calendar year 2025 (amended § 45D(f)(3)).
9. Paid family and medical leave (PFML) credit (70304). The credit is permanent (§ 45S(i) is stricken). The credit is modified to allow employers to elect to claim the credit for an applicable percentage of insurance premiums paid or incurred on insurance policies to provide the PFML coverage in lieu of the applicable percentage of wages paid to qualifying employees while on family and medical leave. The rate of payment under the insurance policy (for purposes of

determining the applicable percentage) is determined without regard to whether any employees were on family and medical leave during the year (amended § 45S(a)(3)). In addition, the credit now includes an aggregation rule which requires each member of a controlled group (those treated as a single employer under §§ 414(b) and (c)) to have a written policy for PFML that meets the requirements of § 45S to qualify for the credit unless the employer has a substantial and legitimate reason for failing to provide a written policy (amended § 45S(c)(3)). Finally, for the qualifying employee rules, the employer may elect to lower the employee minimum work requirement from 1 year to six months and the compensation amount is determined on an annualized basis (pro-rata for part-time employees) (amended §§ 45S(d)(1) and (2)).

10. Employer-provided child-care credit (70401). The credit rate is increased from 25% to 40% (50% for an eligible small business) of qualified child care expenditures (amended § 45F(a)(1)). The maximum credit amount (dollar limitation) is increased from \$150,000 to \$500,000 (\$600,000 for an eligible small business), with the higher amounts being adjusted for inflation after 2026 (amended § 45F(b)). An “eligible small business” is one that meets the gross receipts test under § 448(c), but rather than using the average annual gross receipts for the previous three years, uses average annual gross receipts for the previous **five** years (new § 45F(c)(4)). The credit is expanded to apply to child care services provided through third-party intermediary contracts (amended § 45F(c)(1)(A)(iii) and jointly owned or operated child care facilities (new § 45F(c)(2)(C)).
11. Low-income housing credit (70422). The state housing credit ceiling increase is permanent with the multiplier used set at 1.12 (instead of 1.125) for calendar years beginning after Dec. 31, 2025 (amended § 42(h)(3)(I)). In addition, the tax-exempt bond-financing threshold is lowered from 50% to 25% for buildings placed in service in taxable years beginning after Dec. 31, 2025, and for bonds issued after 2025 (amended § 42(h)(4)(B)).
12. Opportunity zones (70421). The credit is permanent. Significant changes have been made to the credit, including a rolling, ten-year designation beginning July 1, 2026 (new § 1400Z-1(c)(2)(C)), a limitation on the number of designations (amended § 1400Z-1(d)(1)), and the narrowing of the eligibility requirements for census tracts to be designated as a low-income community (amended § 1400Z-1(c)). Investors will be able to invest in the newly designated opportunity zones beginning Jan. 1, 2027 (amended § 1400Z-1(e)(2)).

SELECT ENERGY CREDITS SUMMARY

IRC	Description	Prior law	Major changes
25E	Previously owned clean vehicles	Terminated for vehicles acquired after Dec. 31, 2032.	Terminated for vehicles acquired after Sep. 30, 2025. (70501)
30D	Clean vehicle credit	Terminated for vehicles acquired after Dec. 31, 2032.	Terminated for vehicles acquired after Sep. 30, 2025. (70502)
45W	Credit for qualified commercial clean vehicles	Terminated for vehicles acquired after Dec. 31, 2032.	Terminated for vehicles acquired after Sep. 30, 2025. (70503)
25C	Energy efficient home improvement credit	Terminated for property placed in service after Dec. 31, 2032.	Terminated for property placed in service after Dec. 31, 2025. (70505)
25D	Residential clean energy credit	Terminated for expenditures made after Dec. 31, 2034.	Terminated for expenditures made after Dec. 31, 2025. (70506)
30C	Alternative fuel vehicle refueling property credit	Terminated for property placed in service after Dec. 31, 2032.	Terminated for property placed in service after Jun. 30, 2026 (70505)
45L	New energy efficient home credit	Terminated for homes acquired after Dec. 31, 2032.	Terminated for homes acquired after Jun. 30, 2026. (70508)
45Y(d)(4)	Clean electricity production credit	Phaseout for wind and solar facilities through 2032.	Terminated for wind and solar facilities placed in service after Dec. 31, 2027, with a safe harbor for wind and solar projects that begin construction by July 4, 2026, and generally are completed within 4 years. (70512) See Notice 2025-42 .
48E(e)	Clean electricity investment credit	Phaseout for wind and solar facilities through 2032.	Terminated for wind and solar facilities placed in service after Dec. 31, 2027, with a safe harbor for wind and solar projects that begin construction by July 4, 2026, and generally are completed within 4 years. (70513) See Notice 2025-42 .
45V	Credit for production of clean hydrogen	Terminated for construction of facilities beginning on or after Jan. 1, 2033.	Terminated for construction of facilities beginning on or after Jan. 1, 2028. (70511)

NOTE: The credits in 45Y and 48E above, as well as those in 45Q (credit for carbon oxide sequestration, 45U (zero-emission nuclear power production credit), and 45Z (clean fuel production credit) now contain restrictions related to a prohibited foreign entity (as defined in new § 7701(a)(51)) and material assistance from a prohibited entity (as defined in new § 7701(a)(52)).

SELECT ENERGY-RELATED DEDUCTIONS SUMMARY

IRC	Description	Prior law	Major changes
168(e)(3)(B)(vi)	Cost recovery for energy property (as described in § 48(a)(3) to include solar or wind energy)	Considered as 5-year property for purposes of cost recovery.	Removed as 5-year property for property the construction of which begins after Dec. 31, 2024 (70509)
179D	Energy efficient commercial buildings deduction	Permanent deduction.	Terminated for property the construction of which begins after Jun. 30, 2026. (70507)

See [FS-2025-05](#) for the FAQs on the modifications of §§ 25C, 25D, 25E, 30C, 30D, 45L, 45W, and 179D.

OTHER RECENT CHANGES

1. Recordkeeping and the Burden of Proof

Several recent cases have been decided based on the taxpayer's lack of recordkeeping. According to Tax Court Rule 142(a), the burden of proof to substantiate expenses falls on the taxpayer, unless the Court or a statute provides otherwise. IRC § 7491(a)(1) shifts the burden of proof to the IRS when "a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the tax liability of the taxpayer."

Under § 6001 and Reg. § 1.6001-1, taxpayers are required to keep sufficient records to substantiate gross income, deductions, credits or other tax attributes. The use of estimates is generally not allowed; however, taxpayers lacking sufficient records often attempt, unsuccessfully, to invoke the *Cohan* rule in cases before the Tax Court.

The *Cohan* rule, named after the 1930 decision in *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930), is often cited as a basis for the Court to estimate the amount of an expense. The rule only comes into play, however, if a taxpayer establishes that a deductible expense has been paid but cannot establish the precise amount of the expense. Repeatedly, the Tax Court has ruled that it will not estimate a deductible expense unless the taxpayer presents sufficient evidence on which an estimate can be made.

In *Weston v. Commissioner* (T.C. Memo 2025-16), the Tax Court found that the taxpayers failed to provide any basis on which it could make an estimate under the *Cohan* rule. The taxpayers had claimed a business loss, but the Court found their records insufficient, writing "[W]e have no grounds on which to estimate either the ... business gross receipts or the amounts of ... payments that were spent." A similar conclusion was reached in *Langlois v. Commissioner* (T.C. Memo 2025-12). Citing the use of the "shoebox method," the Court found it impossible to determine which expenses were supported by the receipts and stated, "we will not sort through ... voluminous evidence to decide whether he substantiated each and every expense he claimed."

Practice Pointer. Tax season is a good time to remind clients of their recordkeeping responsibilities and to review the burden of proof rules.

2. Marijuana Business Deductions

With many states legalizing marijuana for medical and/or recreational use tax professionals are running into clients who are involved in its sale. Under § 280E, no deductions are allowed for expenses for businesses "trafficking in controlled substances (within the meaning of schedule I or II of the Controlled Substance Act." (Cost of goods sold is not an expense; rather, it is a reduction in gross income per Reg. § 1.61-3(a) so it is allowed even for those businesses subject to § 280E.) Marijuana is listed as Schedule I but the DOJ has begun the process of moving it to Schedule III, which would take it out of § 280E. In the interim, the IRS and the courts have consistently denied deductions for expenses.

In a novel argument, a taxpayer with a state-legal medical marijuana business has petitioned the Tax Court after an IRS audit. The case, *New Mexico Top Organics, Inc. v. Commissioner* (No. 19661-24 (T.C. 2025), argues that the § 280E reference to "within the meaning of schedule I or II" does not mean "listed in schedule I or II." While contesting the IRS's disallowance of its substantiated cost of goods sold, the petitioners are also requesting a \$2.76 million refund for general § 162 expenses not previously claimed on its returns but to which the petitioners believe it is entitled based on the above. The petition was filed Dec. 16, 2024, and no hearing has been scheduled as of this writing.

Meanwhile, legislation ([S.471](#)) has been introduced to prevent the deduction of business expenses by marijuana businesses even if the proposed rescheduling takes place.

3. BOI Reporting Not Required for Domestic Entities and Owners

Summary. All entities created in the United States and their U.S. beneficial owners are no longer required to file Beneficial Ownership Information (BOI) reports. Existing foreign companies have at least 30 days from March 21 to file.

Background. The Financial Crimes Enforcement Network (FinCEN) is a bureau of the U.S. Department of the Treasury (Treasury) and is responsible for implementing the Corporate Transparency Act (CTA), which includes BOI reporting. After numerous court challenges – some still ongoing – FinCEN [announced](#) on Feb. 18 a filing deadline of March 21, 2025, for most reporting companies established prior to Jan. 1, 2024, to file initial, updated, and/or corrected BOI reports. Its Feb. 18 notice indicated that it would be revising the BOI reporting requirements and that a further delay in the requirement may be forthcoming.

In a Feb. 27 [release](#), FinCEN announced that it would not take any enforcement actions, including fines or penalties, against any reporting companies that failed to comply with the BOI reporting requirements by the current deadlines. The release stated that an interim final rule to extend the BOI reporting deadlines would be issued by March 21.

On March 2, Treasury [released](#) a statement that it will not enforce any penalties or fines associated with the BOI reporting requirements under the existing deadlines and that no penalties or fines will be enforced against U.S. citizens, domestic reporting companies, or their beneficial owners after rule changes take effect. Further, Treasury will be issuing a rule “that will narrow the scope” of the BOI reporting rule “to foreign reporting companies only.”

The Treasury release elicited some pushback from the bipartisan FACT Coalition and other groups concerned that the exclusion of domestic reporting companies made it possible for [dirty money](#) to flow into the U.S. and may be unconstitutional. In a March 6 briefing, the groups stated that as many as 99.8 percent of all covered entities would be exempt, effectively gutting the anti-money laundering law.

BOI Reporting Requirements Eliminated for U.S. Companies and U.S. Persons. In a March 21 [release](#), FinCEN announced the issuance of an [interim final rule](#) (IFR) that eliminated the requirement for U.S. companies and U.S. persons to report beneficial ownership information. Entities formed under the law of a foreign country and have registered to do business in the United States will have to report their foreign beneficial owners only. Those foreign entities who registered to do business in the United States before the publication of the IFR must file BOI reports within 30 calendar days of publication. Those who register to do business after the publication of the IFR have 30 calendar days after receiving notification that their registration is effective to file their initial reports.

Comment. It was previously estimated that 71,000 foreign entities would have to file BOI reports in 2024, and about 11,000 new foreign entities would have to file each year after 2024. This pales in comparison to the estimated 36 million domestic entities required to file in 2024 and an additional 5 million each year after that. During the March 6 briefing, one concern voiced was that the distinction between shell companies formed in the U.S. and those formed in foreign companies fails to consider the underlying risk. Transparency International’s Scott Greytak stated in the briefing that “The problem here is anonymous shell companies, regardless of where they are formed.” It is reasonable to expect litigation on this.

4. Access to Information Returns Added to the IRS Individual Online Account Tool ([IR-2025-28](#))

Form W-2 and Form 1095-A for tax years 2023 and 2024 have been added to taxpayer’s Individual Online Account. More forms are expected to be added soon.

5. New ERC FAQ

Summary. The IRS added five questions to its [FAQ about the Employee Retention Credit \(ERC\)](#) on Mar. 20, 2025. FAQs are not authoritative guidance but provide answers to some of the questions that have been raised. The ERC was generally available to eligible businesses from Mar. 31, 2020 to Sep. 30, 2021. Recovery startup businesses were eligible through Dec. 31, 2021. The deadline for filing 2021 ERC claims ended April 15.

The added FAQ. The five FAQ and a summary of the IRS’s answers are below.

- **Claiming the ERC — Q7. Does the ERC affect my income tax return?** The short answer is Yes. The ERC reduces the amount claimed as wage expense on the tax return for the year in which the qualified wages were paid or incurred. The IRS answer also points to the “Income tax and ERC” section below.
- **Income Tax and ERC.** This new section contains three questions.
 - **Q1. Should I have reduced my wage expense on my income tax return when I filed for the Employee Retention Credit (ERC)?** Yes. For additional information see [Notice 2021-20](#) (section II.F and questions 60 and 61 in section III.L).
 - **Q2. I claimed the ERC but didn’t reduce my wage expenses on my income tax return. The ERC claim was paid in a subsequent year. What do I do?** You can include the overstated wage expense amount as gross income on your income tax return for the tax year when received (under the tax benefit rule). Because of this, **no amended return is necessary**. The following table summarizes the application of this question:

Examples	Year ERC claim filed	Year ERC claim received	Amended return filed?	Include income in year received?
2020 ERC claim	2021	2022	Yes	N/A
2020 ERC claim	2022	2024	Yes	N/A
2021 ERC claim	2022	2024	No	Yes
2021 ERC claim	2022	Not received	No	Yes

- **Q3. What can I do if My ERC claim was disallowed and I'd already reduced my wage expense on my income tax return by the amount of ERC I expected?** In the year the claim disallowance is final, you can increase your wage expense by the same amount that it was reduced when you made your claim. Because of this, **no amended return is necessary.** (The option to file an amended return or protective claim remains, as long as the statute has not expired.) The following table summarizes the application of this question:

Examples	Year ERC claim filed	Year ERC claim received	Amended return filed?	Year ERC claim disallowed	Pick up as a deduction?
2020 ERC claim	2021	2022	Yes	2024	Yes
2020 ERC claim	2022	2024	Yes	2025	Yes
2021 ERC claim	2022	2024	No	2025	N/A
2021 ERC claim	2022	Not received	No	2026	N/A

Practice Alert! As can be seen from the tables above, whether or not an amended return was filed prior to the issuance of Q2 and Q3 plays a significant role in the subsequent inclusion of income or deduction of wage expense. In addition, if the eligible wages were capitalized rather than expensed, adjustments may be needed to those items.

- **ERC scams — Q3. How do I report fraud regarding ERC?** To report illegal activities related to ERC, complete [Form 14242, Report Suspected Abusive Tax Promotions or Preparers](#) (caution: form only opens in Firefox), include any supporting material, optionally provide your contact information), and fax or mail the form and documents to the address or fax number provided in the FAQ.

Reliance on FAQ. As previously noted, FAQ are not authoritative. Several tax professionals have noted that reliance on them may be good for potential penalty relief but not much else, so taxpayers should be careful about relying on them. The tax professionals noted that the FAQ allow taxpayers to account for the effects of ERC in the year of resolution, a position which contradicts previous guidance in Notice 2021-20 and [Notice 2021-49](#), as well as the statutes instructing taxpayers to follow the rules similar to § 280C(a). Those rules require a reduction of the wage deduction in the year the credit is determined. Given the regulatory freeze, however, the FAQs may be the best that the IRS can do right now.

6. Updated List of Automatic Changes in Accounting Methods ([Rev. Proc. 2025-23](#))

The IRS has updated the list of automatic changes in accounting methods for which the procedures in Rev. Proc. 2015-13, as modified, apply. The new Rev. Proc. also supersedes, in part, Rev. Proc. 2024-23. Listed are 18 significant changes, including 10 that remove obsolescent language and five that are clarifications. Automatic accounting method changes are generally made by attaching Form 3115, "[Application for Change in Accounting Method](#)," to the income tax return and filing a duplicate.

7. Partnership Basis Shifting Transaction-of-Interest (TOI) Regulations to Be Removed ([Notice 2025-23](#)).

The U.S. Treasury Department and the IRS announced that the basis shifting TOI regulations under § 1.6011-18 will be removed. The regulations were published in January. The penalties under §§ 6707A(a), 6707(a) and 6708 will be waived. This notice also withdraws Notice 2024-54. In the wake of this announcement, several bills have been introduced to address related party basis shifting.

8. Proposed Regulations Modify Timing of Certain Partnership Gain or Loss Information ([REG-108822-25](#), Aug. 19, 2025).

The IRS has issued proposed regulations that would give partnerships additional time to report certain gains or losses to affected partners. Under current regulations (§§ 1.6050K-1(c)(1) and (2)), the information contained in Part IV of [Form 8308](#), “Report of a Sale or Exchange of Certain Partnership Interests,” must be reported by Jan. 31 of the year following the calendar year in which a § 751(a) sale or exchange occurred (or, if later, 30 days after the partnership is notified of the sale or exchange). Section 751(a) denies capital gain treatment for the portion of the gain or loss from the sale or exchange of a partnership interest attributable to unrealized receivables or inventory of the partnership i.e., “hot assets.” Gains or losses from the sale or exchange of hot assets are ordinary income, calculated based on a deemed (or hypothetical) sale. Part IV of Form 8308, as revised in 2023, requires the partnership to report the gain or loss under § 751(a), as well as the collectibles gain under § 1(h)(5) and the unrecaptured § 1250 gain under § 1(h)(6) for both the partnership and share allocable to the transferring partner.

As noted in the preamble to the proposed regulations, stakeholders commented that many partnerships were unable to provide the required information by the due date because not all information to do so is available. In response, the IRS provided limited relief from § 6722 penalties for calendar years 2023 (Notice 2024-19) and 2024 (Notice 2025-02).

The proposed regulations remove Reg. § 1.6050K-1(c)(2) completely and modify Reg. § 1.6050K-1(c)(1) to remove the reference to a “completed copy of Form 8308,” replacing it with a reference to “a copy of Form 8308 filled out in accordance with the instructions to the form.” The form instructions are to be updated to provide that only the information in Parts I, II, and III are required by the January 31 due date. A completed Form 8308, including Part IV, would still be required as an attachment to the partnership’s Form 1065, and the partnership will still be required to furnish the information to the transferor partner, by the due date of Form 1065. Comments on the proposed regulations are due by Sep. 18, 2025.

6. Proposed regulation on line of business for certain fringe benefits ([REG-132805-17](#), Aug. 6, 2025).

The IRS has issued proposed regulations to update the industry classification system used for determining an employer’s line of business for purposes of determining the fringe benefit exclusion for no-additional-cost services or qualified employee discounts under § 132(a)(1) and (2), respectively. Under the existing regulations (Reg. § 1.132-4(a)(2)), an employer’s line of business is determined by reference to the Enterprise Standard Industrial Classification Manual (ESIC Manual), which has not been updated since 1974. Due to its age, many current industries are not accounted for in the ESIC Manual because they did not exist at the time, including such industries as internet service providers, cell phone manufacturers, cell phone service providers, and smart phone application developers.

The proposed regulations seek to replace the ESIC Manual with the [North American Industry Classification System \(NAICS\)](#). The NAICS provides more current information as it is updated every five years. It was last updated in 2022. Its use will clarify how to determine if a given business qualifies for these two fringe

benefit exclusions. Other changes include an amendment to the aggregation rules when entities operate in more than one line of business. Comments on the proposed regulations are due by Nov. 4, 2025.

PROPERTY TRANSACTIONS: BASIC CONCEPTS

A. Background

General. Gross income includes gain from any transaction in property. §61(a)(3). Gain for tax purposes is the “amount realized” in excess of the property’s “adjusted basis.” §1001(a).

Amount Realized. Amount realized is the cash plus the fair market value of any “other property” received in the transaction §1001(b). “Other property” has been very broadly construed to include nonrecourse debt assumed by the buyer (even if the nonrecourse debt exceeds the actual fair market value of the property). *Crane v. Comm.*, 33 US 1 (1947); *Comm. v. Tufts*, 461 US 300 (1983).

Timing And Characterization. The most frequent issues arising with respect to property transactions are: 1) timing of the gain/loss recognition, and 2) characterization of the gain/loss. Consequently, this chapter deals largely with the gain characterization rules (e.g., capital, §1231, depreciation recapture, etc.) and the timing of gain recognition rules (e.g., involuntary conversions, like-kind exchanges, etc.).

B. Capital Gains and Losses

- 1. C Corporation Capital Gains Taxed Same as Ordinary Income.** Despite the changes to the taxation of long-term capital gains for individuals, long term capital gains of C corporations are taxed at the same tax rate as all other corporate income.
- 2. Corporate Capital Loss Restrictions.** Notwithstanding the lack of lower capital “gain” rates, C corporations are saddled with capital “loss” restrictions. **A C corporation may deduct capital losses only up to the amount of its capital gains §1212(a)(1).** Consequently, a net capital loss cannot be deducted in the current year. The capital loss, however, may be carried back and forward as explained below.
- 3. Capital Loss Carryback/Carryover.** A C corporation’s **net capital loss** is first **carried back three years**. It is deducted from any total net capital gain that occurred in that year. If the loss is not completely used up, it is **carried forward** one year (two years back) and then one more year (one year back). If it is still not used up, it is **carried over** to future tax years, one year at a time, for **up to five years**. So, corporate **capital losses are carried back three years and forward five years**.
- 4. S Corporation Capital Losses.** Capital gains and losses recognized by an S corporation pass through to the stockholders. The treatment of capital gains and losses as applied to individuals is discussed in the “Individual Income Tax Workshop” materials.
- 5. Elements Required for Capital Gain/Loss Treatment.** §1222 requires there to be a “capital asset” and a “sale or exchange” in order for a capital gain/loss to exist. A sale or exchange is typically easy to identify; however, taxpayers, the courts, and the IRS have wrestled for years over the proper definition of a capital asset.
- 6. What Is a Capital Asset?** §1221 appears to define capital asset very broadly as “property held by the taxpayer (whether or not connected with his trade or business)” **Note!** Notwithstanding this apparently broad definition, it is clear that Congress intended capital gain treatment to be the exception, not the rule. This is accomplished by a statutory list of **exceptions to the definition of a capital asset, as follows:**
 - 1) Inventory, property held primarily for resale. §1221(a)(1).

