2025-2026

# TAX PLANNING **GUIDE**

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

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# 2025 brings more tax planning certainty and some new tax breaks

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

That's not all: The OBBBA introduces some new tax breaks (though many are temporary) and enhances some existing breaks. However, it terminates many tax breaks related to clean energy.

To keep your taxes to a minimum, you need to know how the OBBBA will affect your specific situation. Then you have to implement strategies that allow you to take maximum advantage of the tax savings opportunities available to you while staying in compliance with tax law.

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

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# How will tax law changes affect your taxable income and deductions?

The OBBBA makes the TCJA's lower income tax rates permanent. It also makes permanent TCJA changes to various deductions. And it introduces a few new but generally temporary deductions. To maximize your tax savings, familiarize yourself with the OBBBA provisions that affect you as well as traditional strategies for reducing taxes.

## Standard deduction vs. itemizing

Taxpayers can either itemize certain deductions or take the standard deduction for their filing status. Itemizing saves tax when the total will be larger than the standard deduction, but it makes filing more complicated.

The OBBBA makes permanent and, for 2025, slightly increases the TCJA's nearly doubled standard deduction for each filing status. The new amounts will be annually adjusted for inflation after 2025. (See Chart 1 for the 2025 amounts.)

For 2025 through 2028, the OBBBA creates a temporary deduction of up to $6,000 for taxpayers age 65 or older. It can be taken *in addition to* the standard deduction *or* itemized deductions. The deduction begins to phase out when modified adjusted gross income (MAGI) exceeds $75,0000 ($150,000 for joint filers).

Beginning in 2026, the OBBBA will limit itemized deductions for taxpayers in the top (37%) bracket. If you'll be affected, you may want to accelerate deductible expenses into 2025 where possible.

## SALT deduction

Under the TCJA, your entire itemized deduction for state and local taxes — including property tax and the greater of income or sales tax — has been limited to $10,000 ($5,000 for separate filers). Beginning in 2025, the OBBBA increases the SALT deduction limit to $40,000 ($20,000 for separate filers). When MAGI exceeds $500,000 ($250,000 for separate filers), the cap is reduced by 30% of the amount by which MAGI exceeds the threshold — but not below $10,000 ($5,000 for separate filers). The limit and the threshold will increase 1% annually through 2029, after which the $10,000 limit is scheduled to return.

Deducting sales tax instead of income tax may be beneficial if you reside in a state with no, or low, income tax or you purchased a major item, such as a car or boat.

## Home-related breaks

Consider both deductions and exclusions in your tax planning:

**Property tax deduction.** As noted earlier, your property tax deduction is subject to the SALT deduction limit, which the OBBBA has significantly, though temporarily, increased.

**Mortgage interest deduction.** You generally can claim an itemized deduction for interest on mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your principal residence also may be deductible.

The OBBBA makes permanent the TCJA's reduction of the mortgage debt limit to $750,000 ($375,000 for separate filers) for debt incurred after Dec. 15, 2017, with limited exceptions. It also makes permanent the elimination of the home equity interest deduction for debt that wouldn't qualify for the mortgage interest deduction, such as home equity debt used to pay off credit cards. But the OBBBA generally makes mortgage insurance premiums deductible as mortgage interest beginning in 2026.

**Home office deduction.** If you're an employee and work from home, home office expenses aren't deductible. Why? For employees, this used to be a miscellaneous itemized deduction. But the TCJA suspended such deductions, and the OBBBA has now permanently eliminated them. (If you're self-employed, you may still be able to deduct home office expenses; see page 11.)

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

Chart 1
**2025 standard deduction**

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

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

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

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

**Home sale gain exclusion.** When you sell your principal residence, you can exclude up to $250,000 of gain ($500,000 for married couples filing jointly) if you meet certain tests. Legislation has been proposed that would exclude from tax more — or perhaps even all — gain on the sale of a principal residence. Check with your tax advisor for the latest information.