- 2) Land or depreciable property used in a trade or business. §1221(a)(2).
 - 3) Certain copyrights, literary, musical, or artistic compositions. See §1221(a)(3) for more details.
 - 4) Accounts receivable and certain notes receivable acquired in the ordinary course of a trade or business. See §1221(a)(4) for more details.
 - 5) Certain U.S. Government publications. See §1221(a)(5) for more details.
 - 6) Certain commodities, hedging transactions, and supplies. See §1221(a)(6)-(8) for more details.
7. **Property Held “Primarily for Resale”** One of the most frequently contested issues involving capital gain designation is determining when a taxpayer is deemed to hold property “primarily for sale to customers in the ordinary course of his trade or business” as described in §1221(a)(1). For example, when is the taxpayer a “dealer” in real estate?
 8. **Real Estate.** This issue most frequently arises in relation to the ownership of real estate. That is, taxpayers often buy real property either to hold for long-term investment (connoting capital gain treatment), or to develop and sell to outsiders (indicating ordinary income treatment).
 9. **“Dealer Status.”** A taxpayer who is deemed for tax purposes to hold real estate primarily for resale is commonly labeled a “dealer” in real estate and receives no capital gain treatment on the sale of such real estate.
 10. **Beware!** A “dealer” in real estate qualifies for neither §1031 like-kind exchange treatment for real estate held for sale, nor §453 installment sales treatment, §453(b)(2), (l)(1)(B); §1031(a)(2)(A). **Practice Alert!** In Rev. Rul. 2016-15, the IRS ruled that “dealer” real estate does not qualify for the “qualified real property business indebtedness” exception to COD income under §108(a)(1)(D).
 11. **Facts and Circumstances Test.** Courts have evaluated “dealer” status on a case-by-case, facts and circumstances basis.
 12. **Examples.** *Malat v. Ridell*, 383 U.S. 569 (1966) (the Supreme Court allowed capital gain treatment on real estate purchased with the “primary” intent of long-term investment, even though taxpayer had a “substantial” intent to develop and resale); *Bynum v. Comm.*, 46 TC 295 (1966) (the Tax Court held that real estate originally acquired for long-term investment could later be converted to “dealer” property where taxpayer subdivided the realty, added streets, water, curbs, etc., and began selling off the lots).
 13. **Statutory “Dealer” Relief.** The act of subdividing realty often is the trigger for the Service to assert “dealer” status. To reduce litigation in this area, in 1954 Congress enacted §1237 which provides that a taxpayer will not be deemed to hold real estate “primarily for resale” solely because the taxpayer subdivided the land if:
 - 1) The taxpayer has never been a “dealer” in the subdivided property, and in the year of sale the taxpayer is not a dealer in any other real property;
 - 2) No substantial improvement has been made to the property that substantially enhances the property’s value; and
 - 3) Unless the property was acquired by inheritance or devise, the taxpayer has owned the property for at least 5 years.

Note! For further special rules, see §1237(b).

Practice Pointer! A taxpayer who holds undeveloped realty that has depreciated in value may wish to take necessary “development” actions (while avoiding §1237) in an effort to convert capital losses into ordinary losses.

14. Judicial and Regulatory Exceptions to Capital Asset Treatment The Courts have struggled to refine the definition of a capital asset by looking beyond the statutory definition. At times, the courts take an expansive view of capital assets, and at other times a very narrow view.

15. IRS Issues Ruling Explaining Whether Loss on Abandonment of Partnership Interest Is Ordinary or Capital (Rev. Rul. 93-80, IRB 1993-38, Nov. 10, 1993)

- a. **Background.** Where a partnership makes a distribution to a partner, §731(a) provides generally that any gain or loss recognized by the partner is treated as gain or loss from the sale of the partnership interest.
- b. **Rev. Rul. 76-189 held that the loss upon a termination of a partnership with no assets is a capital loss.** This was so even though there was no actual or deemed distribution from the partnership. IRS said that §731 applied as if an actual distribution had taken place. **But in Rev. Rul. 70-355, IRS held that a limited partner had an ordinary loss on the bankruptcy of the partnership.**
- c. **Clarifying its earlier position, the IRS says that a loss on the abandonment or worthlessness of a partnership interest is an ordinary loss if sale or exchange treatment does not apply.** But if there is an actual or deemed distribution to the partner, or if the substance of the transaction is a sale or exchange, the partner's loss is a capital loss. **If a partner's share of partnership liabilities shows a decrease, this is considered to be a distribution which triggers the §731 rule for recognition of loss resulting in a capital loss. Please consult the ruling for more details.**

C. Additional Self-Created Property Not Treated as a Capital Asset UNDER TCJA (§1221(a)(3), Effective for dispositions after 2017)

TCJA amends §1221(a)(3) to provide that gains or losses from the sale or exchange of a patent, invention, model or design (whether or not patented), or a secret formula or process which is held either **1)** By the taxpayer who created the property, or **2)** A taxpayer with a substituted or transferred basis from the taxpayer whose personal efforts created the property (and a taxpayer for whom the property was created) are not capital gains and losses. **Note!** Income from self-created copyrights, literary or artistic compositions, letters or memoranda, or similar property, which are held either by the taxpayer who created the property, or (in the case of a letter, memorandum, or similar property) a taxpayer for whom the property was produced, was already treated as ordinary income under §1221(a)(3).

Practice Alert! Section 1221(b)(3) continues to allow taxpayers who own **musical compositions or copyrights in musical works** that the taxpayer created (or a taxpayer to which the musical compositions or copyrights have been transferred by the works' creator in a substituted basis transaction) to elect to treat such musical compositions and copyrights in musical works as capital assets.

D. Applying the Capital Gain Rules to Partnerships, S Corporations and Trusts

Background

Regulation §1.1(h)-1 (effective for transfers of S corporation, partnership or trust interest after 9/21/2000) establishes the rules for the taxation of capital gains for sales or exchanges of interests in partnerships, S corporations, and trusts. The Taxpayer Relief Act of 1997 amended §1(h) of the Internal Revenue Code to reduce the maximum statutory tax rates for long-term capital gains of individuals in general. Certain technical corrections and other amendments to §1(h) were enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998.

§1(h) provides that 28% and 25% intermediate level rates apply to long-term capital gains from certain transactions, such as sales or exchanges of collectibles, §1202 stock (with respect to a portion of the gain), and §1250 property with gain attributable to straight-line depreciation. §1(h)(11) provides authority to the Secretary to issue such regulations as are appropriate to apply these rules in the case of sales or exchanges by pass-thru entities and of interests in pass-thru entities. These regulations provide rules for sales or exchanges of interests in partnerships, S corporations, and trusts. They also provide rules relating to dividing the holding period of a partnership interest.

Collectibles Gain and Unrecaptured Section 1250 Gain

- a. 25% Gain on Sale of Partnership Interest to Extent Of 25% Gain at Partnership Level.** The sale or exchange of an interest in a partnership with a long-term holding period generally will result in capital gain in the 20% rate gain category to the extent that §751(a) is not applicable. §751(a) generally provides that an amount received in exchange for a partnership interest, to the extent attributable to unrealized receivables and inventory, shall be considered as an amount realized from the sale or exchange of property other than a capital asset. **§1250 property is treated as an unrealized receivable for purposes of §751 to the extent of the amount that would be treated as gain to which §1250(a) would apply.** Under §1(h)(7)(A) (in conjunction with §§751(a) and (c), the amount of long-term capital gain (not otherwise treated as ordinary income under §751(a)) that would be treated as ordinary income under §751(a) if §1250 applied to all depreciation (§1250 capital gain) must be taken into account in computing unrecaptured §1250 gain when an interest in a partnership (with a holding period of more than one year, or more than 18 months during certain periods in 1997) is sold or exchanged. See H. Rep. No. 105-356, 105th Cong. 1st Sess. (1997), at 16, fn. 11; S. Rep. No. 105-174, 105th Cong. 2d Sess. (1998), at 149, fn. 65.
- b. 28% Tax on Sale of Partnership, S Corporation or Trust to Extent of Collectibles Gain.** Effective for taxable years ending after May 6, 1997, when an interest in a partnership, an S corporation, or a trust held for more than one year (or more than 18 months during certain periods in 1997) is sold or exchanged, section **1(h) provides special treatment for “collectibles gain” in property held by a partnership, S corporation, or trust.** Specifically, §1(h)(6)(B) provides that any gain from the sale of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles shall be treated as gain from the sale or exchange of a collectible, applying rules similar to §751(a) to determine the amount of the gain.

Allocation Of 25% or 28% Gain

- a. Regulations Deem All Collectibles or §1250 Property Sold.** The proposed regulations provide guidance with respect to the application of these rules to a sale or exchange of an interest in a partnership, S corporation, or trust holding assets with collectibles gain and a partnership holding assets with §1250 capital gain. Generally, the amount of such gain is determined by reference to the gain that would be allocated to the selling partner, shareholder, or beneficiary (to the extent attributable to the portion of the transferred interest that is subject to long-term capital gain) if the partnership, S corporation, or trust had sold all of its collectibles or if the partnership had sold all of its §1250 property in a fully taxable transaction immediately before the transfer of the partnership, S corporation, or trust interest. Special rules are provided where the partner, S corporation shareholder, or trust beneficiary recognizes less than all of the gain upon the sale or exchange of its interest.
- 4. Gain From Sale of Partnership Interest Not Treated as §1231 Gain for Purposes of Limiting §1250 Gain.** For purposes of applying §1(h)(7)(B), which provides that a taxpayer's unrecaptured §1250 gain cannot exceed the taxpayer's net §1231 gain, gain from the sale of a partnership

interest that results in §1250 capital gain is not treated as §1231 gain even if §1231 could apply to the disposition of the underlying partnership property. Although §1(h)(7) (in combination with §751) applies a limited look-thru rule for purposes of determining the capital gain rate applicable to the sale of a partnership interest, no similar look-thru rule applies for purposes of applying §1231. Anomalous results would follow if §1250 capital gain derived from the sale of a partnership interest were treated as §1231 gain for purposes of applying the limitation in §1(h)(7)(B) but not for purposes of actually applying §1231.

See Regulation 1.1(h)-1(f) for four examples of these provisions.

5. “Redemption” of Interest in S Corporation, Partnership, or Trust

The rules for the “look through” taxation of 25% and 28% gains **do not apply to the redemption of a partnership, S corporation or trust interest.**

6. Determination of Holding Period in a Partnership (§1.1223-3)

- a. **General.** Regulation §1.1223-3 provides rules relating to the allocation of a divided holding period with respect to an interest in a partnership. **These rules generally provide that the holding period of a partnership interest will be divided if a partner acquires portions of an interest at different times or if an interest is acquired in a single transaction that gives rise to different holding periods under §1223.** The holding period of a portion of a partnership interest shall be determined based on a fraction that is equal to the fair market value of the portion of the partnership interest to which the holding period relates (determined immediately after the acquisition) over the fair market value of the entire partnership interest. A selling partner may use the actual holding period of the portion of a partnership interest sold if the partnership is a “publicly traded partnership” (as defined under §7704(b)), the partnership interest is divided into identifiable units with ascertainable holding periods, and the selling partner can identify the portion of the interest transferred. Otherwise, the holding period(s) of the transferred interest must be divided in the same ratio as the holding period(s) of the partner’s entire partnership interest.
- b. **Sale or Exchange of Entire Interest in a Partnership.** If a partner sells or exchanges the partner’s entire interest in a partnership, any **capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss** in the same proportions as the holding period of the interest in the partnership is divided between the portion of the interest held for more than one year and the portion of the interest held for one year or less.
- c. **Sale or Exchange of a Portion of an Interest in a Partnership.** **1)** If the ownership interest in a **publicly traded partnership** (as defined under §7704(b)) is divided into identifiable units with ascertainable holding periods, and the selling partner can identify the portion of the partnership interest transferred, the selling partner may use the actual holding period of the portion transferred. **2)** If a partner has a divided holding period in a partnership interest, and the partnership is **not a publicly traded partnership**, then the holding period of the transferred interest shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the transferor partner would realize if the entire interest in the partnership were transferred in a fully taxable transaction immediately before the actual transfer.
- d. **Distributions To Partners.** In general, a partner’s holding period in a partnership interest is not affected by distributions from the partnership. However, if a partner is required to recognize capital gain or loss as a result of a distribution from a partnership, then the capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the distributee partner would realize if such

partner's entire interest in the partnership were transferred in a fully taxable transaction immediately before the distribution. **See Regulation 1.1223-3(e) for eight examples of these rules.**

E. §1231 Gains and Losses

Background

The statutory definition of a capital asset expressly excludes depreciable property used in a trade or business and land used in a trade or business. §1221(2). Yet most practitioners recognize that these assets frequently are granted capital gain treatment. Why? Because §1231 picks up the assets carved out by §1221(2) and treats them as quasi-capital assets.

General Rule

If “§1231 gain” for any taxable year exceed “§1231 losses,” such gains and losses will be treated as long-term capital gains/losses. §1231(a)(1). **Conversely**, if “§1231 losses” exceed “§1231 gains” for any taxable year, such gains and losses will be ordinary (non-capital). §1231(a)(2).

1. Mechanics For Computing §1231 Gains/Losses

Step 1: Determine “Types of Assets” Potentially Subject to §1231. §1231 is designed to pick up certain assets that are otherwise carved out of the regular capital gain structure. Consequently, §1231 potentially applies to:

“§1231(b) Assets.” As previously noted, capital assets do not include land or depreciable property used in a trade or business §1221(2). However, §1231 applies to so called “§1231(b) assets” which are generally defined as depreciable property and real property **held for more than one year** and used in a trade or business (i.e., the very assets carved out by §1221(2)). §1231(b) assets **expressly exclude** (among others): 1) inventory and 2) property held primarily for sale to customers. §§1231(b)(1)(A), (B).

Example. In *International Shoe Machine Corporation v. U.S.*, 491 F.2d 157 (1st Cir. 1974), the Court held that shoe machinery equipment leased to customers that was sold to the customer following the lease was property "held primarily for resale" and therefore was not a §1231(b) asset.

Capital Assets. As discussed in more detail below, §1231 applies to certain transactions involving a "capital asset which is held for more than one year ... in connection with a trade or business or a transaction entered into for profit." §1231(a)(3)(A)(ii)(II).

Step 2: Determine "Transactions" Subject to §1231. §1231 applies only to two types of transactions:

Type 1. Any **recognized gain** (or loss) from the "sale or exchange" of a §1231(b) asset. §1231(a)(3)(A)(i). **Note!** A fully nonrecognition exchange (e.g., §1031 like-kind exchange or §1034 involuntary conversions) is excluded from the §1231 computations.

Type 2. Any **recognized gain** (or loss) from an "involuntary conversion" (destruction, theft, seizure, or threatened condemnation) of: **1)** a §1231(b) asset, or **2)** any capital asset held more than one year in connection with a trade or business or a transaction entered into for profit. §1231(a)(3)(A)(ii).

- **Note!** Since an "involuntary conversion" is not a sale or exchange for "regular" capital gain treatment, an involuntary conversion of §1231 assets are governed by §1231 which may grant them capital gain treatment.

- This is consistent with a Congressional desire to grant favorable tax treatment to gains derived from uncontrollable transactions (e.g., §§104(a)(2), 1041, 1014, etc.).
- **Special Exception.** §1231(a)(4)(c) expressly provides that §1231 will **not** apply to transactions arising from an involuntary conversion involving a **casualty** (fire, storm, shipwreck, theft or other casualty) — condemnations **are not** covered — of any §1231(b) assets, or capital assets (held more than one year in a trade or business or for profit), if the **losses** from such transactions exceed the **gains**.
- **What Is Going On Here?** Congress is trying to assist the taxpayer where so-called “casualty losses” exceed “casualty gains.” If that situation exists, the casualty losses and gains are excluded from §1231 and therefore **are given “ordinary” treatment** because there has been no “sale or exchange.” Furthermore, by excluding these transactions from §1231, potentially there will be more §1231 gains from other transactions that will qualify for favorable capital gain treatment under §1231.

Step 3: Compare §1231 Gains With §1231 Losses for the Taxable Year

- **§1231 Gains > §1231 Losses.** If §1231 gains exceed §1231 losses, they are all treated as capital gains and losses.
- **§1231 Losses > §1231 Gains.** If §1231 losses exceed §1231 gains, they are all treated as ordinary gains and losses.

Step 4: Consider Potential Recapture/Re-Characterization Provisions. If §1231 gains exceed §1231 losses, then we must consider various recapture rules which may recharacterize all or a portion of the §1231 capital gains as ordinary income, including:

- a. **§§291, 1245, and 1250** depreciation recapture discussed in more detail later in this chapter;
- b. **§1239 re-characterization** on transactions between “related persons,” also discussed in more detail later in this chapter; **and**
- c. **The §1231(c) Five-Year Look Back Rule.**
 - **Background.** Congress feared that crafty taxpayers would play games with §1231 by selling §1231 loss assets exclusively in year #1 (thus receiving complete ordinary loss treatment) and selling §1231 gain assets exclusively in year #2 (thus receiving complete §1231 capital gain treatment).
 - **Congressional Reaction.** In 1984, Congress enacted §1231(c) which essentially requires a taxpayer to re-characterize current net §1231 gains as ordinary income to the extent the taxpayer has had “net §1231 losses” in any of the five most recent preceding tax years.
 - **Example.** Assume taxpayer recognizes a net §1231 loss of <\$100> in year #1, and a net §1231 gain of \$200 in year #2. The §1231 loss of <\$100> in year #1 will qualify for ordinary loss treatment. However, in year #2, \$100 of the \$200 net §1231 gain must be recharacterized as ordinary income because of the five-year look back rule.
 - **Practice Pointer!** §1231(c) is a “look back” rule -- it is not a “look forward” rule. That is, in the above example, taxpayer would not have been subject to any §1231(c) recapture if the

§1231 gain of \$200 had been recognized in year #1, and the §1231 loss of <\$100> had been recognized in year #2.

F. Depreciation Capture Rules (Also See Publication 544)

Background

As previously discussed, §1231 typically grants favorable capital gains treatment to depreciable property used in a trade or business. Moreover, the depreciation deduction typically allows a taxpayer to reduce ordinary taxable income. The combination of these rules creates a tax shelter for individual taxpayers. That is, depreciation is deductible against ordinary income and drives down the basis of the depreciable asset, but the later gain is frequently taxed as a favorable capital gain.

Congressional Reaction

Congress long ago passed the so-called depreciation recapture rules to limit this benefit. The rules were designed primarily to re-characterize §1231 capital gain as ordinary income based on previous depreciation taken with respect to the §1231 asset. The §1245 recapture rules were enacted in 1962, and the §1250 recapture rules were enacted in 1964.

1. §1245 Recapture

- a. “**§1245 Property**” is generally defined as depreciable personal property (although certain narrowly defined depreciable non-personal property is also included). §1245(a)(3). **Note!** Amortizable or depreciable intangible assets also constitute §1245 property. **Beware!** Commercial realty acquired before 1987 depreciated under ACRS (other than the straight-line method) is also §1245 property.
- b. “**Depreciation Recapture Amount.**” Gain on the disposition of §1245 property is characterized as ordinary income to the extent of the **lower of 1)** the “recomputed basis” **or 2)** the excess of the amount realized (if there is a sale/exchange) or the fair market value (if there is another disposition) **OVER** the property’s adjusted basis. §1245(a)(1).
 - “**Recomputed Basis**” is generally defined as the property’s adjusted basis plus all previous depreciation or amortization deductions allowed or allowable. §1245(a)(2)(A). **Practice Pointer!** Reg. 1.179-1(e)(3) states that: “If §1245 applies to a disposition of property, there is no recapture under §179.”
- c. **§179 Deduction** is treated as depreciation for this computation. §1245(a)(2)(c).
- d. **Allowable Depreciation.** If a taxpayer can prove that the depreciation “allowed” was less than “allowable,” only the “allowed” depreciation is recaptured. §1245(a)(2)(B).
- e. **Observation.** The §1245 recapture amount, therefore, is generally the lesser of: **1)** all depreciation previously taken on the property, or **2)** the actual gain on the sale/exchange (or potential gain on any other transaction).

2. §1250 Recapture

- a. **§1250 Property.** §1250 property is generally defined as depreciable real property. §1250(c).

- b. **“Depreciation Recapture Amount.”** Unlike §1245 recapture, the potential §1250 recapture amount is generally the depreciation taken in excess of what would have been taken had the real property been depreciated on the straight-line method. §1250(a)(1)(A), (b)(1). Under the '86 Tax Act, real property acquired after 1986 generally must be depreciated using the straight-line method. Consequently, most real estate acquired after 1986 generally will have no §1250 recapture. However, for C corporations, §291 treats 20% of all straight-line depreciation taken on real estate as §1250 recapture. This is true **even if** the property was depreciated using the straight-line method. **§291 only applies to C corporations, or an S corporation that has been a C corporation within the past three years. §1363(b).** Also, the “on and off” §168(k) 30/50/100% bonus depreciation (discussed in more detail in the Depreciation chapter of this book) is treated as “accelerated depreciation” if and to the extent it is allowed for depreciable real property.

3. Depreciation Recapture Events

Both §§1245 and 1250 expressly state that their depreciation recapture provisions apply “notwithstanding any other provision of this [code]”. §§1245(a)(1), (d); 1250(a)(1), (h). Moreover, both sections require the recapture to be triggered on **any disposition** (not just a sale or exchange), **unless** the statutes **expressly** exempt the transaction from the recapture rules.

- a. **Potential Recapture Events.** The following is a summary of transactions that may or may not trigger depreciation recapture:

- **Gift Transfer.** Gift transfers **do not trigger §1245 recapture.** However, the potential recapture carries over to the donee. **See** §§1245(b)(2); 1250(d)(1).
 - **Death Transfers.** Death transfers **do not trigger** §1245 recapture on the decedent's final tax return. Moreover, the §1014 step-up basis rule eliminates the decedent's recapture potential in the hands of the estate or beneficiary. **See** §§1245(b)(2); 1250(d)(2).
 - **Corporate/Partnership Formation.** **Totally tax-free corporate or partnership formations** under §351 or partnership formations under §721 **do not trigger** depreciation recapture. The recapture potential carries over into the corporation/partnership. §§1245(b)(3); 1250(d)(3).
 - **Conversion To Personal Use.** The Service has ruled that the conversion of an automobile from business to personal use is not a “disposition.” **Rev. Rul. 69-487. Practice Alert!** A conversion to personal use before the end of the “recovery period” may trigger §179 recapture, and/or §280F recapture.
- b. **Installment Sales.** §§291, 1245, and 1250 recapture is triggered on an otherwise qualifying installment sale. §453(i). Legislative history states that the recaptured depreciation increases the property's adjusted basis for purposes of the installment sale computation. Income is reported in the year of sale to the extent of §§291, 1245 or 1250 recapture even if no payments are received in the year of sale.
- c. **Retail Motor Fuels Outlet Not §1245 Property.** The 1996 Act provided that retail motor fuels outlets (convenience stores, etc.) where 50% or more of the sales are from petroleum products or where 50% or more of the floor space is for the sale of petroleum products, are 15-year 150-DB assets for depreciation purposes. Your authors were asked if these facilities were subject to the depreciation recapture rules of §1245 (requiring all depreciation to be recaptured) rather than the depreciation recapture rules of §1250 (requiring only depreciation in excess of straight

line to be recaptured). §168(e)((3)(E) describes as 15-year property “any §1250 property which is a retail motor fuels outlet”. Thus, §168 clearly says the property is §1250 property and “retail motor fuels outlets” are not listed as §1245 property under §1245. Therefore, **it appears that retail motor fuels outlets are §1250 assets and, therefore subject to the §1250 depreciation recapture rules, not the §1245 recapture rules.**

G. §1239 Ordinary Income

Background

§1239 is designed as an anti-abuse statute. Congress feared that, without this provision, a taxpayer could depreciate property, sell it to a related party at fair market value, and report a §1231 gain (at favorable capital gain rates), and then the related party could depreciate the property again.

Mechanics

§1239 mandates that **all gain** will be ordinary income on the sale or exchange by a taxpayer to a "related person" if the property is depreciable **in the hands of the transferee**. §1239(a).

1. **“Related Person”**. A related person generally includes:
 - a. a person and all controlled entities (i.e., a more than 50% controlled corporation or partnership after applying the ownership attribution rules of §267(c);
 - b. a taxpayer and any trust in which such taxpayer (or his spouse) is a beneficiary;
 - c. an employer and any person related to the employer, and a welfare benefit fund (under §419(e)) which is controlled directly or indirectly by such person. §§1239(b), (c), (d).

2. **Beware**

§1239 applies if the property is depreciable in the hands of the transferee, even if the property was not depreciable in the hands of the transferor. For example, if a taxpayer sold his personal residence (which, of course, is nondepreciable) to his controlled corporation to be rented out by the corporation (converting the residence to depreciable property) §1239 would treat any gain that would be otherwise recognized (after applying the potential exclusion under §121) as ordinary income.

3. **Installment Sales**

Under §453(g), a taxpayer is generally not allowed to use the installment method on a sale that would be governed by §1239, unless the taxpayer did not have "Federal" income tax avoidance as one of his principal purposes.

H. §267 Loss Disallowance Between Related Parties (See Also Publication 544)

1. **General**

A loss on the sale or exchange of property is not deductible if the transaction is directly or indirectly between related parties including the following (§267):

- 1) an individual and a corporation more than 50% of which is owned, directly or indirectly, by or for that individual;
- 2) two corporations which are members of the same controlled group as defined by §1563(a), except that "more than 50%" shall be substituted for "at least 80%,"
- 3) a corporation and a partnership if the same persons own more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital interest, or the profits interest, in the partnership
- 4) two S corporations if the same persons own more than 50% in value of the outstanding stock of each corporation; or
- 5) two corporations, one of which is an S corporation, if the same person owns more than 50% in value of the outstanding stock of each corporation.

Selected Items of Interest

A. Tax Court Concludes That Goodwill Was Personal Asset Of 100% Shareholder Of Insurance Brokerage Agency (H&M, Inc., TC Memo 2012-290, (Oct. 15, 2012)

- 1) **Facts.** The taxpayer (a regular "C" corporation) operated an insurance brokerage business. Harold Schmeets (Schmeets), the sole shareholder of the taxpayer, ran the corporation's business and was the primary reason behind the corporation's financial success. Schmeets was well known for his ability to develop and maintain long-term business relations with customers and clients. The corporation agreed to sell its assets to a local competitor by executing a written asset purchase agreement. Under the **asset purchase agreement**, the corporation agreed to sell the insurance agency's name, files, customer lists, contracts, **and goodwill** to the buyer for a total of **\$20,000 payable in six annual installments plus interest**. As part of the sale, the corporation signed a noncompete agreement with the buyer. Schmeets entered into an employment agreement (six-year term) with the buyer and signed a 15-year noncompete agreement with the buyer. The **employment agreement** generally provided that Schmeets would be paid total compensation of approximately **\$600,000 over the six-year term** of his employment agreement. Upon auditing the selling corporation's return, the IRS contended, using a substance-over-form analysis, that a significant portion of the "wages" buyer paid to Schmeets was actually disguised purchase price payments to his corporation (the taxpayer). The IRS further argued that Schmeets, his corporation, and the buyer agreed to undervalue the assets of corporation in the sale so that: 1) the buyer could deduct the compensation it paid to Schmeets, (as opposed to nondeductible "goodwill"), and 2) Schmeets could avoid being taxed twice on the proceeds of the sale (i.e., once at the corporate taxpayer level, and again when distributed as a "dividend" to Schmeets as shareholder). **Note!** The sale occurred in 1992, one year before the enactment of §197 in 1993 which allows 15-year amortization for the purchase of goodwill in an "applicable asset acquisition."
- 2) **Tax Court's Conclusion.** In holding for the taxpayer corporation, the Court concluded that the \$600,000 paid to Schmeets should not be reallocated to his corporation, in part, because of: 1) Schmeets' extensive personal relationships with his clients and customers, which he largely maintained for the buyer after the sale, and 2) Schmeets' experience in running all facets of an insurance agency and his responsibilities as manager of his former insurance agency after he sold it to the buyer. The Court, in essence, concluded that the \$600,000 was paid to Schmeets for his services, his noncompete agreement, and his personal goodwill. **Note!** Because Schmeets' individual tax liability was not before the Court, the Court pointed out that it did not need to determine the amount of the \$600,000 allocable to his services to the buyer, his personal goodwill, and his promise not to compete.

- 3) **Key Quotes From the Decision.** The Court made several instructive statements in this case, including:
- “[A] professional **practice’s goodwill** can attach to **both the professional and the business.**” [Emphasis added].
 - “There will be **no salable goodwill** [by a corporation], however, where the **business of a corporation depends on the personal relationships of a key individual**, see **Martin Ice Cream Co. v. Commissioner**, 110 T.C. 189, 207-08 (1998), **unless he** [the key individual] **transfers his goodwill to the corporation** by entering into a covenant not to compete or other agreement so that his relationships become property of the corporation, see **Norwalk v. Commissioner**, T.C. Memo. 1998-279.” [Emphasis added]
 - “And we specifically find that when customers came to his agency, they came to buy from him [Schmeets] — **it was his name and his reputation** that brought them there. We also find **he had no agreement with H & M** [Schmeets’ wholly owned corporation] **at the time of its sale** that prevented him from taking his relationships, reputation, and skill elsewhere, which was precisely what he did when he began working for the [buyer].” [Emphasis added]
- 4) **Practice Pointers!** When a closely held C corporation (or a converted S corporation subject to the §1374 built-in gains tax) sells its assets, the shareholders frequently receive a payment from the purchaser of the corporation’s assets for the shareholder’s “personal” goodwill. If an allocation to personal goodwill (rather than corporate goodwill) is effective, where the corporation sells its assets, the shareholder would not only avoid the corporate level tax on the gain from the sale of goodwill, but the shareholder would also pay a single individual capital gain tax (currently at a maximum rate of 20% [23.8% if subject to the 3.8% tax on net investment income]) on the shareholder’s gain from the sale of the personal goodwill. Furthermore, **if the sale of a corporation is structured as a stock sale, the buyer has a tax incentive to allocate as much of the purchase price as possible to the personal goodwill of the selling shareholders (and/or to payments for shareholders’ noncompete agreements)** so that the buyer can **amortize those costs over 15 years under §197**. However, the selling shareholder generally prefers allocations to personal goodwill (taxed at capital gains rates) as opposed to noncompete payments (taxed at ordinary income tax rates).

This case is one of the most recent in a series of cases that began in the 1990s, where the IRS has argued that goodwill related to a corporate business operation should not be treated as a personal asset of a shareholder. In several of these cases, the taxpayer has prevailed. See **Martin Ice Cream v. Comm’r**, 110 T.C. 189 (1998) and **Norwalk v. Comm’r**, TC Memo 1998-279 (1998) where the taxpayers were successful in selling personal goodwill. However, in both the **Martin Ice Cream** case and the **Norwalk** case (as in **this H & M, Inc. Case**), there was no covenant not to compete between the shareholders and their selling corporation. However, this case confirms that if the selling shareholder has a non-compete agreement with his or her own corporation (or perhaps even an “employment agreement” with her own corporation), it will be extremely difficult to successfully argue that the goodwill is the shareholder’s personal asset.

To have the best chance of effectively treating goodwill as a personal asset of the selling shareholders (rather than a corporate asset), we should take the following steps: 1) Make sure that there is no covenant-not-to-compete (and, if possible, no employment agreement) between the selling shareholder and the corporation; 2) Establish that the shareholder has a meaningful, personal, and valuable relationship and reputation with the existing customer base; 3) From the very beginning of the negotiations of the sale, emphasize in all communications the critical nature of these relationships and the value to the buyer of the shareholders’ personal goodwill; 4) Document the desired sales price allocations at the earliest stages of the negotiations and, if possible, support the allocations with independent appraisals; 5) If the seller is required to enter

into a non-compete agreement *with the buyer*, allocate a reasonable sum to the non-compete separate and distinct from the allocations to the goodwill (again, supported by independent appraisals if possible); and 6) If possible, emphasize the value of the selling shareholder's relationship with the customer base by having the buyer hire the selling shareholder during the transition period (in lieu of a standalone non-compete agreement), and pay the shareholder independently-determined, reasonable compensation for those services separate and distinct from the personal goodwill. Finally, for a recent Tax Court case where the Court held that sales proceeds allocated to the personal goodwill of the 100% owner of a “consulting” PSC should be re-allocated to “consulting” and “non-compete” payments to the shareholder, see **Kennedy, TC Memo 2010-206**.

B. In a Series of Rulings, IRS Makes it Clear That §1202 “Qualified Small Business Stock” May Be Issued by an LLC Electing to Be Taxed as a Corporation (PLRs 201603010 — 201603014, Jan. 15, 2016)

Summary Of Rulings. In each of five private letter rulings (PLRs 201603010 - 201603014), the IRS was asked about the following **fact pattern**: 1) An entity initially formed as a corporation under state law qualified as a “qualified small business” under §1202; 2) Upon receipt of the corporation's stock, the shareholders held “qualified small business stock” under §1202 (§1202 stock); 3) Later the corporation was converted to an LLC pursuant to state law and timely and effectively elected to have the LLC taxed as a corporation for Federal income tax purposes; and 4) The transaction converting the corporation to an LLC qualified as a reorganization under §368(a)(1)(F). **Observation!** §368(a)(1)(F) provides that a corporate reorganization includes a “mere change in identity, form, or place of organization of one corporation, however affected.”

C. Retail Sale of Drugs Found to Be a Qualified Trade or Business For §1202 Gain Exclusion Purposes (PLR 202221006, May 27, 2022)

1. Facts.

- 1) Taxpayer is a C corporation involved in the retail sale of a limited number of drugs and does not manufacture them. The manufacturers of these drugs prefer entering into exclusive distribution arrangements with companies such as Taxpayer.
- 2) Employees of Taxpayer include several pharmacists who fill prescriptions received from physicians. Other employees coordinate the insurance coverage with respect to such prescription orders. Once the insurance process is complete and the prescription is filled by the pharmacist, Taxpayer mails the prescription to the patient's home.
- 3) The non-pharmacist employees are not subject to state licensing requirements or classified as healthcare professionals by any applicable state, Federal or regulatory authority.
- 4) Pharmacists and other employees of Taxpayer have no contact or interaction with physicians, other than to receive prescriptions from them.
- 5) Pharmacists interact with patients only if a patient has a question about a particular prescription.
- 6) Employees are never involved in diagnosing any medical issues or recommending any treatment or drug to individuals. Their interaction with patients is limited to the filling and maintenance of prescriptions as ordered by a physician.
- 7) Therefore, none of Taxpayer's employees diagnose, treat or manage any aspect of any patient's care.
- 8) Taxpayer's revenues are strictly related to the sale of such drugs, and Taxpayer earns no revenues in connection with the medical care of patients.

2. IRS Concludes Taxpayer Engaged In a “Qualified Trade Or Business.” The IRS concluded that based on the facts presented, Taxpayer was engaged in a qualified trade or business as

defined in §1202(e)(3) as of the date of the ruling request. In reaching this conclusion, the IRS said in part:

“§1202(e)(3) excludes businesses from being a qualified trade or business if they offer value to customers primarily in the form of certain specified services, or in the form of individual expertise. A question arises as to whether Taxpayer is (i) involved in the performance of services in the field of health or (ii) where the principal asset of the trade or business is the reputation or skill of one or more of its employees.

Taxpayer's employees are not engaged in the provision of medical services. Other than the pharmacists, such employees are not certified healthcare providers and are not otherwise regulated under state or Federal law. Taxpayer's pharmacists fill prescriptions provided by health care professionals, and other employees help manage the insurance process and occasionally communicate with patients regarding prescription issues and timely refill requests. Any interaction with patients regarding their prescriptions is merely incidental to ensuring receipt of their required prescriptions or answering a patient's question about them. Taxpayer's employees do not provide any diagnostic services or medical care to either patients or physicians, and all revenues are generated by the sale of the drugs. Also, Taxpayer's principal asset is not the reputation or skill of one or more employees, but its exclusive pharmaceutical distribution rights.

We conclude that for the purposes of §1202(e)(3), Taxpayer is not in a trade or business (i) involving the performance of services in the field of health or (ii) where the principal asset of the trade or business is the reputation or skill of one or more of its employees.”
[Emphasis added]

D. IRS Rules That Business Facilitating Leasing of Property Between Lessors and Lessees on its Website Is Involved in “Brokerage Services” and Is Not a Qualified §1202 Trade or Business (CCA 202204007)

1. **Background.** Please see the “Background” section of the previous segment concerning CCA 202221006 which explains that a “Brokerage” business is not a “Qualified Trade or Business” under §1202(e)(3).
2. **Facts.**
 - 1) Taxpayer sold stock in a C corporation (Corporation).
 - 2) Corporation operates a website on which potential lessees may use the website to make nonbinding reservations for the use of certain facilities at specified rental rates from facility lessors that are included in the website data base.
 - 3) Corporation has no authority to enter into or sign leases on behalf of the potential lessors or lessees.
 - 4) A legally binding rental agreement for the use of a facility does not arise until the potential lessor and the potential lessee enter into a lease agreement.
 - 5) Corporation's website will show a user that is considering leasing one or more facilities in a particular location the facilities in that area that are included in the website data base.
 - 6) Potential lessees do not pay any fee to Corporation for the use of Corporation's website. In its “Terms of Service” for lessees, Corporation states that it has no control over the facilities to be leased and does not guarantee the accuracy of any listings.
 - 7) Corporation does not guarantee that a lessee will actually be able to lease a facility listed in its database.
 - 8) The lessors are responsible for all payments to the Corporation.

- 9) Corporation charges lessors a recurring periodic fee for simply being listed in the database, and a contingent fee based on a percentage of rent paid by a lessee actually leasing a facility
 - 10) The facilities listed for lease on Corporation's website include real property.
 - 11) In its "Terms of Service" Corporation represents to potential lessees that it is not responsible for, and does not engage in, brokering, selling, purchasing, exchanging, or leasing posted properties. However, it also represents that it may hold a real estate broker license in one or more states.
 - 12) Corporation may also provide other services to lessors; for example, it may charge a lessor a monthly fee to build and host a website for the lessor to be used in conjunction with the leasing of the lessor's facility.
- 3. Advice Requested.** This CCA was in response to a request for technical advice from an IRS attorney as to whether Corporation was involved in a "Brokerage" trade or business and its shareholder was, therefore, not able to exclude gain on the sale of Corporation's stock under §1202.
- 4. IRS Ruled Corporation Was in Brokerage Trade or Business.** IRS Chief Counsel's office ruled that Corporation was in a "Brokerage" trade or business and therefore a sale of its stock did not qualify for the §1202 exclusion. Specifically, Chief Counsel said *"The fact that Corporation's services are provided by software created by people rather than directly by people does not change the functional nature of the services. Because Corporation provides brokerage services within the meaning of §1202(e)(3)(A), taxpayer is not entitled to exclude any of the gain from the sale of stock in Corporation under §1202."* [Emphasis added]

Observations! In concluding that Corporation was involved in a brokerage trade or business, the Service observed that §1202 does not define "Brokerage Services." Therefore, the IRS reviewed several sources dealing with brokerage services including: 1) **§6045(a)** which requires information returns to be filed by brokers; 2) **§448(b)(2)** dealing with personal service corporations; 3) **Reg 1.199A-5(b)(2)(x) which provides that for purposes of §199A only**, the performance of services in the field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in §475(c)(2)) for a commission or fee, including stock brokers and other similar professionals but does not include services by real estate agents and brokers, or insurance agents and brokers; and 4) Dictionary definitions.

It seems the IRS settled on the definition of "Brokerage Services" in §6045 and in various dictionaries for the definition of "Brokerage Services" under §1202. The CCA says in part:

"We have found no case law that addresses the issue of what constitutes "brokerage services" for federal income tax purposes. However, in the absence of evidence to the contrary, words in a statute are assumed to bear their ordinary, contemporary, common meaning. Pioneer Investment Services Co. v. Brunswick Associates Ltd. Partnership, 507 U.S. 380, 388 (1993). To ascertain the meaning of statutory terms, courts often take into account the definitions of those terms in dictionaries. See e.g. Walters v. Metropolitan Educational Enterprises, Inc., 519 U.S. 202, 207 (1997); Metro One Telecommunications, Inc. v. Commissioner, 704 F.3d 1057, 1061 (9th Cir. 2012).

One popular dictionary definition of broker defines the term similar to the definition of broker under §6045. Specifically, Merriam-Webster defines "broker" as "one who acts as an intermediary: such as a: an agent who arranges marriages b: an agent who negotiates contracts of purchase and sale (as of real estate, commodities, or securities)." Additional, less

common, meanings are “power broker” and “one who sells or distributes something.” Broker, Merriam-Webster.com, <https://www.merriam-webster.com/dictionary/broker> (last visited Jan. 7, 2021).

BLACK’S LAW DICTIONARY (11th ed. 2019) provides a more elaborate definition of broker, stating, “One who is engaged for another, usually on a commission, to negotiate contracts to property in which he or she has no custodial or proprietary interest, or an agent who acts as an intermediary or negotiator, especially between prospective buyers and sellers.” * * *

We conclude that Corporation should be classified as a broker under the common meaning of the term and as it is defined under §6045, rather than the narrower definition that applies for purposes of §199A. While Corporation states that it does not provide brokerage services but instead provides advertising services, it is our view that the actions and services provided by Corporation support our position that Corporation is a broker for purposes of §1202(e)(3)(A).

A broker serves as an intermediary between a buyer and a seller, and Corporation does this. Corporation does not just passively publish advertisements on its website that are provided to it from potential lessors desiring to lease property. Unlike a search engine that provides content to users and also sends targeted advertisements to those users based on their search history, Corporation’s website is solely devoted to effectuating agreements between potential lessors and potential lessees of certain property.

Corporation charges a minimum flat fee to lessors irrespective of whether a potential lessor succeeds in entering into lease agreements as a result of the use of Corporation’s website. However, Corporation is also compensated on a commission basis based on leasing transactions that are entered into as the result of the use of Corporation’s website.

Corporation does not have the authority to enter into leasing agreements on behalf of lessors that use its services. Corporation only provides a vehicle for potential lessees to transmit non-binding reservation requests to potential lessors. Only the potential lessor and lessee have the authority to enter into a binding lease agreement. However, brokerage activity can include simply bringing a potential buyer and seller together to work out the transaction. See American West Hotel Brokers v. Wu, 697 P.2d 34, 36 (Colo. 1985).

*The fact that Corporation’s services are provided by software created by people rather than directly by people does not change the functional nature of the services. Because Corporation provides brokerage services within the meaning of §1202(e)(3)(A), **taxpayer is not entitled to exclude any of the gain from the sale of stock in Corporation under §1202.*** [Emphasis added]

5. **CCA Distinguishes §1202 Definition From §199A Definition of Brokerage.** In footnotes 8 and 9, the CCA distinguishes the §1202 definition of “Brokerage” from the definition provided in the §199A regulations.

Footnote 8. “Treas. Reg. §1.199A-5(b)(2)(i) provides that the rules of §1.199A-5(b)(2) apply solely for purposes of §199A and therefore may not be taken into account for purposes of applying any provision of law or other regulation other than §199A and the regulations thereunder, except to the extent such provision expressly refers to §199A(d) or Treas. Reg. §1.199A-5.”

Footnote 9. *“It is important to emphasize that the §199A regulations’ narrow interpretation of what constitutes brokerage services by its terms only applies for purposes of §199A and no other Code section.”*

IRS FORMS (Located at www.irs.gov)

Form 8594 (Asset Acquisition Statement Under §1060)

Form 8023 (Elections Under §338 for Corporations Making Qualified Stock Purchases)

IRS PUBLICATIONS (Located at www.irs.gov)

Publication 544 (Sales and other Dispositions of Assets)

Planning Ideas

A. Sale or Exchange of Corporation Appreciated Assets

General. Sales of a corporation’s assets will trigger tax at the corporate level if the fair market value of the assets is in excess of their basis. The advisor should first assume that any transfer or exchange of appreciated assets by a corporation (including an S corporation) will trigger gain, then look for specific exclusions that cover the transaction.

Typical transactions where gain is recognized: 1) The sale of corporate assets and 2) Distribution of appreciated assets to shareholders.

Typical transactions where gain is not recognized: 1) The tax free transfer of assets to the corporation solely in return for stock by shareholders owning 80% or more of the stock (§351); 2) The liquidation of an 80% owned subsidiary into its parent (§337); 3) A tax-free reorganizations (§§368(a)(1), (A), (B), (C), (D), (E), (F), etc.); 4) Tax-free exchanges of “like-kind” real estate (§1031); and 5) Gain upon the involuntary conversion of property if the proceeds are timely reinvested (§1033).

B. Locking in Capital Gain on Undeveloped Realty by Using an Installment Sale to a Related Person

Individuals holding appreciated land often decide to develop the property, perhaps by subdividing and constructing homes for sale. However, once the individuals engage in a certain level of *development* activity, they will likely be classified as “dealers” in real estate for tax purposes causing the gain upon the sale of the lots (and homes) to be taxed as ordinary income. In other words, by taking certain steps to develop the property, the taxpayers could easily convert any gain upon the sale of the land from long-term capital gain to ordinary income. One way to possibly preserve or lock in the long-term capital gain treatment on the appreciation of the land *that exists prior to the development activities* is to sell the land to a related S corporation. **Caution!** If the sale of the property is to a “related person” for purposes of §1400Z-1 and §1400Z-2 (which will frequently be the case), the resulting capital gain will not qualify for the tax benefits that are generally available for a capital gain that is re-invested in a Qualified Opportunity Fund (which is discussed in more detail in a later Chapter of this Manual entitled “**Qualified Opportunity Zone Funds**”). Moreover, a sale to a partnership owned *directly or indirectly* by more than 50% of the individuals who owned the land will generate ordinary income if the purchasing partnership develops the property and becomes a “dealer” in real estate. See §707(b)(2). Therefore, the **sale should generally be to an S corp and not a partnership. Practice Alert!** Since undeveloped real estate is not depreciable, neither §453(g) nor §1239 should apply to the sale.

If this technique is used, the individuals should avoid conducting any development activities prior to the sale to the S corp to possibly avoid a successful IRS argument that the development activities

of the S corporation are attributed to the individuals. Also, the IRS has at times attacked similar transactions by arguing that the related-party installment note is really, for tax purposes, equity in the purchasing S corporation. If successful, this argument would result in the promissory note being treated as "**preferred stock**" issued in return for a §351 transfer of the land to the S corp and the gain on the original sale of the real estate to the development S corp would not be recognized. Instead, all of the original built-in gain in the undeveloped real estate would ultimately be taxed at ordinary income rates when, after development, the property is sold by the S corporation. See, e.g., **Sun Properties v. US**, 220 F.2d 171 (5th Cir. 1955) and **Warren H. Brown**, 27 T.C. 27 (1956) where the IRS argued that the sale was actually a contribution to capital, but the court upheld the sale.

Also, if the IRS is successful in this attack, treating the installment note as preferred stock would result in the termination of the development corporation's S election. This would result in the entire gain on the purchased real estate being subjected to double taxation upon its ultimate sale by the development corporation. To minimize the chance of these negative tax consequences occurring, the S corp could borrow the purchase price from an unrelated lender and purchase the land from the individuals for cash. However, this would result in all the gain on the land being triggered up-front. Therefore, if the purchase price is not paid up front and an installment note is utilized, **there are several ways to strengthen the argument that the installment note is not stock**: 1) have the development corporation make a down payment in the amount common for similar transactions; 2) have sufficient shareholder equity in the development corporation so that the corporation's debt-equity ratio is not too high (it is generally recommended that the debt-equity ratio be no higher than 4:1); 3) make sure that a market rate of interest is provided on the note, the note is not subordinated to general creditors, and the note does not have any features allowing the note holders to convert the note into an equity interest in the S corporation (i.e., make sure that the note constitutes "straight debt" under §1361(c)(5)); 4) make all note principal and interest payments when due; **and 5)** have the sellers retain a recorded mortgage in the real estate.

In addition, the sales price of the land should be based upon an independent appraisal and all the parties involved should document the non-tax business reasons for selling the real estate to the related S corporation. Also, it would be helpful if the development corporation has shareholders unrelated to the owners of the land.

TRAVEL, MEALS, AND ENTERTAINMENT

Tax Cuts and Jobs Act

A. IRS Issues Final Regs Explaining Treatment of Meals and Entertainment Expenses Under TCJA (TD 9925, Reg §§1.274-11 and 1.274-12, Sept. 30, 2020)

1. Background.

Prior to the TCJA. Prior to amendment by the Tax Cuts and Jobs Act (TCJA):

- 1) **50% Deduction for Food, Beverage, And Entertainment.** §274(n)(1) generally limited the deduction for food, beverage, and entertainment expenditures incurred in the course of a trade or business to 50% of the amount that otherwise would have been allowable.
- 2) **Entertainment Expenditures Required to Meet Directly Related Or Business Discussion Requirement.** Prior to TCJA, taxpayers generally could deduct 50% of entertainment expenditures only if the taxpayer established that: 1) The expenditure was **directly related** to the active conduct of the taxpayer's trade or business (directly related exception), or 2) In the case of an expenditure directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), the expenditure was **associated with** the active conduct of the taxpayer's trade or business (business discussion exception).
- 3) **Trade Or Business Entertainment Expenditures: 0% Deductible**
- 4) **Trade Or Business Food & Beverage Expenditures: Most 50% Deductible**

2. TCJA Changes Effective for Amounts Paid or Incurred After 2017.

- 1) **50% Reduction Under §274(n) No Longer Applies to Entertainment Expenditures.** Under TCJA, the 50% reduction rule under §274(n) only applies to food and beverage expenditures and not to entertainment expenditures.
- 2) **Entertainment Expenditures Generally Not Deductible Even if Directly Related or Business Discussion Requirement Met.** TCJA repealed the directly related and business discussion exceptions to the general prohibition on deducting entertainment expenditures in §274(a)(1)(A). Therefore under TCJA, entertainment expenses are generally not deductible.
- 3) **Entertainment Expenditures 100% Deductible if Described in §274(e).** Entertainment expenditures are 100% deductible if one of the **nine exceptions** in §274(e) applies.

3. Meals for 2026 and Beyond

Employer-Provided Meals and Snacks Lose Their Deductibility

Meals provided by an employer for the convenience of the employer (e.g. cafeteria meals, on-site lunches, breakroom snacks, coffee, etc.) will **no longer** be deductible beginning in 2026.

Employer-operated eating facilities: Costs for running employer cafeterias or similar on-site eating facilities become nondeductible starting in 2026.

Meals for employer's convenience: The “for convenience of employer” provision that allowed some meals to be deductible at 50% will be phased out — i.e. those meals become nondeductible.

3. Boston Bruins U.S. Tax Court Case (*Jacobs v. Commissioner*, 148 T.C. No. 24, decided June 26, 2017)

Case Background

Parties: Jeremy M. Jacobs and Margaret J. Jacobs (owners of the Boston Bruins, via passthrough entities) vs. IRS.

Years in Dispute: Taxable years **2009 and 2010**.

What's at Issue: The Bruins provided meals and snacks to players and staff before away games (while staying in out-of-town hotels). They deducted 100% of those meal costs. The IRS contended that only 50% should be deductible under the general meals expense limitation (§ 274(n)(1)), unless an exception applies.

Relevant Tax Law

A few sections of the U.S. Internal Revenue Code and Treasury Regulations were key:

§ 274(n)(1): Generally limits business meals deductions to 50%.

§ 274(n)(2)(B): Provides an exception to the 50% limitation if the meals are a *de minimis fringe benefit* under § 132(e).

§ 132(e): Define what qualifies as a *de minimis fringe benefit*. Includes conditions like non-discriminatory provision, use of an employer-operated eating facility, location “on or near” business premises, etc.

§ 119: The exclusion for meals furnished for the convenience of the employer and on the business premises; that plays a role in measuring whether the facility meets certain cost/revenue tests.

Key Facts Found by the Court

To qualify for the *de minimis* fringe exception (and escape the 50% limitation), several “tests” must be met. The Bruins had to satisfy each. The court found that they did. Some of the critical fact findings:

Eating Facility Owned or Leased by Employer

The Bruins contracted with away-city hotels to have sleeping rooms *and* banquet or conference rooms for meals/snacks. The contracts gave Bruins rights to use and occupy the rooms, determined what food is served, times, attendees, etc. The court treated those meal rooms as leased facilities.

Employer Operates the Eating Facility

Though the hotel provided the physical location, the Bruins dictated many operational details (what food, schedules, attendees). The Bruins paid for the rooms and food services, even if via contracts. That was enough under the regulation to show employer operation.

Facility Is On or “Near” Employer’s Business Premises (for Being a Business Premise)

The court took an expansive view that when traveling for away games, the hotels used are temporary work sites/business premises for purposes of § 132(e), § 119, etc. Even though the hotel is not the Bruins’ home base in Boston, because the team is required to travel, arrive early, prepare, and conduct substantial business in the hotel, it counts.

Meals Provided During, Immediately Before, or After the Employee Workday

Pregame meals/snacks and required attendance met this timing requirement. It was not purely social.
Nondiscriminatory Availability

Meals were furnished to all traveling team employees, not just a select highly compensated group, under a classification that did not favor high earners.

Revenue/Operating Cost Test

There was a subtle point here: even though the Bruins didn't charge those employees for the meals (provided "without charge"), the regulations allow treating the value of meals as though employees "paid" the direct operating cost in certain circumstances if the meals are excludable under § 119 for a majority of employees.

The Court's Holding

Because the Bruins satisfied *all* of the requirements, the U.S. Tax Court held that the pregame meals provided at away game hotels are **de minimis fringe benefits** under § 274(n)(2)(B). Hence, those meal costs are **100% deductible**, not subject to the 50% limitation.

IRS Reaction

The IRS **acquiesced** *in result only* to the case. This means the IRS agreed to follow the outcome (allow 100% deduction in similar circumstances) but did **not** agree to the reasoning in a broader sense. So its acquiescence is limited.

Implications and Significance

The decision is powerful (and somewhat unusual) because typically the IRS and courts strictly enforce the 50% limitation for business meals. An exception like *de minimis fringe* status, especially in this kind of away-game hotel setting, is relatively narrow. The Bruins case expands what counts as an employer-operated eating facility, "business premises," etc.

It provides a roadmap for *other employers* in similar situations (sports teams, travel-intensive businesses, performing arts, entertainment, etc.) to try to qualify away-from-home meals as fully deductible, provided they organize their contracts and operations to meet the required criteria.

But it's not a blanket permission: the requirement that the facility be "on or near" business premises and that the eating facility is owned or leased and operated by the employer are often the hardest to meet. Also, nondiscrimination and timing requirements must be satisfied. If your situation is even slightly different (e.g. meals optional, only part of staff, hotel food services without control, etc.), the outcome may diverge.

Travel and Meals: Basic Concepts

A. Commuting Expenses

General Rule. The regulations have long held that "commuting" costs to and from work are not deductible business expenses. Regs. §§1.162-2(e), 1.262-1(b)(5). This rule is based on the notion that the decision on how far to live from your business is inherently personal and, therefore, any commuting expenses should be disallowed (regardless of the distance). See *Comm. v. Flowers*, **326 US 465 (1946)**.

Rigid Application. The courts typically disallow commuting expenses even if there is a valid **nonpersonal** reason for not living near your work location. For example, the Ninth Circuit

disallowed travel expenses incurred by civilian taxpayers who lived in the nearest civilian community to the Air Force Base where they worked, even though the civilian taxpayers were not allowed to live on base. The Court compared this to suburban commuters who could not find suitable housing near their urban place of employment, **Sanders v. Comm.**, 439 F.2d 296 (9th Cir., 1971). Furthermore, commuting costs are disallowed regardless of the number of trips made during the day (e.g., driving back to the office after dinner). **Rev. Rul. 76-453.**

“On Call” Argument. The 10th Circuit held that a police officer's travel from his home to the police headquarters was not a commute if the officer was “on call” during the drive. **Pollei v. Comm.**, 877 F.2d 838 (10th Cir., 1989). **Note!** Some commentators have predicted that businessmen with cellular car phones will argue they are “on call” during their travel from home to work. **Practice Alert!** The IRS has made it clear that it will challenge this position. **See AOD 1990-031.**

“Regular” Versus “Temporary” Work Locations. In 1990, the IRS issued **Rev. Rul. 90-23** which revised and clarified how the Service defines a commute. **Please Note** that the IRS has issued **Rev. Rul. 94-47** and **Rev. Rul. 99-7** amplifying and clarifying this ruling (as discussed later in this chapter). **The key points under Rev. Rul. 90-23 are as follows:**

Transportation Between Work Locations. Daily transportation between two specific business locations (whether in the same or different businesses) is business travel. **See Rev. Rul. 55-109.**

Transportation to Regular Work Locations. Daily transportation between the taxpayer's residence and **one or more regular places of business** is a nondeductible commuting expense.

IRS Restates and Refines its Position. In **Revenue Ruling 94-47**, as updated by **Revenue Ruling 99-7**, the IRS says that travel expenses from a taxpayer's residence to “any” work location will be deductible **only** if one of the following three conditions exists:

- **General Rule.** A taxpayer can deduct daily travel from his residence to a “temporary work location” if such work location is “outside” the metropolitan area where the taxpayer lives and normally works.
- **Regular Place of Business Away From Home.** If a taxpayer has one or more regular work locations “away from the taxpayer's residence,” the taxpayer may deduct daily transportation expenses between home and a temporary work location in the same business, **regardless of the distance.** **Rev. Rul. 99-7** says that a work location is “temporary” (absent facts indicating otherwise) if employment at the location is realistically expected to last (and does in fact last) for one year or less.
- **Principal Place of Business in Home.** If the taxpayer's home constitutes a “principal place of business” under §280A(c)(1)(A) (qualifies as for home office deduction), the taxpayer may deduct daily travel between the residence and another work location in the same trade or business, regardless of whether the other business location is “regular” or “temporary”; and regardless of the distance. **Practice Alert!** The ruling also states that: “The determination that a taxpayer's residence is the taxpayer's principal place of business within the meaning of §280A(c)(1)(A) is **not necessarily determinative** of whether the residence is the taxpayer's **tax home** for other purposes, including the **travel-away-from-home** deduction under §162(a)(2).” [Emphasis added].

- **Metropolitan Area.** The ruling does not define “metropolitan area.” In **Wheir, TC Summ. Op. 2004-17**, the Court embraced (but did not establish) a 35 mile rule. Please consult the case for additional details.

Examples. Daily transportation by a doctor between his residence and one or more offices, clinics, or hospitals where he performs services on a regular basis are nondeductible commuting expenses (travel between the “regular places of businesses” would be business travel). By contrast, CPAs who maintain offices away from their homes and who go directly to a client’s “in town” location should generally qualify as business travel without having to go to the office first.

B. Other Transportation Expenses

Background. The Tax Reform Act of 1986 established the following special rules regarding travel expenses:

Travel as a Form of Education. §274(m)(2) provides that no deduction is allowed for expenses for travel that otherwise would be deductible only on the ground that the travel itself constitutes a form of education. **For example**, this provision disallows deductions by a French teacher who travels to France to maintain general familiarity with the French language and culture.

Travel as an Investment-Related Expense. §274(h)(7) provides that no deduction is allowed for travel or other costs of attending a convention, seminar, or similar meeting unless the activity relates to a trade or business of the taxpayer. **For example**, registration fees, travel and transportation costs, and meals and lodging expenses incurred in connection with attending an investment seminar or similar meeting relating to investments, financial planning, or other activities for the production or collection of income are not deductible.

C. Transportation Mixing Business and Pleasure

As discussed previously, qualified business travel is generally deductible (e.g., business-related flights, etc.). However, if the trip combines business and pleasure, the transportation costs to and from the location are deductible **only if** the “primary purpose” of the trip is business. Regs. §1.162-2(b)(1). The travel expense to and from the location is not deductible at all if the primary purpose for the trip is personal (although local transportation costs while at the location properly allocated to business would be deductible).

D. Meals and Lodging While “Away-From-Home”

General. Generally, §162(a)(2) allows a taxpayer to deduct travel expenses only if she is “away-from-home.” This apparently simple rule has raised questions regarding what constitutes a taxpayer’s “home,” and when is a taxpayer deemed to be “away” from his or her home.

Overnight (Sleep and Rest) Rule. The IRS long ago adopted the so-called overnight or sleep and rest rule for meals and lodging expenses. That is, a taxpayer must be required to stay overnight or sleep and rest in order to deduct meals and lodging. This is sometimes referred to as being in “travel status.” This rule has been embraced by the Supreme Court. **Correll v. U.S., 389 U.S. 299 (1967).**

“Away From Home.” §162(a)(2) allows the deduction for travel expenses if the taxpayer incurs the expenses while “away-from-home.” The Service and the courts have long debated the meaning of this phrase, yet the Supreme Court has never interpreted it. The Service typically believes the “home” is the taxpayer’s primary place of business, while some courts believe it is the taxpayer’s principal residence.

See Rev. Rul. 93-86 where the IRS confirmed its position that a taxpayer's "home" is generally considered to be located at the taxpayer's regular or principal (if more than one regular) place of business, if none, then the home will be taxpayer's abode in a real and substantial sense).

Business Nexus. The courts frequently argue that in order for a taxpayer to deduct business travel from their home to a temporary work location outside the metropolitan area where the home is located, there must be a business reason (or nexus) for maintaining the original home. For example, the First Circuit has held that a Harvard Law School student could not deduct her travel, food, and apartment relating to a summer clerkship in New York City even though she maintained a home in Boston with her husband. The Court concluded that maintaining the home in Boston was primarily for personal reasons, not business. **Hantzis v. Comm.**, 638 F.2d 248 (1st Cir., 1981). See also, **Raush, TC Memo 1998-245**.

Must Have at Least One "Home." The courts will typically disallow travel expenses if the taxpayer maintains no permanent (or quasi-permanent) home. The theory is that a taxpayer cannot be "away-from-home" if he or she has no home. See, e.g., **Rosenspan v. U.S.**, 438 F.2d 905 (2d Cir., 1971) and **Henderson v. Comm.**, 81 AFTR2d Pp 98-652, 9th Cir, 1998. Also, see **Bechtelheimer**, BC-DC Fla-1999, where the Court denied travel expenses to taxpayers who traveled in their motor home from state to state selling their wares, because the motor home was their place of abode; **McNeill, TC Memo 2003-65**, where the Tax Court denied a long-haul trucker travel and meal expenses because he essentially lived out of his truck and, therefore, had no "tax home."

More Than One Home. The IRS has taken the position that a taxpayer can have more than one "tax" home for purposes of business travel. Thus, the Service took the position that a taxpayer's travel from his home near his business in Massachusetts to his second home near his second business in Florida was nondeductible business travel. Moreover, the Service argued that no lodging or meal expenses while at either location were deductible. Although the Tax Court initially agreed with the IRS, the First Circuit Court of Appeals reversed the Tax Court. The First Circuit held that so long as there were business exigencies for the taxpayer buying the second home, concluding that the taxpayer had two "tax" homes was "inconsistent with the well-settled policy underlying §162(a)(2): that duplicated living expenses necessitated by business are deductible." **Andrews v. Comm.**, 931 F.2d 132 (1st Cir., 1991).

Temporary Work Assignment (Notice 93-29). Historically, temporary work assignments frequently raised questions regarding the "away-from-home" requirement. More specifically, the issue frequently arose whether a temporary work assignment had become an indefinite shifting of the taxpayer's "home", thus eliminating the deductions for travel, food, and lodging.

Employer Reimbursement. Any reimbursement received by an employee for the nondeductible expenses generally must be included in the employee's gross income under the rules provided under §62(c) and Regs. §1.62-2.

Statutory One-Year Rule. The **Energy Policy Act of 1992** amended §162 to read as follows: "[T]he taxpayer shall not be treated as being temporarily away from home during any period of employment if such period exceeds 1 year."

Revenue Ruling 93-86 gives further clarification to this statutory one-year rule by establishing the following rules:

- **Rule #1.** If employment away from home in a single location is "realistically expected" to last (and does in fact last) for **one year or less**, the employment will be treated as temporary in the absence of facts and circumstances indicating otherwise.

- **Rule #2.** If employment away from home in a single location is “realistically expected” to last **more than one year** and there is no “realistic expectation” that the employment will last 1 year or less, the employment will be treated as indefinite, regardless of whether it actually exceeds 1 year.
- **Rule #3.** If the employment away from home in a single location initially is “realistically expected” to last for **one year or less**, but at **some later date the employment is “realistically expected” to exceed one year**, the employment will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date the taxpayer’s “realistic expectation” changes.

“**Realistic Expectation.**” Rev. Rul. 93-86 does not define this term.

Chief Counsel’s Memoranda Provide Informal Guidance on “Temporary Work Assignment Rule.” The IRS has released a series of Chief Counsel’s Memoranda (CCM) that provide informal guidance on how the IRS will evaluate the one-year “temporary work assignment rule.” The following represents *selected* highlights from these CCMs:

- **Separate Project Gets Separate One-Year Rule.** **CCM 200018052** suggests that if a work assignment involves separate projects at separate locations, the taxpayer can apply the one-year rule to each project. For example, if an employee is assigned to work at three different projects at different locations (each of which lasts less than one year) which in the aggregate last more than one year, the employee will be deemed to be on a temporary work assignment.
- **Separate Phases of Single Project Collapsed For One-Year Rule.** **CCM 2000252052** provides that separate phases of a single project in the same location will not be given separate one-year periods — even if the worker’s job classification is changed.
- **Will Break-in-Service Create a New One-Year Period?** In **CCM 2000252052**, the IRS concedes that there is no ironclad rule whether a worker’s break-in service will “re-start the one-year clock.” However, the IRS did conclude that a two-to-three week break will definitely not re-start the one-year clock, while a break of more than one year would. **CCM 200026025** suggests that a continuous seven-month break-in-service would re-start the one-year clock.
- **Travel “Between” Worksites Is Business Travel.** **CCM 200027047** reminds us that travel between worksites is deductible notwithstanding the one-year temporary travel rule.
- **Each Separate Worksite Gets its Own One-Year Period.** **CCM 200027047** concludes that each separate worksite at a different location is given a separate one-year period, even if each worksite is considered part of an overall single project.
- **35 Workdays Per Year Is “Temporary.”** **CCM 200026025** suggests that if a worker spends no more than 35 work days at a single work location during a calendar-year period, the assignment will be deemed temporary - - even if the job assignment period is actually indefinite. **Practice Alert!** The Tax Court treated an independent contractor’s travel as “temporary” even though he spent over 100 days a year at the business location over a five-year period. **Mitchell, TCM 1999-283** (where the tax Court said: “*Merely because an independent contractor may return to the same general location in more than one year does not mean ... that the independent contractor is employed in that general location on an indefinite basis.*”).

In **PLR 9641003**, the IRS concluded that employer-paid airline tickets to a remote work location where the taxpayer “realistically expected” to work more than one year constituted taxable income to the employee.

See *Johnson v. Comm.*, TC Memo 1999-153, where the Court held that a contract engineer could not deduct expenses related to a long-term assignment after his second six-month assignment was extended.

IRS Says That Changing Employers Does Not Start New One-Year Period. CCM 200020055 states that if an employee is working on a project in a single location and, for whatever reason, changes employers while working on the project, a new one-year period is not started merely due to the change of employers.

E. Family Member's Travel Expenses

General Rule. Prior to RRA '93, a taxpayer could deduct the cost of taking a spouse or dependent on a business trip only if there was a bona fide business reason for the person's presence. Regs. §1.162-2(c).

Revenue Reconciliation Act of 1993. Congress believed that under the old rule, too many taxpayers were deducting expenses for spouses on business trips without satisfying the bona fide business purpose test. Consequently, **effective for amounts paid or incurred after Dec. 31, 1993**, no deduction is allowed (except as a moving expense under §217) for travel expenses with respect to a spouse, dependent, or other individual accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel, unless: **1)** such person is an employee of the taxpayer, **2)** the travel of such person is for a bona fide business reason, **and 3)** such expenses would otherwise be deductible by the spouse, dependent, or other individual. §274(m)(3).

Selected Items of Interest

A. Sole Proprietor Unable to Use the Federal Per Diem Method to Substantiate Lodging Expenses (Starr, TC Memo 2000-305, Sept, 27, 2000)

A sole proprietor who conducted a business that provided hot air balloon rides to customers was not entitled to use the federal per diem rate to substantiate lodging expenses he incurred while in another state. The Tax Court ruled that although the per diem rates are available for certain employer/employee reimbursement relationships, **self-employed individuals are precluded from using the per-diem method to substantiate lodging expenses under Rev. Proc. 94-77. Rather, self-employed individuals are entitled to deductions for actual expenses incurred and are required to substantiate the amount of the expense, the time and place of travel and the business purpose of the expense with documentary evidence.** Thus, deductions claimed by the taxpayer in excess of the amount determined by the IRS were disallowed absent sufficient substantiation.

B. Long-Haul Trucker Had No "Tax Home"; Travel and Meal Expenses Disallowed (McNeill, TC Memo 2003-65, March 6, 2003):

During the years at issue, the taxpayer (William McNeill) owned and operated a long-haul, over-the-road truck. He was on the road about 360 days in 1998 and about 345 days in 1999. On his 1998 return, William deducted \$8,006 for travel expenses and \$6,480 for meal expenses. On Schedule C attached to his 1999 return, William deducted \$5,799 for travel expenses and \$5,760 for meal expenses. In the notice of deficiency, respondent disallowed all these claimed deductions. William had no permanent residence. In 1998, he stayed in a friend's house rent free for five days. In 1999, he made a \$1,000 payment for a friend's mobile home and stayed there for 20 days. The court ruled that William was not entitled to deduct the claimed expenses for travel and meals because, during the tax years at issue, he had no principal place of business and did not incur substantial living expenses at a permanent residence. Thus, he had no tax home under Code Sec. 162(a)(2). The taxpayer was on the road all but five days in one of the tax years at issue, and all but 20 in the other year at issue.

C. IRS Allows Day Care Providers to Use Standard Deduction Rates for Food Costs (Rev. Proc. 2003-22, Feb. 24, 2003)

Purpose. This revenue procedure provides taxpayers engaged in the trade or business of providing family day care with optional standard meal and snack rates to use in computing the deductible cost of food provided to **eligible children receiving care** from family day care providers. Day care providers may use the standard deduction rates instead of keeping detailed records and receipts of food purchased for use in the day care business. This revenue procedure applies to any family day care provider, whether or not licensed, registered, or otherwise regulated by the state or locality in which the family day care operates, who chooses to use the standard meal and snack rates provided in this revenue procedure to substantiate the deductible cost of meals and snacks provided to eligible children in the family day care.

Standard Meal and Snack Rates. The standard meal and snack rates are equal to the **Tier I reimbursement rates of the CACFP** (The Child and Adult Care Food Program) **for meals served in day care homes.** For purposes of this revenue procedure, the standard meal and snack rates for a taxable year are the Tier I rates **in effect on Dec. 31 preceding the beginning of the family day care provider's taxable year.** For example, for the 2016 taxable year, calendar year family day care providers will use the Tier I rates in effect on Dec. 31, 2015, as the standard meal and snack rates to calculate their deductible food costs for the entire 2016 taxable year. **The rates will be adjusted annually.** Generally, the CACFP **reimbursement rates may be found on the Internet at www.usda.gov** under "Child and Adult Care Food Program." The Service includes the standard meal and snack rates that are current at the time of publication in **Publication 587, Business Use of Your Home.**

Other Requirements. Please see **Rev. Proc. 2003-22** for detail rules for using these standard deduction rates.

D. Various Judicial Decisions Addressing Whether "Daily" Travel Qualifies as Deductible "Business" Travel or Is a Non-Deductible "Commute"

Court Cases. While providing valuable guidance, Revenue Ruling 97-7 (discussed previously in this chapter) by no means answers all questions regarding the precise dividing line between a non-deductible commute and legitimate daily business travel. Consequently, business-related travel expenses are one of the most frequently litigated topics, resulting in a continuing stream of tax cases. The following are summaries of **selected** 2014 court cases that have addressed various issues involving **daily business-travel** expenses:

1. **Third Circuit Court of Appeals Affirms Tax Court's Analysis of Non-Deductible "Commuting" Expenses Under Revenue Ruling 99-7 (Bogue, CA-3, 111 AFTR 2d 2013-2179, June 3, 2013; Cert Denied March 31, 2014).** Taxpayer (an independent contractor performing residential renovations) lived in a house owned by his fiancée. During the 2 tax years at issue, Taxpayer worked on 5 different renovation projects that were the following distances from his home, respectively: 20.1, 15.7, 15, 14.7, and 4 miles. Taxpayer generally worked on each project exclusively until it was completed, and then moved on to the next project until it was finished. IRS argued that Taxpayer's daily travel from his home to these work sites were nondeductible "commuting" expenses, and initially litigated the case in the Tax Court. **Bogue, TC Memo 2011-164.** In ruling against the Taxpayer, the Tax Court essentially concluded that the Taxpayer's daily travels were non-deductible "commutes" based on the following analysis of **Revenue Ruling 99-7** (discussed earlier in this Chapter):

- a. **With Regard to Rule #1 in Revenue Ruling 99-7 (i.e., Daily Travel to a “Temporary” Work Location Outside the “Metropolitan Area” Where Taxpayer Lives and Normally Works).** The Tax Court refused to adopt a “rigid definition” of what constitutes a “metropolitan area” for purposes of Revenue Ruling 99-7. The Tax Court instead “described” (without actually defining) a location outside the “Metropolitan Area” as “a *work site unusually distant from the area where petitioner lives and normally works.*” The Court then observed that Taxpayer generally worked on projects that averaged approximately 15 miles from his home, and that four of the five work sites were clustered relatively close together in Philadelphia or its suburbs. The Court further observed that the work sites were in an area Taxpayer “normally worked” and, therefore, essentially concluded that his daily travel was not outside the “metropolitan area” in which the taxpayer normally works. **Practice Pointer!** For a similar analysis, see **Saunders, TC Memo 2012-200.**
- b. **With Regard to Rule #2 In Revenue Ruling 99-7 (i.e., Daily Travel to a “Temporary” Work Location Where Taxpayer Has One or More “Regular” Work Locations Away From Residence).** The Tax Court concluded that Taxpayer had no “regular place of business” away from his home, therefore, Rule #2 could not apply. Consequently, the Tax Court ruled that Taxpayer’s daily transportation expenses for travel to the various work locations were non-deductible “commutes.” **Practice Alert!** The Tax Court, however, said that Taxpayer could treat mileage “*between work sites*” and “*short errands to pick up materials at building supply stores*” as business mileage, if adequately documented.
- c. **With Regard to Rule #3 in Revenue Ruling 99-7 (i.e., “Qualified Home Office” Rule).** Taxpayer established that he used a room in his fiancé’s house as his “office.” However, the Tax Court concluded that Taxpayer did not provide sufficient evidence that his home office met the requirements of a “qualified home office” under §280A (i.e., used regularly and exclusively as his home office). In particular, it appeared from the testimony that the office was not used “exclusively” as a home office. The Court pointed out that Rule #3 does not apply unless Taxpayer establishes that the home office is Taxpayer’s principal place of business. In addition, the Court said that a home office could not be a principal place of business unless the office meets the requirements of §280A.
- d. **Third Circuit Court of Appeals Affirms Tax Court With Further Clarification of Rule #2.** On appeal, the **3rd Circuit Court** of Appeals **affirmed** the **Tax Court** decision. At appeal, the Taxpayer argued that he satisfied **Rule #2** of Revenue Ruling 99-7 because he periodically traveled to his “bank” and “various building supply stores” which were, in turn, “regular work locations” away from his home. In rejecting Taxpayer’s argument, the Appeals Court said in part: “*Construing a building supply store or bank as a ‘regular work location’ strains the meaning of ‘work location,’ as [Taxpayer] was at those locations as a customer, rather than a worker.*” [Emphasis added]. **Practice Alert!** On March 31, 2014, the **Supreme Court** declined *certiorari* and refused to review the Third Circuit’s decision.
- E. **Tax Court Holds That Taxpayer’s “Tax Home” Was In Las Vegas Even Though He Spent From 25% to 50% of Total Business Time in Washington, DC (Barrett, TCM 2017-195, Oct. 2, 2017)**

Summary. The Tax Court allowed a self-employed Taxpayer (who had only one client) to treat Las Vegas (where his residence was located) as his “**tax home**” even though he traveled to Washington, D.C. (DC) on an ongoing basis to provide services at his client’s business facilities. His “*business*” time in DC for his client usually constituted less than 50% of his overall business time. The Court allowed Las Vegas to be Taxpayer’s “*tax home*” largely because: 1) “[Taxpayer]

*performed substantial services for [his client] in Las Vegas [Taxpayer estimated 75%],” 2) Although Taxpayer’s travel to DC “was long term [usually around two weeks per trip], his travel to DC was **sporadic and for short periods** totaling less than half a year,” and 3) Taxpayer had a “**business justification**” (beyond merely personal reasons) for maintaining his home in Las Vegas because “[He] performed **some business services and had rental activities [in Las Vegas] to justify maintaining a home in Las Vegas.**”*

G. Computation of Additional Compensation for Personal Use of Employer’s Vehicle

A. Overview

The following is a summary of the various rules (i.e., methods) for calculating the value of an employee’s personal use of an employer-provided vehicle. **These are computational summaries only. Please consult Reg. §1.61-21 for the details for the alternative computational methods outlined below.**

- 1. Commuting Rule.** The employer has a written policy that the only personal use of the vehicle is commuting to and from work and the employer requires the employee to commute to and from work in the vehicle for bona fide non-compensatory business reasons. This method is not generally available for an officer whose salary equals or exceeds \$50,000, a director, an owner of 1% or more of company stock, or an employee with salary equal to or greater than \$100,000.

_____ X \$3.00 = \$ _____
 Days Commuting to Work Additional compensation

- 2. Lease Value Tables** — Method available to any employee

Base Amount:

\$ _____ \$ _____ x _____ x 1/12 x _____ = _____
 FMV Vehicle First Annual Months Used Personal (A)
 Day Available For Lease Value For Business Use %
 Use By Employee Per Table During Year

Gas Paid by Employer:

_____ x 5.5 cents = _____
 Personal Miles (B)

Additional Compensation Using Lease Value Tables:

_____ + _____ = \$ _____
 (A) (B) Add'l Compensation

- 3. Facts and Circumstances Method** — Method available to any employee; burden of proof on taxpayer

Cost to Rent Comparable Vehicle	_____ (A)
Insurance	_____ (B)
Maintenance	_____ (C)
Fuel	_____ (D)
Total Cost (Add A, B, C, & D)	_____ (E)

Personal Use percentage $X(F)$

Additional compensation ((E) X (F)) \$ _____

- 4. Cents Per Mile Method** — Only available if the following conditions are met:
- Vehicle is regularly used in employer's trade or business throughout the year, **or** total business and personal miles driven at Least 10,000 per year, **and** vehicle is primarily used by employee (not family members), and
 - Fair Market Value does not exceed **\$61,200** for autos, trucks, and vans placed-in-service in 2025

Personal Miles from Jan. 1, 2025 – Dec. 31, 2025 _____ x 70 cents = \$ _____ See indexed items for rates.

IRS Publications (Located at www.irs.gov)

Publication 463 (Travel, Entertainment, Gift and Car Expenses)

Publication 535 (Business Expenses)

Publication 1542 (Per Diem Rates — for Travel Within the Continental United States)

Planning Ideas

A. Recordkeeping

Logs, Etc. Consider keeping logs for autos and other listed property. This is needed: **1)** To prove "no personal use" for fringe benefit purposes, and **2)** To prove listed property is used more than 50% business.

Written Evidence From Witnesses. Consider obtaining written evidence of auto use from independent, third-party witnesses if you don't have "records". If you don't have records or "other corroborative evidence" you must say so on your tax return.

Written Policy. If you can use the "no personal use" or "no personal use but commuting exceptions", be sure you meet the requirements and that the employer's policy is **"written."**

Employee Questionnaire. Ask clients to send the employee questionnaire for company autos to their employees. This is needed for the client to: **1)** Document the deduction under Sec. 274, and **2)** To properly report "personal use" of the company auto for W-2 and withholding purposes.

B. Meals and Travel

Proper Classification. Examine clients meal and travel expense accounts carefully to ensure that all items exempt from the 50% reduction are not included in amounts reduced.

Simplified Per Diems. To simplify an employer's recordkeeping, consider using the High/Low per diems provided by the most recent IRS releases for documenting employee business expenses.

Simplified Per Diems Not Sufficient. If the high/low per diems are not sufficient to reimburse actual expenses, consider requiring employees to provide the employer with the actual lodging receipt. Then, the employer can reimburse the actual hotel bill and give the employee the Federal meal and incidentals per diem reimbursement for the area traveled. If this method is followed, the only detailed record keeping is for the hotel receipt.

Owner/Employees. Remember, per diems (except for the M&I per diem) do not constitute documentation for expenses of more than 10% owner/employees. Technically, the IRS can require the company to produce §274 documentation for these owner/employees.

Nonaccountable Reimbursements. If an employer reimburses employees for meal and travel expenses and the reimbursement arrangement does not qualify as an accountable reimbursement arrangement, then the reimbursements must be included in the employee's W-2 as taxable wages. **Caution!** Moreover, in this event, after TCJA the employee could not deduct the meal and travel expenses because they would be classified as "miscellaneous itemized deductions" (i.e., employee business expenses that were not reimbursed under an "accountable plan").

Employer Required to Withhold On Nonaccountable Plan Reimbursements. Employers are required to withhold FICA and wage withholding taxes on non-accountable, expense reimbursement arrangements. This includes, for example, allowances for autos, travel, uniforms, etc. where the reimbursement is not made under an accountable reimbursement arrangement.

C. Some Vehicles Exempt From Documentation Requirements

Some vehicles are exempt from the recordkeeping requirements because they are of a type that are **unlikely to be used for personal purposes**. The following is a survey of these exemptions (**Note! deductions for these vehicles must still satisfy the general ordinary and necessary business expense requirements**).

Vehicles Not Susceptible to Personal Use. Any vehicle that by reason of its nature is **not** likely to be **used more than a *de minimis* amount** for **personal** purposes is exempt from the recordkeeping requirements of §274(d). The House Ways and Means Committee and the regulations say §274(d) was not intended to apply to vehicles where the **characteristics** of the vehicle **make it highly unlikely** that it will be **used more than a minimal amount for personal purposes**. The Regulations list assets which are not susceptible to personal use: 1) Forklifts; 2) Cement mixers; 3) Dump trucks (including garbage trucks); 4) Refrigerated trucks; 5) Tractors; 6) Combines; 7) Delivery trucks with seating **only for the driver**. A vehicle with a jump seat (i.e., a seat that folds up flat) in addition to the seat only for the driver would also qualify; 8) Flatbed trucks; 9) Any vehicle designed to carry cargo with a **loaded gross vehicle weight over 14,000 pounds**; 10) Passenger buses **used as such** with a capacity of at least 20 passengers; **11) Clearly marked** police, fire, or public safety officer vehicles (Reg. §1.274-5(k)(3)); 12) Ambulances **used as such**; 13) Hearses **used as such**; 14) Bucket trucks ("cherry pickers"); 15) Cranes; 16) Derricks; 17) School buses (even if capacity less than 20); 18) Qualified moving vans; 19) Qualified specialized utility repair trucks; 20) Any unmarked law enforcement vehicles, and 21) Vehicles where substantially all the use is in a trade or business providing transportation of persons or goods for hire.

Use of These Vehicles Results in No Income. The §1.274(d) temporary regulations issued Nov., 1985 treat 100% of the use of vehicles "not conducive for personal use" as business (apparently even when driven by officers, owners, etc.). **This means that employees using such vehicles for personal purposes (including commuting) should have no taxable income for the personal use.**

Certain Pickup Trucks and Vans Are "Qualified Nonpersonal Use Vehicles" (Rev. Rul. 86-97).

General. The purpose of this revenue ruling is to provide guidelines for determining when the IRS will recognize certain specially modified pickup trucks or vans as "qualified nonpersonal use vehicles" for purposes of §1.274-5T(k)(7) of the Temporary Income Tax Regulations.

If these guidelines are met, gross income will not include the value of the use by an employee of the employer's "qualified nonpersonal use vehicle." Also, the vehicle is exempt from the vehicle recordkeeping rules of §274(d).

The exception from the substantiation requirements of §274(d) of the Code and the exclusion from gross income as a working condition fringe benefit under §132 apply to the use of a qualified nonpersonal use vehicle because of its design and not because of the nature of the employee's service (such as being on 24-hour call). Note! **PLR 8748009** says being on call has nothing to do with the qualification of a vehicle as "not conducive for personal use."

Pickups. A pickup truck with a loaded gross vehicle weight not over 14,000 pounds is a qualified nonpersonal use vehicle if it falls into **either one of the following two categories:**

1. The vehicle is clearly marked with **permanently affixed decals** or with **special painting** or other advertising associated with the employer's trade, business, or function and is **equipped with at least one** of the following: a hydraulic lift gate, permanently installed tanks or drums, permanently installed side boards or panels materially raising the level of the sides of the bed of the pickup truck, or other heavy equipment, such as an electric generator, welder, boom, or crane used to tow automobiles and other vehicles, **or**
2. The vehicle is clearly marked with **permanently affixed decals** or with **special painting** or other advertising associated with the employer's trade, business, or function, is actually **used primarily** for transporting a particular type of load other than over the public highway **in connection with** a construction, manufacturing, processing, farming, mining, drilling, timbering, or other similar operation, and has been specially designed or modified to a significant degree for such use.

Vans. A van with a loaded gross vehicle weight not over 14,000 pounds is a qualified nonpersonal use vehicle if it is clearly marked with **permanently affixed decals** or with **special painting** or other advertising associated with the employer's trade, business, or function, it has a seat only for the driver or the driver and one other person, and either permanent shelving has been installed that fills most of the cargo area or the cargo area is open and the van constantly (during both working and non-working hours) carries merchandise, material, or equipment used in the employer's trade, business, or function.

Summary. In the above cases, the exception from the substantiation requirements of §274(d) of the Code and the exclusion from gross income as a working condition fringe benefit under §132 apply to the employee's use of the qualified nonpersonal use vehicle.

Note! A pick-up truck or van that does not meet the requirements of this revenue ruling may still be a qualified nonpersonal use vehicle, if based upon the particular facts, it satisfies requirements similar to those of this revenue ruling.

COMPARISONS OF §179 DEDUCTION AND 100% §168(k) BONUS DEPRECIATION

Advantages of 100% §168(K) Bonus Depreciation Over §179 After TCJA

There are differences in the categories of property qualifying for the 100% §168(k) depreciation deduction and the §179 deduction and the limitations on these deductions. As a reminder, depreciation deductions are generally taken in the following order: 1) §168(k) Bonus Depreciation; 2) §179 Depreciation; and 3) MACRS. Of course, one can always elect out of bonus depreciation by asset class. §179 depreciation may be opted into on an asset by asset basis.

The following are several situations where the §168(k) depreciation deduction is more advantageous than the §179 deduction:

- 1. Certain Real Property With 20-Year or Less Recovery Period Eligible for §168(k) but Not §179.** Generally, §168(k) applies to tangible depreciable property with a recovery period of 20 years or less. This includes certain types of “real” property with a recovery period of 20 years or less, such as: sidewalks; roads; landscaping; fences; modern golf course greens; qualified motor fuels facilities; service station buildings, car wash buildings, and other depreciable land improvements associated with the marketing of petroleum or petroleum products; radio and TV transmitting towers; and farm buildings. These assets do not generally qualify for the §179 deduction since they are not §1245 property.
- 2. §168(k) Depreciation Deduction Has No Deduction Limitation, No Phase-Out, and No Taxable Income Limitation.** There are no limitations on the amount of the §168(k) deduction for a taxable year. There is no maximum deduction amount, no phase-out of the deduction once total acquisitions exceed its threshold, and no active trade or business taxable income limitation as there is for the §179 deduction. Because there is no taxable income limitation under §168(k), the §168(k) deduction may create or increase a net operating loss (NOL).
- 3. §168(k) Has No Limitation for Trucks, Vans, and SUVs.** Trucks, vans, and SUVs with loaded vehicle weights (GVWs) over 6,000 lbs., although exempt from the annual §280F depreciation limits that generally apply to passenger autos, are limited to a maximum §179 deduction. However, there is no dollar limitation on the amount of §168(k) depreciation deduction for SUVs.

Practice Alert! A pickup truck with a cargo area (bed) at least 6 feet in interior length or a van with seating for more than nine persons behind the driver’s seat are not subject to this limitation (See §179(b)(5)).

- 4. §168(k) Allowed to Noncorporate Lessors.** §179(d)(5) generally provides that §179 does not apply to any §179 property which is purchased by a person who is not a corporation and with respect to which such person is the lessor (i.e., a noncorporate lessor) unless: **1)** The property subject to the lease has been **manufactured or produced** by the lessor, **OR 2)** The following requirements are met: **a)** The **term of the lease** (taking into account options to renew) is **less than 50%** of the class life of the property (as defined in §168(i)(1)), **AND b) During the first 12 months** after the date on which the property is transferred to the lessee the **sum of the deductions** with respect to such property which are allowable to the lessor solely by reason of §162 (other than rents and reimbursed amounts with respect to such property) **exceeds 15% of the rental income** for such property. There are no similar restrictions on the §168(k) deduction taken by noncorporate lessors.

5. Failure to Use Property More Than 50% in Trade or Business Triggers Recapture of §168(k) Only for “Listed Property.”

a. No “More Than 50% Business Use Requirement” for §168(k) Property Other Than “Listed Property.” §179(d)(10) and **Reg §1.179-1(e)** provide that if the §179 deduction is taken on property, and that property is not used more-than-50% in the trade or business of the taxpayer before the end of the property’s recovery period, the taxpayer must recapture as ordinary income the amount of the §179 deduction in excess of the amount of the MACRS depreciation deduction that would have been allowed on the §179 deduction amount through the year of recapture. By contrast, although §168(k) depreciation is subject to §1245 recapture with respect to §1245 property and §1250 recapture with respect to §1250 property, there is no provision, except for listed property, requiring the recapture of the §168(k) deduction where the property is not used more than 50% in the trade or business. **Practice Pointer! Revenue Ruling 69-487** and **Reg §1.168(i)-4(c)** generally provide that conversion of a business asset to personal use does not trigger §1245 or §1250 recapture. However, there could be recapture for listed property and for property for which a §179 deduction was taken as discussed above.

b. Recapture Where “Listed Property” Not Used More Than 50% in Trade or Business. Where the business use of “*listed property*” under §280F (e.g., vehicles used for transportation) drops to 50% or below before the end of the property’s “*recovery period*,” the taxpayer is required to **recapture as ordinary income** any **§179 and §168(k) deduction** taken on the property to the extent the total §179, §168(k) depreciation, and MACRS depreciation deductions taken through the year of recapture exceed the MACRS depreciation deductions the taxpayer would have taken through the year of recapture using the straight-line depreciation method under §168(g) without the §168(k) and §179 deductions. See §280F(b), §179(d)(10), and §168(k)(2)(D)(i).

c. Under TCJA, Computers and Peripheral Equipment Only Subject to Recapture If Taking §179. TCJA generally provides that, for property placed in service after 2017, **Computers and Peripheral Equipment** are no longer “*Listed Property*” under §280F. Thus, any §168(k) deduction taken for computers or peripheral equipment placed in service after 2017 is no longer subject to the §280F recapture provisions if the business use percentage drops to 50% or below during the recovery period. However, if a §179 deduction is taken for a computer or peripheral equipment, under §179, such equipment would be subject to the §179(d)(10) recapture provisions.

6. §1250 Recapture for §168(k) Taken on QIP — §1245 Recapture for §179 Taken on QIP. For property placed in service in tax years beginning after 2017, “Qualified Improvement Property” (QIP) qualifies for the §179 deduction and the §168(k) deduction. However, if a §179 deduction is taken for QIP, gain allocated to the QIP upon a sale of the building will be recaptured as “*ordinary income*” **under §1245** to the extent of the §179 deduction taken. See §1245(a)(2)(c), and §1245(a)(3)(c).

By contrast, if a §168(k) depreciation deduction is taken with respect to QIP, **Reg §1.168(k)-1(f)(3)** says the §168(k) depreciation deduction will be treated as “*accelerated depreciation*” **under §1250**. Consequently, if the building is sold, any gain allocated to the QIP attributable to the §168(k) depreciation deduction will be treated as “*ordinary income*” only to the extent determined **under §1250**. Under §1250, gain on the sale of the building allocated to the QIP is ordinary income only to the extent the depreciation deductions taken through the date of sale (including any §168(k) depreciation deduction) exceed the depreciation that would have been taken on the QIP using the straight-line depreciation method through the date of sale. So, the longer the building is held, the smaller the amount of the §1250 ordinary income recapture for the QIP.

Example. Assume a taxpayer takes a 100% §168(k) depreciation deduction for QIP placed in service in a tax year beginning after 2017 and the QIP has a 15-year recovery period. If the taxpayer disposes

of the building and the QIP in the 7th year following the date the QIP is placed in service, only 53% of the §168(k) depreciation deduction taken on the QIP could trigger “ordinary income” under §1250. Moreover, if the taxpayer sold the building and the related QIP after the end of the 15-year recovery period for the QIP, there would be no “ordinary income” triggered because of the §168(k) depreciation deduction. **Practice Pointer!** Any gain attributable to the §168(k) depreciation deduction with respect to the QIP that is not treated as “ordinary income” under §1250, would be subject to the maximum 25% capital gain tax rate under §1(h)(1)(E) (applicable to so-called “unrecaptured §1250 gain”). **Practice Alert!** If the taxpayer in this example took a §179 deduction for the cost of the QIP, any gain allocated to the QIP would be ordinary income under §1245 to the extent of the §179 deduction and the amount of potential ordinary income (i.e., the §1245 recapture exposure) would not decrease in subsequent years.

7. **New Property Used Personally and Later Converted to Business Use Qualifies Under §168(k) but Not §179.** According to Reg §1.168(k)-1(b)(3)(ii)(A), new, qualifying §168(k) property purchased for personal use and later converted to business use by the same owner may qualify for §168(k) depreciation as “new property.” However, the conversion from business use to personal use is not considered a qualifying “purchase” for §179 purposes. Therefore, the “converted asset” does not qualify for a §179 deduction.
8. **Estates and Trusts May Take the §168(k) Deduction but Not §179.** §179(d)(4) provides that the §179 deduction is **not allowed** to *estates and trusts*. In addition, Reg §1.179-1(f)(3) provides that an estate or trust that is a partner in a partnership or a shareholder in an S corporation cannot deduct any portion of the §179 deduction taken by the pass-through entity that is otherwise allocated to the estate or trust. However, an estate or trust may take a §168(k) depreciation deduction.
9. **§168(k) Allowed for Trades or Businesses and for Property Held for the Production Of Income — §179 Only Allowed for Active Trade Or Businesses.** §168(k) can be used for qualifying property held in a “Trade or Business” or for property “held for the production of income.” §179 can only be used only for property “purchased for use in the active conduct of a trade or business.”
10. **Entire Basis of New Real Property Acquired in a Trade-In Under §1031 Qualifies for §168(k).** §179(d)(3) and Regulation §1.179-4(d) provide that §179 property does not include so much of the basis of acquired property as is determined by reference to the basis of other property held at anytime by the taxpayer. Thus, for example, if an integrated hog-raising facility with a \$200,000 adjusted basis plus \$300,000 cash is given in return for a **new** integrated hog-raising facility in a §1031 exchange, only the boot paid (\$300,000) would qualify for the §179 deduction. However, the entire \$500,000 basis (which includes the \$200,000 carryover basis) may qualify for the §168(k) depreciation deduction according to Reg §1.168(k)-2(g)(5)(iii)(A). **Practice Alert!** Reg §1.168(k)-2(g)(5)(iii)(A) provides that if a used, rather than a new hog-raising facility is received in the exchange, only the boot paid of \$300,000 would qualify for the §168(k) depreciation deduction. This is because §168(k)(2)(E)(ii), which allows §168(k) to be taken on used property, provides that any basis in the property received which is determined by reference to the basis of the property given up, does not qualify for the §168(k) deduction to the extent of such carryover basis. This is the same rule that applies to exchanges of both new and used property under §179. **Caution!** This example assumes an integrated hog-raising facility is real property qualifying for a §1031 exchange after 2017.

Advantages of §179 Deduction Over §168(K) Depreciation Deduction After TCJA

1. **“Qualified Real Property” Under §179 vs. “Qualified Improvement Property” Under §168(k).**

Improvements to existing commercial buildings, where the improvements are placed in service in taxable years beginning after 2017, qualify for the §179 deduction if the improvements constitute

“Qualified Real Property” (QRP). Although “Qualified Real Property” includes “**Qualified Improvement Property**” (QIP), the definition of **QRP** is broader than the definition of **QIP**. More specifically, **in addition to QIP, the following “Improvements”** to existing **Commercial Buildings** are generally included in the definition of QRP if placed in service after the building is first placed in service: **1) Roofs, 2) Heating, Ventilation, and Air-Conditioning Property, 3) Fire Protection and Alarm Systems, and 4) Security Systems.**

Observation. Since **QIP** generally includes qualifying “*improvements*” to the “*interior*” of a Commercial Building, these qualifying “*improvements*” could presumably include **Heating, Ventilation, and Air-Conditioning Property, Fire Protection and Alarm Systems, and Security Systems.** Therefore, it appears these specified improvements could qualify as both **QIP** and **QRP**. However, it appears a new “*roof*” for a Commercial Building is not **QIP** (thus no §168(k) deduction) because a *roof* is not an improvement to the “*interior*” of the building. However, a **new roof is expressly included in the definition of QRP for property placed in service in tax years beginning after 2017 and is therefore §179 property.**

- 2. Can Elect to Take §179 Deduction on Some Assets and Not Others — §168(k) Applies To All Qualifying Assets and if Elect Out, Must Elect Out for One or More Classes of Assets.** Taxpayers may choose to take the §179 deduction on some assets and not others. In addition, the §179 deduction may be taken on only a portion of an asset. However, the §168(k) depreciation deduction automatically applies to all qualifying assets acquired during the tax year unless the taxpayer makes an affirmative election for §168(k) to not apply. In addition, the election not to take the §168(k) depreciation deduction must be made for every asset in a particular asset class. Taxpayers may elect out for all classes of assets or for one or more specific classes of assets.
- 3. Some States May Allow More of the §179 Deduction Than the §168(k) Deduction.** Some states allow some or all of the §179 deduction, but, do not allow any or as much of the §168(k) deduction (this varies state-by-state).
- 4. Taxpayer Subject to UNICAP Rules Must Capitalize §168(k) Depreciation, Not §179.** Taxpayers subject to the uniform capitalization (UNICAP) rules of §263A are generally required to capitalize certain direct and indirect costs into inventory. Even though depreciation costs generally are costs required to be capitalized under §263A, Reg §1.263A-1(e)(3)(iii)(c) provides that **the §179 deduction is not required to be capitalized** into inventory. In other words, §179 may be currently deducted. However, the regulations do not exempt the §168(k) depreciation deduction from the **UNICAP** rules.
- 5. Real Property Trades or Businesses and Farming Businesses Electing Out of The §163(j) Limitation, Businesses With Floor Plan Financing, and Certain Regulated Utilities Limited on §168(k) Depreciation, but Not on §179 Deduction.** As discussed previously: 1) If a real property trade or business “**elects out**” of the interest expense deduction limitation provisions of §163(j), the real property trade or business’s “**Qualified Improvement Property**” (QIP) would not qualify for the 168(k) depreciation deduction; 2) If a farming business “**elects out**” of the §163(j) Limitation, property held by the farming business with a recovery period of 10 years or more would not qualify for the §168(k) depreciation deduction; 3) A business with floor plan financing indebtedness with average gross receipts of more than the annual inflation adjusted threshold may not take the §168(k) depreciation deduction on any of its otherwise qualifying §168(k) property unless its business interest expense does not exceed its business interest income plus 30% of adjusted taxable income; **and** 4) Property acquired and placed in service after Sept. 27, 2017 does not qualify for the §168(k) deduction if the property is used by a rate-regulated utility. However, none of these limitations apply to the §179 deduction.

Similar Attributes of §168(K) Depreciation and §179 Deduction

1. **“Used” Property Qualifies for Both.** Before TCJA, §179 had a significant advantage over §168(k) because §179 applied to “used” and “new” property, while §168(k) applied only to “new” property. TCJA eliminated this difference, and now both §179 and §168(k) apply to qualifying “new” and “used” property. **Caution!** Used property may qualify as §168(k) property only if placed in service after Sept. 27, 2017. In addition, used property will not qualify if the taxpayer used the property prior to its acquisition or if the property fails to meet the other requirements of §168(k)(2)(E)(ii).
2. **Property Used In Connection With Lodging May Qualify for Both §179 Deduction and §168(k) Depreciation Deduction.** Before TCJA, the §179 deduction was not available for property used in connection with lodging (other than property providing transient lodging such as hotels, motels, etc.). However, §168(k) had no such limitation. TCJA removed this limitation for the §179 deduction. Therefore, property used in connection with lodging may qualify for both the §179 deduction and the §168(k) depreciation deduction. **Practice Alert!** Since the §179 deduction is only available for property acquired for use in the “active conduct of a trade or business,” the §179 deduction will apparently only be available for rental property which rises to the level of a trade or business.

§179 Carryover vs. Bonus Depreciation When NOLs Are in Play

§179 deductions that are disallowed due to the taxable income limitation don’t disappear — they carry forward indefinitely. When used in a later year, the §179 carryover offsets **100% of taxable income** in that year, because it is treated as a current §179 deduction. There’s no 80% limitation tied to the NOL rules. This makes §179 carryovers extremely valuable for businesses that anticipate returning to profitability, since those deferred deductions can fully eliminate taxable income when applied.

Bonus depreciation, by contrast, is not limited by income and can generate an NOL in the current year. But NOLs arising in tax years after 2017 are generally subject to the **80% of taxable income limitation** (under IRC §172(a)(2)), unless a special CARES Act or other temporary relief applies. That means even though bonus can create a large deduction upfront, the resulting NOL can only offset 80% of taxable income in carryforward years. The effect is that some income is always left exposed to tax, while §179 carryovers can wipe out all of it.

From a planning perspective, this creates an important tradeoff. Bonus is aggressive — it accelerates deductions into the current year and can push taxpayers into an NOL position, which may be useful if the business is uncertain about future profitability or needs the immediate cash tax benefit. But the long-term utility of those NOLs is capped at 80% of future income. §179, on the other hand, may defer deductions when income is low, but its carryover is more flexible, offering the ability to fully eliminate taxable income in future profitable years without the 80% cap. Practitioners often find that a blended strategy works best: using bonus to maximize current deductions when immediate shelter is valuable, and relying on §179 carryovers as a “cleaner” tool for fully offsetting income in years where the taxpayer expects to have substantial taxable income.

State Considerations

When deciding between §179 expensing and bonus depreciation, the federal and state rules often drive very different outcomes, and practitioners should weigh these carefully. §179 is more widely accepted by states, though often with lower limits than the federal allowance. Many states still cap §179 deductions at levels well below the federal limit, but they generally conform in concept and permit current expensing, making it a more predictable choice across jurisdictions. By contrast, bonus depreciation is where the most significant divergence occurs. While federally it has been a powerful tool for immediate write-offs, many states decouple from bonus depreciation entirely. This means that although a business may enjoy an upfront deduction federally, at the state level it will often be required to add back the bonus amount and recover it over time under regular MACRS schedules or phased-in adjustments.

For planning purposes, practitioners should first consider the taxpayer's income position. §179 is limited to taxable income and cannot create a loss, but unused deductions can carry forward, which may be advantageous for steady or growing businesses. Bonus depreciation, however, is not subject to an income limitation and can create or increase an NOL, which may be beneficial where loss carrybacks or carryforwards provide cash tax savings. From a multistate perspective, §179 may simplify compliance where limits are manageable, while bonus depreciation can create mismatches between federal and state income that must be tracked carefully and could distort estimated payments or state apportionment. Practitioners should also weigh the timing of asset acquisitions: if immediate federal savings are critical and the taxpayer can tolerate state add-backs, bonus depreciation may be the stronger choice. Conversely, where state conformity is more important or where predictable deductions are preferable over multiple years, §179 may be more effective. In practice, many businesses use a mix of both, electing §179 for assets where state conformity is favorable and using bonus depreciation selectively to generate federal losses or accelerate deductions in high-income years.

PARTNERSHIPS AND S CORPORATIONS ELECTING TO PAY STATE AND LOCAL TAXES AT ENTITY LEVEL

A. IRS Allows State and Local Income Taxes Imposed Directly on Partnerships and S Corporations to Bypass SALT Limitation (Notice 2020-75, Nov. 9, 2020)

1. Purpose. Notice 2020-75 says the IRS intends to issue proposed regs which will clarify that “Specified Income Tax Payments” (as defined below) are deductible by partnerships and S corps in computing their non-separately stated income or loss (i.e., Specified Income Tax Payments are not passed through to owners as state and local taxes (SALT) subject to the \$10,000 SALT limitation on the owners’ returns). In other words, **Notice 2020-75 provides that partners and S corporation shareholders can avoid the \$10,000 SALT limitation on state and local taxes applicable to the partners’ or shareholders’ allocable share of the entity’s income if the requirements of Notice 2020-75 are met. The IRS says taxpayers may rely on this notice prior to the issuance of the proposed regulations.**

Note on SALT Rules under OBBB (2025–2030): The One Big Beautiful Bill Act (OBBB) significantly changes the State and Local Tax (SALT) deduction limits for individual taxpayers for tax years 2025 through 2029.

Key changes include:

Higher Cap in 2025: The SALT deduction cap is raised from **\$10,000** to **\$40,000** beginning in 2025. For married filing separately, the corresponding amount is **\$2,000 each**.

Phase-Down for High Earners: The increased cap is gradually reduced (phased down) for taxpayers whose Modified Adjusted Gross Income (MAGI) exceeds **\$500,000** (for joint filers) (\$250,000 for separate filers), by **30%** of the excess income above the threshold. The cap is not allowed to drop below the old \$10,000 level (or \$5,000 if married filing separately).

Annual Increases: From 2026 through 2029, both the SALT cap and the phase-down threshold increase by about **1% per year**.

Sunset/Reversion: In **2030**, the SALT cap reverts back to **\$10,000** (\$5,000 for married filing separately), with no phase-down.

Interaction with PTET/Notice 2020-75: The OBBB does *not* eliminate pass-through entity tax (PTET) workarounds or the ability to deduct state or local taxes paid at the entity level under Notice 2020-75. These remain relevant planning tools under the new SALT rules.

2. Effective Date. IRS says this treatment is **generally effective for Specified Income Tax Payments made on or after Nov. 9, 2020**. However, the notice says it applies to Specified Income Tax Payments made by partnerships or S corps in a tax year ending after 12/31/17 and made before 11/9/20 if the Specified Income Tax Payments are made pursuant to a law **enacted before Nov. 9, 2020**.

3. “Specified Income Tax Payment.” Means any **amount paid** by a partnership or S corporation to a State, a political subdivision of a State, or the District of Columbia (Domestic Jurisdiction) **to satisfy its liability for income taxes “directly imposed” on the partnership or the S corporation by the domestic jurisdiction. Practice Alert!** The tax must be imposed by a State or a subdivision of a State directly on the partnership or S corporation for these tax payments to avoid the SALT limitation.

A Specified Income Tax Payment includes any amount paid by a partnership or an S corp pursuant to a direct imposition of income tax by the domestic jurisdiction on the partnership or S corp, **without regard to whether:**

- i) The **imposition of** and liability for the **income tax** is **the result of an election by the entity, or**
- ii) **Whether the partners or shareholders receive a partial or full deduction, exclusion, credit,** or other tax benefit based on their share of the amount of state or local income taxes paid by the partnership or S corporation. **Practice Alert!** States that have enacted legislation imposing state income taxes directly on the partnership or S corporation either allow the partners and shareholders a credit on their individual returns for the tax paid by the partnership or S corporation or allow a reduction in the partner's or shareholder's state taxable income for the income taxed to the entity.

4. Deductibility of Specified Income Tax Payments by the Partnership or S Corporation. Notice 2020-75 says ***"If a partnership or an S corporation makes a Specified Income Tax Payment during a taxable year, the partnership or S corporation is allowed a deduction for the Specified Income Tax Payment in computing its taxable income for the taxable year in which the payment is made."***

Planning Alert! Notice 2020-75, seems to require the income tax to be "paid" to the state or local taxing authority during a taxable year to be deductible by the entity during that taxable year. Therefore, unless the IRS provides otherwise, it seems prudent for the partnership or S corporation to "pay" the income taxes on or before the end of its taxable year (even if it is using the accrual method of accounting) so the deduction will be allowed for that taxable year. Obviously, this could be done by **making estimated income tax payments to the state or local government before the end of the tax year.**

Support for Accrual Method PTEs to Use Recurring Item Exception. Notice 2020-75 says that if a partnership or an S corporation makes a specified income tax payment during a tax year, it is allowed a deduction for the payment "in computing its taxable income for the taxable year in which the payment is made." This implies a deduction is only allowed in the year of payment. However, the notice fails to address whether special rules apply to accrual-basis taxpayers and the timing of their state income tax deductions.

The language in Notice 2020-75 seems consistent with a taxpayer using the cash method and Reg §1.461-1. A taxpayer using the cash method of accounting is generally allowed a deduction for an item in the tax year in which it is paid. For an accrual-basis taxpayer, the notice is also consistent with the general rules under Reg §1.461-1 but does not address special rules that might allow for the acceleration of a deduction for state income tax payments. A taxpayer utilizing an accrual method is generally allowed a deduction for a liability when all events occur to establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance occurs with respect to the liability. For state income taxes, Regs §§1.461-4(g)(6) provides that economic performance occurs as the tax is paid to the governmental authority that imposed the tax. Therefore, the rule for the timing of deductibility by an accrual method taxpayer is generally the same as for a cash method taxpayer. The deduction for state income taxes is generally allowed for the tax year in which the tax is paid. However, Reg §1.461-5 provides a special rule for accrual-basis taxpayers regarding the timing of a deduction for certain recurring items, such as state income taxes. This is known as the recurring-item exception.

Under the recurring-item exception, an accrual-basis taxpayer may deduct a qualified item in the tax year preceding the actual year of payment, provided that at the end of that tax year:

All events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy;

- Payment occurs on or before 8½ months after the end of the tax year;
- The liability is recurring in nature; and
- Either the amount of the liability is not material or the accrual of the liability for that tax year results in better matching of the liability with the income to which it relates.

For a state income tax liability, the regulations provide that the matching requirement of the recurring-item exception is deemed satisfied. Thus, under the recurring-item exception, an accrual-basis taxpayer generally may accelerate the deduction for state income taxes to the year prior to payment, notwithstanding the general economic performance rules under §461.

Although the notice does not speak to this issue, it is arguable that, provided the requirements of the recurring-item exception are met, an accrual-basis taxpayer should be able to utilize this exception to deduct a specified income tax payment in the tax year accrued, even if payment is made in the subsequent year. However, a couple things should be kept in mind:

- 1) **The recurring-item exception is a method of accounting.** A PTE should review its prior income tax return filings and determine if a method of accounting has been established for the deduction of state income taxes. If not, taxpayers can adopt the recurring-item exception the first time they incur the item. If the PTE's method of accounting for income taxes has been to deduct the taxes when paid, PTE's may qualify to make an automatic accounting method change to begin applying the recurring item exception. See Section 20.02 of Rev. Proc. 2023-24.
- 2) **The all events test must be met by year end.** For the recurring item exception to apply, all events must have occurred that establish the fact of the liability and the amount of the liability must be determinable with reasonable accuracy before the recurring-item exception can be utilized. The state's PTE provisions should be reviewed to determine whether the liability is fixed and determinable at year end.
- 3) **The Regulations do not require an expense to be accrued each year in order to qualify for the recurring item exception.** Reg. §1.461-5(b)(3) says, "*A liability is recurring if it can generally be expected to be incurred from one taxable year to the next. However, a taxpayer may treat such a liability as recurring in nature even if it is not incurred by the taxpayer in each taxable year. In addition, a liability that has never previously been incurred by a taxpayer may be treated as recurring if it is reasonable to expect that the liability will be incurred on a recurring basis in the future.*" [Emphasis added]

Therefore, a state income tax expense could qualify for the recurring item exception in the first year the PTE election is made. It could also qualify for a recurring item exception even though the PTE election is made one year and not the next.

Additional Information. For additional discussion of this issue, please see the April 1, 2023 article in the Tax Advisor titled "PTE deduction: Timing issues for accrual-method taxpayers."

5. Specified Income Tax Payments Not Taken Into Account for SALT Deduction Limitation. In essence, **Notice 2020-75 prevents Specified Income Tax Payments from being subjected to the \$10,000 SALT limitation on an individual owner's income tax return.** This was a 180-degree reversal of the position the IRS had previously taken **where** states impose the state income tax directly on the partnership or S corporation. Many states have been at work trying to develop strategies to help their taxpayers preserve their federal tax deduction. To accomplish this objective, many states have imposed income taxes directly on partnerships and S corporations arguing that the taxes are deductible by the entity and do not flow through to the owners as separately stated state income taxes subject to the \$10,000 SALT limitation. Notice 2020-75, in essence, provides that the IRS concedes the issue and agrees with these states.

Overview of Entity Classification Regulations (Check-the-Box)

When a business is formed, it must be classified for U.S. income tax purposes. Some entities are taxed as **flow-throughs**, where income, losses, and credits pass directly to the owners, while others are taxed as **corporations**, which pay tax at the entity level and again when income is distributed to shareholders.

Before 1997, classification followed the **Kintner regulations**, which compared entities against six corporate characteristics. This approach became difficult to apply, especially as LLCs and LLPs blurred the distinctions. To simplify matters, the IRS issued **Notice 95-14** and later adopted the **Check-the-Box (CTB) regulations** under §7701, effective Jan. 1, 1997.

Under CTB rules, most business entities can elect their classification: either as a corporation, a partnership, or a disregarded entity (if single-owner). Certain entities, however, are **per se corporations** (e.g., those formed under corporate statutes or listed foreign entities) and cannot elect out. If no election is made, a **default classification** applies, depending on the number of owners and liability rules.

A significant outcome of the CTB regulations is the creation of **hybrid entities**, where an entity may be treated one way for U.S. tax purposes and another way under foreign law. For example, an entity might be a partnership in the U.S. but a corporation abroad (a “hybrid”), or the opposite (a “reverse hybrid”). These hybrids raise complex tax issues that are covered separately.

Default Classifications (if no election is made)

- **Domestic eligible entities:**
 - Partnership if there are two or more owners.
 - Disregarded entity (DRE) if there is a single owner.
- **Foreign eligible entities:**
 - Partnership if there are two or more owners and at least one does not have limited liability.
 - Corporation if all owners have limited liability.
 - DRE if there is a single owner without limited liability

Requirements to Elect a Different Classification

To make an election under the Check-the-Box (CTB) regulations:

- **Eligible entity:** Must be a business entity, not an individual, and not a “per se” corporation.
- **Filed election:** Submit Form 8832 (“Entity Classification Election”).

Form 8832 must:

- Be properly completed and filed.
- Not change classification within 60 months of a prior election.
- Be signed by all owners or an authorized person.

Additional Notes

When an entity changes classification (by election or through certain ownership changes), the regulations treat it as if **deemed transactions** occur (e.g., formation, liquidation, or contribution), to properly reflect the change in tax status.

Step 1: Domestic or Foreign

The first step in classifying a business entity is to determine whether it is **domestic or foreign**.

- An entity is **domestic** if it is created or organized in the United States, or under the laws of the United States or any State. If it is created or organized in both the U.S. and a foreign jurisdiction, it is still considered **domestic**.
- An entity is **foreign** if it does not meet the definition of domestic.

This determination is made **separately from classification** (e.g., partnership, corporation, or disregarded entity). The domestic vs. foreign status must be established first, because it drives the rules for default classification and the ability to make an election under the Check-the-Box regulations.

Step 2a: Domestic Entities

If a **domestic entity** does not make an election, its **default classification** depends on whether it is an **eligible entity** or a **per se corporation**.

- **Eligible entities (not per se corporations):**
 - Classified as a **partnership** if there are two or more members.
 - Classified as a **disregarded entity (DRE)** if there is only one owner.
- **Per se corporations (not eligible to elect):** A domestic entity is automatically classified as a **corporation** if it is organized under a statute that describes it as incorporated, or as a corporation, body corporate, or body politic. Per se corporations also include:
 - Joint-stock companies or associations
 - Insurance companies
 - State-chartered banks
 - Entities owned by a State, political subdivision, or foreign government
 - Entities taxable as corporations under provisions of the Internal Revenue Code other than §7701(a)(3)

Note: An **eligible entity** that elects, or by default is classified, as an **association** (i.e., corporation under Reg. §301.7701-2(b)(2)) is **not** treated as a per se corporation, because it still had the ability to choose its status.

Step 2b: Foreign Entities

If a **foreign entity** makes no election, its classification depends on whether it is an **eligible entity** or a **per se corporation**.

- **Eligible entities (not per se corporations):**
 - **Partnership:** If there are two or more members and at least one member does **not** have limited liability.
 - **Corporation (association):** If all members have limited liability.

- **Disregarded entity (DRE):** If there is a single owner who does **not** have limited liability.
- **Limited liability** means that a member is not personally liable for the debts of the entity solely because of being a member. This determination is made under the law of the entity's organizing jurisdiction.
- **Per se corporations:** Certain foreign entities are automatically treated as corporations because they are specifically listed in the regulations (Reg. §301.7701-2(b)(8)). These entities are not eligible to elect their classification. The regulations also provide limited clarifications and exceptions.

Step 3: Procedure for Filing

An entity makes a classification election by filing **Form 8832 (Entity Classification Election)** with the appropriate IRS service center.

- **Eligible entities with at least two owners** may elect to be treated as either a **partnership** or a **corporation (association)**.
- **Single-owner eligible entities** may elect to be treated as a **disregarded entity (DRE)** or a **corporation**.

A copy of the filed Form 8832 must be attached to the entity's federal tax or information return for the year of the election, or, if none is filed, to a return of a direct or indirect owner.

The **effective date** of the election is either the date specified on Form 8832 or, if none is given, the filing date. The election can be made **retroactively up to 75 days** before the filing date or **prospectively up to 12 months** after.

Once an election to change classification is made, the entity generally cannot change its classification again within **60 months** of the effective date, unless the IRS grants permission due to more than a 50% ownership change. An election made by a newly formed entity effective on its date of formation does not count against the 60-month limitation.

Form 8832 must be signed by **all current owners** or by an authorized officer, manager, or member under penalties of perjury. After processing, the IRS service center sends the entity a letter confirming acceptance or non-acceptance of the election.

Failure to Make the Election

Failure to attach Form 8832 to the appropriate federal return does **not** invalidate the election itself. However, the entity or owner that fails to attach may be subject to penalties.

Failure to timely file Form 8832 can sometimes be corrected:

- **Automatic relief** is available if the election is filed within **three years and 75 days** of the requested effective date.
- **Foreign entities** may qualify for automatic correction when the mistake involves the number of owners.
- **"9100 relief"** (Reg. §301.9100) may allow an extension of time to make the election when certain requirements are met.

IRS Examination (Exam) does **not** have the authority to fix or accept a late-filed Form 8832. Relief must come through the automatic provisions or a formal Reg. §§301.9100-1 — 301-9100-3 relief request.

Deemed Elections

Classification can change automatically if the **number of members/owners changes**:

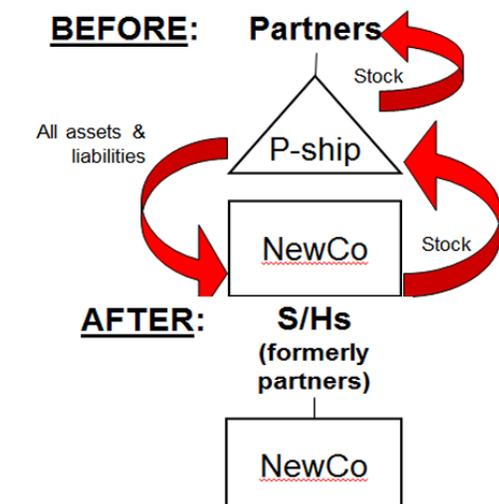
- An **eligible entity classified as a corporation (association)** is **not affected** by changes in the number of members.
- An **eligible entity classified as a partnership** will convert to a **disregarded entity (DRE)** if its membership decreases to a single owner.
- A **DRE** will convert to a **partnership** if its membership increases to more than one owner.
- These ownership-driven changes are **not treated as elective changes** and therefore do **not count** toward the 60-month limitation on reclassifications.
- No Form 8832 is required.

What Happens When Election Is Made?

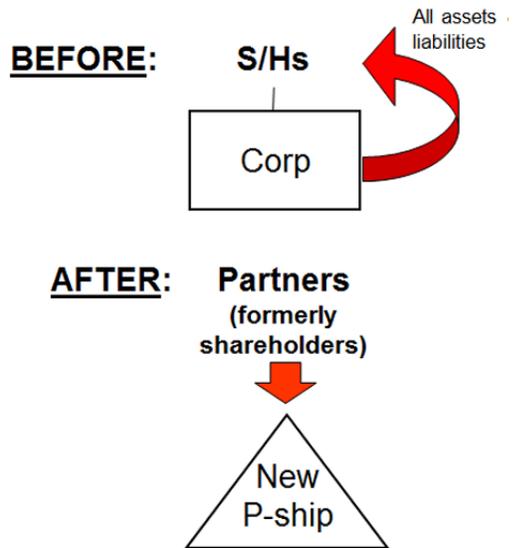
When an entity elects to change its classification, the tax law treats the change as if certain **deemed transactions** occurred on the effective date:

- **Partnership → Corporation**: The partnership is deemed to contribute all assets and liabilities to a newly formed corporation in exchange for stock. Immediately after, the partnership is deemed to liquidate by distributing the stock to its partners.
- **Corporation → Partnership**: The corporation is deemed to liquidate by distributing all assets and liabilities to its shareholders. The shareholders then immediately contribute those assets and liabilities to a newly formed partnership.
- **Corporation → Disregarded Entity (DRE)**: The corporation is deemed to liquidate, distributing all assets and liabilities to its single owner.
- **DRE → Corporation**: The single owner is deemed to contribute all of the DRE's assets and liabilities to a newly formed corporation in exchange for stock.

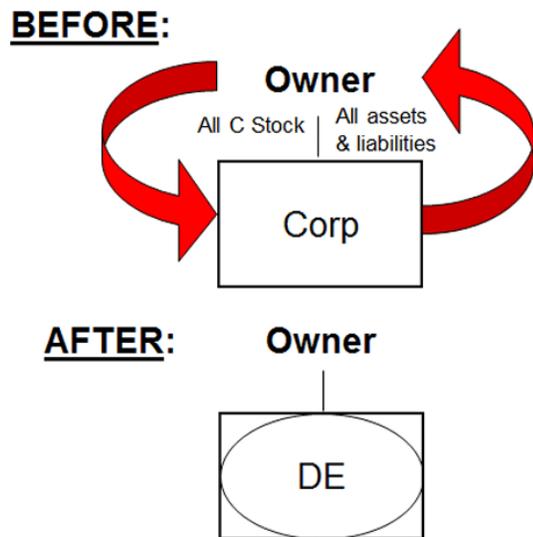
Partnership to Corporation



Corporation to Partnership

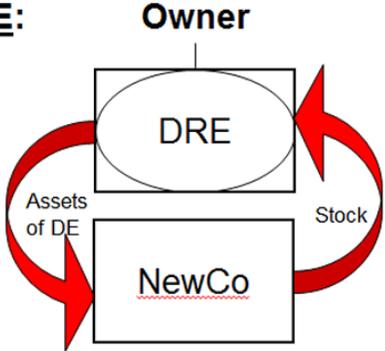


Corporation to DRE

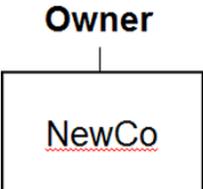


DRE to Corporation

BEFORE:



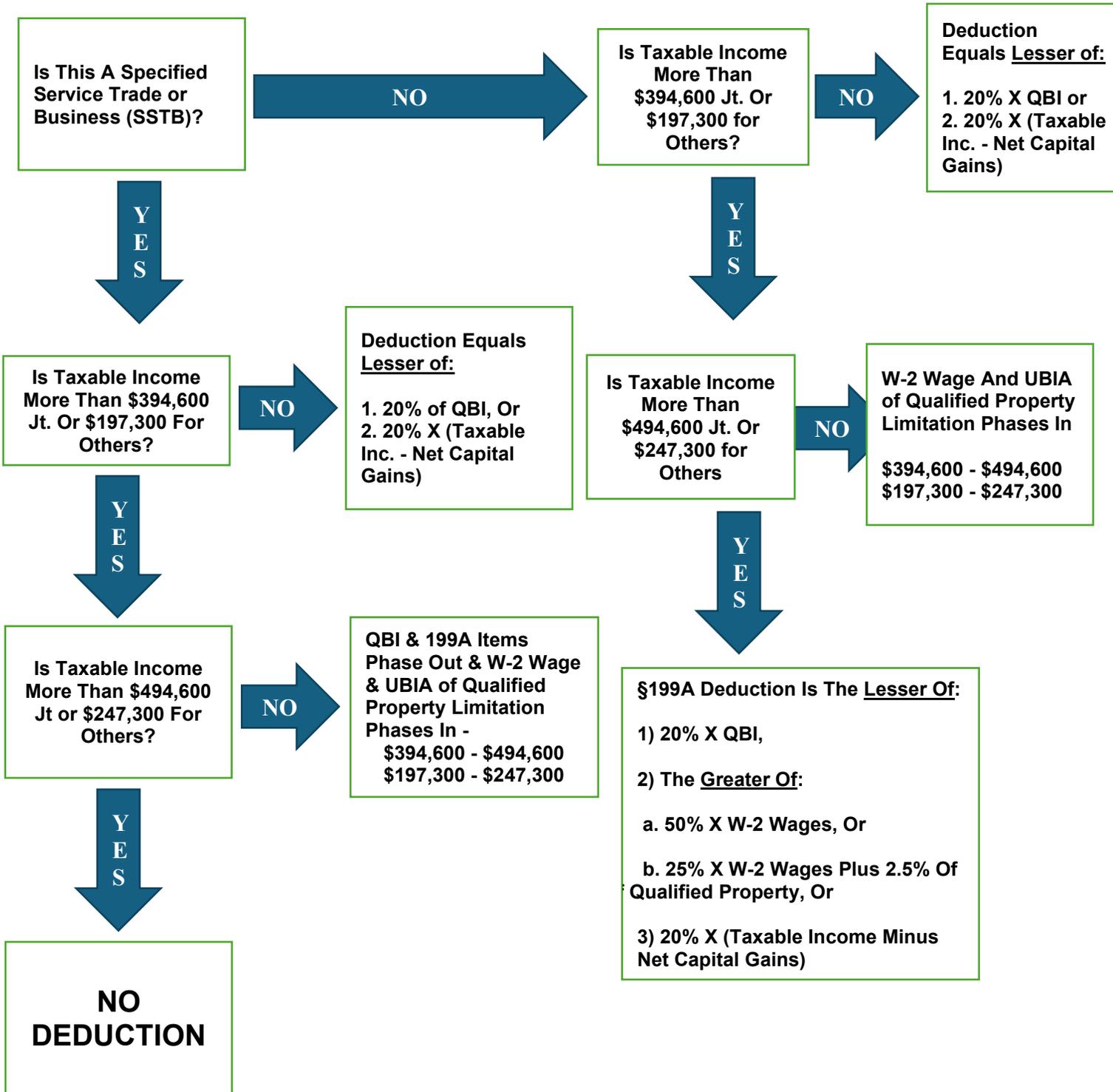
AFTER:



Additional Resource: https://www.irs.gov/pub/fatca/int_practice_units/ore_c_19_02_01.pdf

§199A DEDUCTION REFRESHER

§199A Qualified Business Income Deduction for 2024



Note! This flow chart only deals with the QBI component of the §199A deduction and not with the §199A deduction for qualified REIT dividends and publicly traded partnership (PTP) income. If a taxpayer has REIT dividends and PTP income qualifying for the §199A deduction, 20% of such

amounts would be added to the QBI deduction and the total would be limited to 20% of taxable income minus net capital gains. Please see the Reg §1.199A-1 for the calculation of the §199A deduction where the taxpayer has QBI, REIT dividends, and PTP income.

Selected §199A Planning Strategies

A. Property or Services Provided to 50% or More Commonly Owned SSTB

1. Owners of Rental Property Who Do Not Own Interests in SSTB Do Not Have SSTB Income.

Facts:

- **A, B, C, D, and E** each own 20% of Partnership **X**, which owns a commercial office building.
- **A, B, C, D, and E** are not related to one another as described in §267(b).
- **X** rents 100% of its office building to Law Partnership **Y** (an SSTB) and the rental income from **Y** is the only income of **X**.
- **A, B, C, and D** each own 25% of Law Partnership **Y**.
- **E** is not an attorney and does not own an interest in Law Partnership **Y**.

Conclusions:

- 1) Reg §1.199A-5(c)(2)(i) says “*If a trade or business provides property or services to an SSTB within the meaning of this section and there is 50% or more common ownership of the trades or businesses, that portion of the trade or business of providing property or services to the 50% or more commonly-owned SSTB will be treated as a separate SSTB with respect to the related parties.*” [Emphasis added] **Practice Alert!** It appears from the Preamble to the final regs, “*related parties,*” refers to those who make up the 50% or more common ownership test.
- 2) **A, B, C, and D’s** allocable share of income from Rental Partnership **X** is SSTB income since together they own 100% of Law Partnership **Y** and 80% of Rental Partnership **X** and, therefore, meet the 50% or more common ownership test.
- 3) It appears that **E’s** allocable share of the income from Rental Partnership **X** is not SSTB income because **E** is not one of the group of individuals owning 50% or more of both Law Partnership **Y** and Rental Partnership **X**.

Practice Alert! Reg §1.199A-1(b)(14) says “*rental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a §162 trade or business is nevertheless treated as a trade or business for purposes of section 199A, if the property is rented or licensed to a trade or business conducted by the individual or an RPE which is commonly controlled under §1.199A-4(b)(1)(i).*” Reg §1.199A-4(b)(1)(i) provides that trades or business are “*controlled*” where “*The same person or group of persons, directly or by attribution under §§267(b) or 707(b), owns 50% or more of each trade or business * * * .*” This test does not require “*common ownership*” in both the entities. It only requires that the “*same person or group of persons*” directly or through attribution owns 50% or more of each trade or business. In fact, the Preamble to the final regs says that those included in the 50% ownership test are not required to own an interest in each trade or business.

Although the more stringent “*control*” test under SSTB Reg §1.199A-5(c)(2) is not met in this example for **E** (because **E** does not own an interest in both Rental Partnership **X** and Law Partnership **Y**), it appears the self-rental safe harbor under Reg §1.199A-1(b)(14) applies to **E** as well as to **A, B, C, and D**, since **A, B, C, D, and E** together own 100% of Rental Partnership **X** and Law Partnership **Y**. Therefore, the rental income received from Law Partnership **Y** by Rental Partnership **X** and allocated to **A, B, C, D and E** should be trade or business income under the Reg §1.199A-1(b)(14) self-rental safe harbor. However, as noted above, the **A, B, C, and D’s (but not E’s)** allocable share of income from Rental Partnership **X** is SSTB income.

2. SSTB Owners of Rental Property That Is Only Partially Rented to Commonly Owned SSTB Only Partially Have SSTB Income

Facts:

- **A, B, C, D, and E** each own 20% of Partnership **X**, which owns a commercial office building.
- **A, B, C, D, and E** are not related to one another as described in §267(b).
- **X** rents **80%** of its office building to Law Partnership **Y** (an SSTB), and the **remaining 20%** of the office building is rented to **F** (an unrelated third party). **80% of the total rents** are generated from the rental to Law Partnership **Y**, and the **remaining 20%** is generated from the rental to **F**.
- **A, B, C, and D** each own 25% of Law Partnership **Y**.
- **E** is not an attorney and does not own an interest in Law Partnership **Y**.

Conclusions:

- As concluded in the previous example, none of E's share of the rental income from Partnership **X** would be re-classified as SSTB income.
- Reg §1.199A-5(c)(2)(i) states that the portion of the self rental that is re-classified as SSTB income is **"that portion of the trade or business of providing property or services to the 50% or more commonly owned SSTB."** [Emphasis added]. Since **only 80%** of Partnership **X's** rental income is generated from the self rental to Law Partnership **Y**, **only 80%** of Partnership **X's** rental income would be re-classified as SSTB income.
- Therefore, **A, B, C, and D's** allocable share of **only 80%** of the income from Rental Partnership **X** is treated as SSTB income.
- Also, Reg §1.199A-5(c)(2)(i) states: **"If a trade or business provides property or services to an SSTB within the meaning of this section and there is 50% or more common ownership of the trades or businesses, that portion of the trade or business of providing property or services to the 50% or more commonly-owned SSTB will be treated as a separate SSTB with respect to the related parties."** Consequently, the fact that **80%** of Partnership **X's** rental income that is treated as SSTB income as to **A, B, C, and D** is presumed to be a **"separate"** trade of business, the 10%/5% SSTB anti-abuse *de minimis* rule should not cause the remaining 20% of Partnership **X's** rental income to be re-classified as SSTB income with respect to **A, B, C, and D**.

3. Rental Income Received by Partnership Owned Equally by Four Dentists and Rented to Dentists' Separate Dental Practices, Arguably Not SSTB Income.

Facts:

- Four dentists, **A, B, C, and D**, who are not related parties under §267(b), each owns 25% of Rental Partnership **X** which owns an office building.
- Each dentist owns 100% of an S corporation which conducts the dentist's practice.
- One fourth of the office building owned by **X** is rented to **A, B, C, and D's** respective S corporation.

Conclusions:

- As mentioned in the immediately preceding item, the regulations say that rental income from renting property to an SSTB is SSTB income if there is 50% or more common ownership of the rental property trade or business and the SSTB.
- Reg §1.199A-5(c)(2)(ii) says **"50% or more common ownership includes direct or indirect ownership by related parties within the meaning of §§267(b) or 707(b)."**
- In this example, there is not 50% or more common ownership of each of the S corporations and Rental Partnership **X**.
- Each dentist owns 100% of his or her dental practice. However, each dentist owns only 25% of Rental Partnership **X**.
- Therefore, if none of the dentists are related under §267(b), it appears that **A, B, C, and D's** allocable share of **rental income from Partnership X would not be SSTB income**.

Practice Alert! From a reading of Reg §1.199A-5(c)(2), your authors believe this is a proper interpretation of the anti-abuse provision of the regulation. However, your authors have asked the IRS to provide examples explaining Reg §1.199A-5(c)(2). This SSTB anti-abuse provision needs additional clarification.

4. Rental Income From Renting Real Estate to a C Corporation Performing SSTB-Type Services Is Arguably Not SSTB Income.

Facts:

- Four CPAs own 25% each of Rental Partnership **X** which owns a commercial office building.
- The four CPAs also each own 25% of C Corporation **Y** in which they conduct a CPA practice.
- The office building is rented entirely to C Corporation **Y**.

Conclusions:

- Although C Corporation **Y** is conducting an SSTB activity (i.e., Accounting) and there is 100% common ownership of C Corporation **Y** and Rental Partnership **X**, the rental income of Partnership **X** allocated to the CPA partners is arguably not SSTB income.
- On Feb. 22, 2019, your authors discussed this issue with a representative of the Associate Chief Counsel's Office. She said it is their position that a C corporation is not included in the definition of "trade or business" under §199A. Therefore, a C corporation cannot be an SSTB. Thus, rental income received from a 50% or more commonly-owned C corporation conducting an SSTB activity is not SSTB income. **Caution!** This is an unofficial opinion and is not binding on the IRS. Hopefully, the IRS will clarify this issue in future guidance.

B. Wages Paid to S Corporation Shareholder/Employee

1. S Corp Shareholder/Employee's W-2 Wages Treated Same as Other Employees' W-2 Wages.

Facts:

- S corporation **X** has net income of \$50,000 for 2020.
- **Y** owns 100% of **X** and is paid wages of \$30,000 by the S corporation during 2020.
- Does the S corporation have QBI of \$50,000 or \$80,000 (i.e., \$50,000 plus \$30,000)?

Conclusion:

The QBI of X is \$50,000. The W-2 wages of an S corporation shareholder/employee are treated under §199A the same as the W-2 wages paid to any other employee.

Practice Alert! The \$30,000 of wages paid to the shareholder may also qualify as W-2 Wages for purposes of the W-2 Wage and Qualified Property Limitation if the wages are properly reported on a Form W-2 filed within 60 days of the due date.

2. S Corp Shareholder/Employee's Medical Insurance Premiums Timely Included in W-2 Are Generally W-2 Wages for Purposes of the W-2 Wage Limitation.

Wages subject to withholding are qualified W-2 wages assuming the Form W-2 is filed within 60 days of its due date. Medical insurance premiums included in an S corporation shareholder/employee's W-2 are generally not subject to FICA or Medicare tax, but, are subject to wage withholding. So, they are qualifying wages, assuming the W-2 is filed within 60 days of its due date. However, please see Rev. Proc. 2019-11 for the three methods for determining wages. If the "Unmodified Box Method" is chosen for determining the W-2 Wage Limitation and Box 5 is less than Box 1, then the W-2 wages of the S corporation owner would not be picked up (even though they are qualifying wages) because Box 5 only includes Medicare wages.

C. Business Must Be §162 Trade or Business to Produce QBI

1. There Are No Owner “Material Participation” Requirements Under §199A

Facts:

- Individuals **A, B, C, and D**, each owns 25% of a Partnership **W** that owns a commercial rental property.
- **A** works in the rental partnership managing the rental property and takes care of the record keeping. **B, C, and D**, do not work in the partnership at all.
- Based on the work done by **A**, the rental of the commercial property qualifies as a §162 trade or business and Partnership **W** has substantial income (QBI) for 2020.
- Since only **A** participates in Partnership **W**'s trade or business, does that mean that **B, C, and D**'s allocable share of **W**'s rental income does not qualify for the §199A deduction?

Conclusions:

- Each partner's allocable share of Partnership **W**'s income is QBI, even for the partners who do not work in the business.
- **There are no material participation requirements for business owners under §199A.** Therefore, if the owner, employees, and/or independent contractors work with regard to the rental property, that work counts toward demonstrating the rental activity is a §162 trade or business. So, if the rental activity rises to the level of a §162 trade or business activity as discussed in the following paragraph, the pass-through income should be QBI for all the partners.

Practice Alert! The IRS confirms the conclusion in this example at FAQ 62 which says “§199A does not have a material participation requirement. Eligible taxpayers with income from a qualified trade or business may be entitled to the QBID regardless of their level of involvement in the trade or business.”

2. Do Not Have to Use Rev. Proc. 2019-38 to Show Rental of Real Property Is §162 Trade or Business

For the income from rental property, or any other business, to be QBI, Reg §1.199A-1(b)(14) requires the business to be a §162 trade or business. There are three ways to show the rental of real property is a §162 trade or business: **1)** Qualifying under the §162 trade or business safe harbor outlined in Rev. Proc. 2019-38, **2)** Qualifying under the Self-Rental safe harbor under Reg §1.199A-1(b)(14), **or 3)** Based upon facts and circumstances.

- Rev. Proc. 2019-38 Deemed §162 Trade or Business Safe Harbor for Rental Real Estate Enterprise.** Generally, an individual or pass-through entity meets the §162 safe harbor under Rev. Proc. 2019-38 and may treat a rental real estate enterprise as a §162 trade or business if **1)** the owner of the rental real estate “enterprise” or someone else (e.g., employees, independent contractors, etc.) provides at least 250 hours of the types of services recognized under Rev. Proc. 2019-38 with respect to the rental real estate enterprise for the year; **2)** separate books and records are maintained for each rental real estate enterprise; **3)** for taxable years beginning after 2019, the taxpayer or pass-through entity keeps contemporaneous records, including time reports, logs, or similar documents, documenting the hours for all services performed, a description of the services performed, dates the services were performed, and who performed the services; **4)** the lease is not a “triple net lease” as defined in Rev. Proc. 2019-38, **and 5)** a statement is attached to the tax return stating that the requirements of the safe harbor have been satisfied (including the contemporaneous records requirement for tax years beginning after 2019).

Practice Alert! A concern with using the safe harbor is whether the individual or pass-through entity owning the rental real estate enterprise will be willing to include a statement with the return that the individual or pass-through entity has contemporaneous records of the hours of

rental services provided, the types of services provided, and who performed those services. “Contemporaneous” records were not required for 2018 or 2019. However, “contemporaneous” records are required for 2020 and subsequent years to use the safe harbor under Rev. Proc. 2019-38.

- b. Self-Rental §162 Trade or Business Safe Harbor.** Reg §1.199A-1(b)(14) provides that the rental or licensing of tangible or intangible property to a §162 trade or business is treated as a §162 trade or business if the rental or licensing activity and the §162 trade or business are commonly controlled under Reg §1.199A-4(b)(1)(i) and the lessee is not a C corporation. Reg §1.199A-4(b)(1)(i) provides that businesses are “Commonly Controlled” if the businesses are owned 50% or more by the same person or group of persons. In determining if there is 50% or more common ownership, the attribution rules under §267(b) or §707(b) apply.
- c. Facts and Circumstances.** If an individual or pass-through entity does not qualify for or chooses not to use the 250-hour safe harbor under Rev. Proc. 2019-38 and the self-rental safe harbor does not apply, whether the rentals constitute a §162 trade or business is a facts and circumstances determination.

Practice Pointer! If the owner of a rental “enterprise” or someone else (e.g., employees, independent contractors, etc.) provides at least 250 hours of the types of services recognized in the safe harbor under Rev. Proc. 2019-38 with respect to the rental real estate property or properties owned by an individual or pass-through entity, it is arguable that the rental real estate property or properties are §162 trade or business activities without the safe-harbor. If we can demonstrate the rental real estate activity is a §162 trade or business activity based upon facts and circumstances, the rental income would be QBI.

The Supreme Court said in *Groetzinger*, 59 AFTR 2nd 87-532, to be a §162 trade or business, the activity must be **conducted for profit and conducted with regularity and continuity**. In addition, to understand when the courts, in general, have recognized a rental activity as a §162 trade or business, your authors suggest reading the “trade or business” segment of a 2013 article in the *Journal of Taxation* by Todd Keator. Although Mr. Keator’s article focuses on the 3.8% net investment income tax under §1411, his discussion of whether renting real estate constitutes a §162 trade or business is relevant under §199A and his article analyzes the bulk of the case law on the issue. You can find the article by googling “Journal of Taxation, Todd Keator.” Mr. Keator concludes in the article *“the holding of real estate for rental usually (and perhaps ‘almost always’) constitutes a trade or business activity, even if the activity involves only a single rental and the taxpayer’s efforts with respect to the rental are modest in scale * **
** Provided the taxpayer leases the property with continuity and regularity, and with the intent to earn a profit.”*

A review of the cases cited in this article (especially those discussed on pages 63, 64 and 65 of the article) confirms Mr. Keator’s conclusions. However, on page 65 of the article, Mr. Keator says, *“a triple-net lease is the most likely candidate to fail the trade or business determination, although this may not be certain in every instance.”* Therefore, where rental properties do not qualify for any of the safe harbors, it would be preferable to avoid triple-net leases if possible.

IRS QBI FAQ 65 Speaks to Triple Net Leases. IRS FAQ 61 says the following:

“Q65. Triple net leases do not qualify for the safe harbor of Revenue Procedure 2019-38. Does this mean that income, gains, deductions, and losses from a triple net lease can never be included in QBI?”

A65. No. As explained in Q&A 56, rental real estate is treated as a trade or business for purposes of the QBID if it rises to the level of a §162 trade or business, is a self-rental as described in Treas. Reg. §1.199A-1(b)(14) or is a rental real estate enterprise relying on the safe harbor described in Revenue Procedure 2019-38. Revenue Procedure 2019-38 only

excludes triple net leases from being included in a rental real estate enterprise (and are therefore not eligible for the safe harbor).

A single triple net lease does not generally rise to the level of a §162 trade or business. See Notice 2006-77. However, if rental real estate involving a triple net lease is otherwise treated as a trade or business under §199A, then the income, gains, losses, and deductions would be included in QBI. [Emphasis added]

Practice Alert! FAQ 65 indicates that income from even a single triple net lease could be QBI where the lease is a self-rental under Reg §1.199A-1(b)(14). Also, several triple net leases may constitute a §162 trade or business qualifying for the QBI deduction where the individual or pass-through entity owns multiple properties subject to triple net leases which require someone to manage the properties, etc., on a regular, continuing basis as required by the Supreme Court in *Groetzinger*. However, to be safe for triple net leases that are not self-rentals, taxpayers should consider renegotiating existing triple-net leases if possible so the owner must pay the taxes and insurance and is responsible for the lawncare and landscaping, janitorial service, garbage pickup, repairs, and maintenance. If this is done, there are two potential benefits: **1)** the owner will not be prohibited from using the 250-hours safe harbor under Rev. Proc. 2019-38, **and 2)** if the safe harbor is not used, the landlord has a more than fighting chance the rental activity is a §162 trade or business activity, even where the lease involves a single rental property.

- 1. Rental Real Estate Qualifying as a Trade or Business May Be Aggregated With Other Trades or Business.** In QBI FAQ 61, the IRS says that rental real estate qualifying as a trade or business under any of the alternatives at item 2, above, may be aggregated with other trades or businesses including other trade or business rental properties if the requirements of Reg §199A-4 are met.

The FAQ says:

“Q61. Can rental real estate that is a trade or business for purposes of §199A be aggregated using the rules in Reg. §1.199A-4?”

A61. Rental real estate that is a trade or business can be aggregated with other trades or businesses, including other rental real estate trades or businesses, if the rules of section 1.199A-4 of the Regulations are met. This includes rental real estate that rises to the level of a section 162 trade or business, rental real estate enterprises that meet the safe harbor requirements of Revenue Procedure 2019-38 and self-rentals as described in §1.199A-1(b)(14).”

- 4. Rental Real Estate Qualifying as a Trade or Business Is Still Generally Reported on Form 1040 Schedule E, Not Schedule C, and Is Generally Not Subject to S/E Tax.** IRS QBI FAQ 60 confirms that rental real estate qualifying as a §162 trade or business is generally reported on 1040 Schedule E (not Schedule C) and is generally not subject to S/E tax. Here is the FAQ:

“Q60. If rental real estate is treated as a trade or business for purposes of the QBID (discussed in Q&A 56), do I report the rental real estate on Schedule C of my Form 1040, and is it subject to self-employment tax?”

A60. In general, the answer to both questions is no. How rental real estate is reported on Form 1040 has not changed due to the QBID. Rental real estate is usually reported on Schedule E, Part I, and is not subject to self-employment tax.

Even if rental real estate rises to the level of a §162 trade or business, it is generally reported on Schedule E, Part I, because rental real estate is generally excluded from self-employment taxable income under §1402(a)(1).

However, some rental real estate is subject to self-employment tax (e.g., boarding house, hotel or motel, and bed and breakfast, where substantial services are rendered for the convenience of the occupants). Rental real estate subject to self-employment tax is reported on Schedule C. [Emphasis added]

5. **Preamble to Final Regs Suggests Filing 1099s for Rental Property Trades or Businesses.** It has been unclear whether owners of rental real estate had to file 1099s as required under §6041 of the Code. However, in the Preamble to the final §199A regs, the IRS says in part **“Similarly, taxpayers should consider the appropriateness of treating a rental activity as a trade or business for purposes of §199A where the taxpayer does not comply with the information return filing requirements under §6041.”** [Emphasis added] Therefore, it is prudent to file 1099s for reportable payments of \$600 or more by those conducting rental real estate trades or businesses. However, clients with rental properties should consider paying for reportable services with a credit or debit card. If they pay with a credit or debit card, there is no 1099 reporting requirement because the credit card or debit card company is required to report the payments.
6. **Encourage Clients to Maintain Contemporaneous Records of Hours Worked If Using Safe Harbor.** Hours spent by owners, employees, agents, and independent contractors will count for purposes of the 250-hour safe harbor. Starting in 2020, “contemporaneous records” of hours spent on the rental property must be maintained by the taxpayer. Owners planning to rely on the Rev. Proc. 2019-38 safe harbor should inform any agents or independent contractors who are being used by the owner that their hours need to be documented in a contemporaneous manner.

D. Aggregation Confusion for Rental Real Estate Properties

1. **There Are at Least Three Different Aggregation Considerations for Rental Real Estate.**
 - a. **Aggregating Rental Real Estate Properties as One Rental Real Estate Enterprise Under Notice Rev. Proc. 2019-38 §162 Trade or Business Safe Harbor.** As discussed above, if a rental real estate “enterprise” satisfies the requirements of Rev. Proc. 2019-38, the rental real estate “enterprise” is deemed to be a §162 trade or business. In satisfying the requirements of Rev. Proc. 2019-38, including the 250-hour requirement, an individual or a pass-through entity may aggregate all commercial rental real estate properties owned into one “enterprise” and may treat all residential rental real estate properties owned as one “enterprise.” However, residential rental and commercial rental properties may not be aggregated together in one “enterprise.” If the individual or pass-through entity does not aggregate, each rental real estate property is a separate “enterprise” and the 250-hour test and the other requirements of Rev. Proc. 2019-38 must be met for each property. **No formal election is required to aggregate qualifying rental real estate properties into one “enterprise” under Rev. Proc. 2019-38.** Please see Rev. Proc. 2019-38 for details.
 - b. **Treating Multiple Rental Real Estate Properties as One §162 Trade or Business.** If an individual or pass-through entity owns directly several business activities (including several rental real estate properties) and **1)** there is one set of books and records for all the businesses, **2)** the businesses share employees, **3)** the businesses conduct similar activities or depend upon one another, the businesses arguably constitute one trade or business under §446 and the related regulations. **Practice Alert!** This treatment of several business operations as one trade or business, could apply to a group of rental real estate properties owned by an individual or a pass-through entity (arguably even where there is a combination of residential rental properties and commercial rental properties). If various rental real estate properties constitute one trade or business under §446 and the related regulations, **1)** the QBI, W-2 wages, and UBI of Qualified Property for all the activities are aggregated in calculating the §199A deduction, **and 2)** the activities of the owners, employees, and independent contractors with respect to the properties are aggregated in determining if the properties constitute a §162 trade or business. **No formal election is required to treat these multiple business operations as one trade or business.** Please see footnote 63 of the Blue Book (JCS-1-18, 12/20/18) for

guidelines in determining if two or more business activities are one trade or business or separate trades or businesses. Also, please see Reg §1.199A-5(c)(1)(iii)(A) — Example 1 and Reg §1.199A-5(c)(1)(iii)(B) — Example 2. **The Blue Book!** On Dec. 20, 2018, the Joint Committee on Taxation issued the General Explanation of Public Law 115-97 (i.e., the Tax Cuts and Jobs Act of 2017) — the so called “Blue Book.” The Blue Book contains 443 pages explaining TCJA provisions.

- c. Aggregating Separate Rental Real Estate §162 Trade or Business Interests Under Reg §1.199A-4.** When one or more rental real estate properties constitute separate §162 trades or businesses, an individual’s interests in those separate rental real estate trades or businesses can only be aggregated in calculating the §199A deduction (e.g., aggregating W-2 Wages and UBI of Qualified Property) if the requirements of Reg §1.199A-4 are met. An individual or pass-through entity may make an “aggregation” election for interests in two or more §162 *trades* or businesses (including rental real estate trades or businesses) only if the individual or pass-through entity can demonstrate that: **1)** The same person or group of persons own 50% or more of each trade or business for the majority of the taxable year, including the last day of the taxable year, **2)** The businesses have the same taxable year, **3)** The businesses are not SSTBs, and **4)** The trades or businesses satisfy at least **two of the following three factors:** **a)** the trades or businesses provide property, products, or services that are the same or customarily offered together; **b)** the trades or businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources; **c)** the trades or businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).

Practice Alert! The Final Regs provide that for purposes of meeting two of the three requirements at item 4) above, a commercial rental property trade or business and a residential rental property trade or business are not the same type of property. Please see Final Reg §1.199A-4(d), Example 17.

To aggregate an individual’s or pass-through entity’s interests in different trades or businesses under Reg §1.199A-4, **a formal election must be made with Form 8995-A** to the individual’s or the pass-through entity’s return.

Practice Pointer! Please remember, the aggregation of two or more §162 trades or businesses is not necessary for individuals filing jointly where taxable income is below the first income phaseout level, since the W-2 Wage and Qualified Property Limitations do not apply.

E. Rental Real Estate Properties With Losses

May Be Better if Rental Real Estate Activity Not a §162 Trade or Business if Produces a Loss. If a rental real estate activity is a §162 trade or business activity, incurs a loss, and the loss is currently deductible, the loss is negative QBI that reduces the QBI of the taxpayer’s other §162 trades or businesses with positive QBI. Therefore, if the rental real estate activity will produce tax losses, it may be advantageous if the rental activity does not qualify as a §162 trade or business. However, if the rental loss is a passive activity loss under §469 and is not currently allowed as a deduction, it will not reduce QBI until the year the loss is deductible.

F. Unadjusted Basis Immediately After Acquisition (UBIA)

Possible Advantage of Treating Significant Costs of Repairing a Roof as a Capitalized Expenditure Rather Than a Repair/Maintenance Expense. If a taxpayer needs additional UBIA and incurs a significant expenditure repairing a roof and decides that it is a close call whether the cost should be “expensed” or “capitalized” under the capitalization regulations, capitalizing the expenditure may be advantageous. If the taxpayer writes off the expenditure as an immediate repair “expense,” the cost will not go into UBIA. However, if the taxpayer capitalizes the cost of the roof improvement, the cost will go into UBIA. Moreover, for property and capitalized improvements placed in service in tax years beginning after 2017, capital improvements to existing roofs of commercial buildings qualify for the §179 deduction. Therefore, the taxpayer could capitalize the roof improvement (which would be included in UBIA) and then deduct the cost under §179 (which does not reduce UBIA).

G. The Employee vs. Independent Contractor Anti-Abuse Rules Apply Only for Purposes of Section 199A!

Solely for purposes of §199A, there is generally a presumption that a worker who has previously been treated as a W-2 employee by a business and is later treated as an independent contractor (or partner or S corp shareholder) by that business, will be considered an “employee” for three years after the change. However, this presumption does not apply for determining whether the business should have treated the worker as a “common law” employee for: **1)** payroll tax purposes, **2)** purposes of the requirements under the Affordable Care Act (ACA) for “Applicable Large Employers” to provide qualified health care coverage to its “employees,” or **3)** purposes of determining whether the unreimbursed business expenses of the worker will be allowed as an above-line deduction (for independent contractors) or non-deductible unreimbursed employee expenses incurred by a common law employee. Consequently, even if a worker is presumed to be an “employee” during the three-year presumption period for purposes of §199A, the worker and the business should continue to maintain the necessary arrangement (and documentation) that supports the worker being classified as an “independent contractor” under the common law tests.

H. Do Individuals At or Below The First Taxable Income Thresholds Ever Have a Reason to Make an Aggregation Election Under REG §1.199A-4?

Generally, no! However, for tax years after 2018, if the tax return is later amended (through audit or otherwise) causing the taxpayer’s taxable income to exceed the income thresholds on the amended return, the taxpayer will not be able to amend the return to make the aggregation election if the election would otherwise be beneficial.

I. Retirement Homes

Retirement homes providing medical services to its residents (e.g., nurse assistance, medical helpers, etc.) could end up being classified an SSTB in the field of health, even though they are providing significant non-SSTB services (e.g., meals, cleaning, entertainment, etc.) to the residents. It might be possible for a retirement home to preserve the §199A deduction for the income generated by the non-SSTB services by placing those services in a separate trade or business (have separate books, employees, billings, and separate entities for the SSTB and non-SSTB services). Please see the example discussed previously in this Chapter for an example contained in the final regulations where a veterinarian was able to operate his veterinarian services (an SSTB activity) in a separate trade or business from his business that developed and sold organic dog food (a Non-SSTB activity).

J. Qualified Business Income

1. Don’t Overlook §751 Gain in the Computation of QBI. We should be advising clients who sell a partnership interest to be sure to review and prepare (if necessary) Form 8308 and determine whether the seller will be reporting any portion of the gain as ordinary income under §751(a). This ordinary gain under §751(a) is included in QBI. Generally, gain on the sale of a partnership will be

“ordinary” under §751(a) to the extent of the selling partner’s pro-rata share of the gain in the underlying partnership’s so-called “hot assets” (i.e., appreciated inventory including “dealer” real estate; zero-basis accounts receivables; and, potential depreciation recapture amounts under §§1245 and 1250). Moreover, final Reg §1.199A-3(b)(1)(i) confirms that any “ordinary gain” that is triggered under §751(b) to a partner on the redemption of all or a portion of the partner’s partnership interest will likewise be included in QBI.

2. **Make Sure to Consider Negative §481 Adjustment’s Effect on QBI.** §481(a) adjustments attributable to a qualified trade or business (whether positive or negative) and arising in a taxable year ending after Dec. 31, 2017, are treated as attributable to that trade or business and enter into the calculation of QBI. **Practice Alert!** For tax years beginning after 2017, TCJA generally allows taxpayers with average gross receipts of \$31 million for tax year 2025 or less to use the cash method of accounting, even if the business utilizes inventories. Accrual-method taxpayers that change accounting methods to switch to the cash method will generally have a negative §481(a) adjustment in the year of the change. When evaluating whether to take advantage of this \$25/\$26 million safe harbor, taxpayers should factor into their evaluation that the negative §481(a) adjustment reduces QBI.
3. **Day Traders Below the Taxable Income Thresholds Might Qualify for the §199A Deduction If They Timely Make the Mark-To-Market Election Under §475(f).** Generally, “traders” in stocks and securities are classified as “SSTBs” and their net income from their trades does not qualify for the §199A deduction. However, if the trader’s taxable income is at or below the **first** threshold), their net gains could qualify for the 20% deduction so long as the net gains are not capital gains (capital gains whether long-term or short-term are never included in QBI). However, if the “trader” makes a timely “mark-to-market” election under §475(f), his or her net gains will be treated as “ordinary” gains. So, in that event, if the “electing” trader is below the taxable income thresholds mentioned above, his or her net “ordinary” gains should be included in QBI. **Caution!** A **§475(f) election to use the mark-to-market method must generally be filed no later than the due date (without regard to extensions) of the original Federal income tax return for the taxable year immediately preceding the election year** and must be attached either to that return or to a request for extension to file the return. **For example**, if a “trader” wanted to elect the mark-to-market method for **calendar year 2022**, the election was due by the **due date of the 2021 return** (excluding extensions). **Once timely made, the election is applicable for the year specified in the election and for each subsequent year.**

K. Updates to IRC § 199A (QBI Deduction) Under the One Big Beautiful Bill Act of 2025

Permanent Extension of the 20% QBI Deduction

The One Big Beautiful Bill Act (OBBA), signed July 4, 2025, **made the Qualified Business Income deduction permanent** by repealing its previous 2025 sunset. Pass-through business owners (partners, S-corp shareholders, sole proprietors) will continue to benefit from the **20% QBI deduction** indefinitely, as the Act **maintained the deduction rate at 20%** (earlier proposals to raise it to 23% were not adopted). This extension preserves the tax break that effectively lowers top pass-through tax rates (37%) down to about 29.6% (80% of 37%), helping keep **parity with the 21% corporate tax rate**. In short, **§199A’s core feature, a 20% deduction on qualified business profits, is now a permanent part of the tax code.**

Higher Income Thresholds and Phase-Out Range

While OBBA left the basic **eligibility thresholds and limitations framework unchanged**, it **expanded the income range over which the deduction phases out** for high earners. Under prior law, once taxable income exceeded a certain “threshold” (approximately \$394,600 joint / \$197,300 single in 2025, inflation-adjusted), the QBI deduction became subject to limits – phasing in a wage-and-capital limitation and eventually barring the deduction for owners of **Specified Service Trades or Businesses (SSTBs)** like law, accounting, healthcare, etc.. Originally, these limits phased in over a \$100,000 range for joint filers (above the threshold) or \$50,000 for others. The OBBA **increased those phase-in ranges by \$50,000 for joint**

returns and \$25,000 for other filers, meaning the deduction's restrictions now kick in more gradually. In practical terms, for joint filers the wage/SSTB limitations fully apply at **threshold + \$150,000** of income (up from +\$100,000), and for single filers at **threshold + \$75,000** (up from +\$50,000).

For example, if the 2025 joint-filer threshold was ~\$394,600, a joint taxpayer could have income up to ~\$544,600 in 2026 and still receive at least a partial QBI deduction, whereas under prior law the deduction would have phased out completely by ~\$494,600. **By extending the phase-out band upward, more high-income business owners can qualify for at least a partial §199A deduction** than before. Notably, the Act **retained the existing SSTB exclusion rules** — owners of specified service businesses **still lose the deduction once above the income phase-out range**, but now that cutoff occurs at a modestly higher income level due to the expanded phase-out window.

New Minimum Deduction for Small QBI

To encourage small business activity, the OBBB added a **new minimum deduction of \$400** for taxpayers with at least **\$1,000 of QBI** from one or more active trades or businesses (in which the taxpayer materially participates). This means even very small businesses are guaranteed a deduction (e.g. \$400 on \$1,000 of QBI, instead of only \$200 which would be 20%). The \$400 minimum will be **indexed for inflation** in future years (adjusted in \$5 increments after 2026). While relatively modest in size, this new provision ensures that entrepreneurs and gig workers with small amounts of qualified income still receive at least some tax benefit from §199A. (If a taxpayer's 20% QBI calculation already exceeds \$400, the normal larger deduction applies — the \$400 deduction is simply a floor.)

Effective Date and Transition Rules

The changes to §199A **do not take effect until after 2025**. Since the pre-OBBB law already allowed the QBI deduction through the end of 2025, Congress made the new provisions **effective for tax years beginning on or after Jan. 1, 2026**. There is no retroactive application to 2025 (unlike some other OBBB provisions), meaning **tax year 2025 still falls under the old §199A rules and limits**. Starting in **2026**, taxpayers will see the permanent deduction and updated phase-out ranges and minimum deduction in action. Notably, no special transition relief was needed for QBI because the deduction was available through 2025 anyway — the Act simply assures it **continues seamlessly into 2026 and beyond, with the new modifications kicking in at that point**. Tax advisors and filers should be aware that the **20% deduction remains in place for 2025 under prior law**, and then the OBBB enhancements (broader phase-out bands and \$400 minimum) apply going forward. Overall, the One Big Beautiful Bill Act's §199A provisions provide **long-term certainty and minor improvements** to the QBI deduction regime, effective post-2025, allowing pass-through business owners to plan around this deduction for the foreseeable future.

SUBSCRIBE *to Don Farmer Tax Education's* **FEDERAL TAX NEWSLETTER**



FEDERAL TAX NEWSLETTER

For over 40 years, Don Farmer Tax Education has been the go-to national authority on federal, corporate and individual income tax, known for delivering engaging taxation seminars like these and a **monthly federal tax newsletter** on pressing tax matters.

CPAs are often too busy to keep up with all tax developments. However, it can be devastating to miss a major development, especially new tax legislation you should be tracking. For these reasons, the team of experts at Don Farmer Tax Education author a monthly newsletter to keep CPAs abreast of the latest updates.

The newsletter is “to the point,” making it a quick but valuable read, sent straight to your inbox each month.

The cost for the Federal Tax Newsletter is \$199 per year. If you wish to subscribe or renew your current subscription, please visit donfarmercpa.com/e-newsletter or scan the QR code below.



**Don
Farmer**
Tax Education