**Loss deduction.** If you sell your home at a loss and part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

**Moving expense deduction.** The TCJA suspended the deduction for work-related moving expenses except by active-duty members of the Armed Forces who move because of a military order that calls for a permanent change of station. The OBBBA permanently eliminates the deduction other than for the military exception. But, beginning in 2026, it expands the exception to include certain intelligence employees and appointees. (If you *are* eligible, you don't have to itemize to claim this deduction.)

## Charitable deductions

Generally, donations to qualified charities are fully deductible up to certain AGI-based limits if you itemize deductions. The OBBBA creates a nonitemizer charitable deduction of up to $1,000 ($2,000 for joint filers), but it doesn't go into effect until 2026. Only cash donations qualify. Also beginning in 2026, a 0.5% of AGI floor will apply to itemized charitable deductions.

For large donations, discuss with your tax advisor which assets to give and the best ways to give them. For example, you might save more tax by giving appreciated securities instead of cash.

WHAT'S NEW!

## 3 new deductions starting this year

The OBBBA creates three deductions that go into effect for 2025. You don't have to itemize deductions to claim them. But these deductions are available only through 2028, unless lawmakers extend them:

1. **Tips income.** Eligible taxpayers can deduct up to $25,000 of qualified tips income, subject to a phaseout that begins when modified adjusted gross income (MAGI) exceeds $150,000 ($300,000 for married couples filing jointly). The taxpayer must be in an occupation that customarily and regularly receives tips. (Payroll taxes still apply to this income.)
2. **Overtime pay.** Eligible taxpayers can deduct up to $12,500 ($25,000 for joint filers) of qualified overtime pay, with a phaseout beginning when MAGI exceeds $150,000 ($300,000 for joint filers). Qualified overtime pay is generally compensation required under Section 7 of the Fair Labor Standards Act that's in excess of the employee's regular rate. (Payroll taxes still apply to this income.)
3. **Car loan interest.** Eligible taxpayers can deduct up to $10,000 of qualified passenger vehicle loan interest expense on the purchase of certain American-made vehicles. The deduction begins to phase out when MAGI exceeds $100,000 ($200,000 for joint filers).

Additional rules apply, and IRS guidance is expected.

## Health care breaks

If medical expenses not paid via tax-advantaged accounts or reimbursable by insurance exceed 7.5% of your AGI, you can claim an itemized deduction for the amount exceeding that "floor." Eligible expenses may include health insurance premiums, long-term-care insurance premiums (limits apply), medical and dental services, and prescription drugs. Mileage driven for health care purposes also can be deducted (21 cents per mile for 2025).

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

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

**HSA.** If you're covered by a qualified high-deductible health plan, you can contribute pretax income to an employer-sponsored Health Savings Account — or make deductible contributions to an HSA you set up yourself — up to $4,300 for self-only coverage and $8,550 for family coverage (plus $1,000 if you're age 55 or older) for 2025. HSAs can bear interest or be invested, growing tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year, allowing the account to grow. After age 65, you can take penalty-free distributions to use for nonmedical expenses, but they'll be taxable.

**FSA.** You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit — not to exceed $3,300 in 2025. The plan pays or reimburses you for qualified medical expenses. (If you have an HSA, your FSA is limited to funding certain permitted expenses.) What you don't use by the plan year's end, you generally lose — though your plan might give you a 2½-month grace period to incur expenses to use up the previous year's contribution. Or it might allow you to roll over up to $660 to 2026.

## More considerations

Other types of taxes could affect you and should be factored into your planning, such as the alternative minimum tax (AMT). The OBBBA makes permanent the TCJA's increased AMT exemption amounts and income phaseout ranges. (See Chart 7 on page 16.) But other OBBBA changes to the phaseouts could increase AMT risk for some taxpayers beginning in 2026.

Your tax advisor can help you determine if you're among the small number of taxpayers who still need to plan for the AMT — or if there are other special considerations for your specific situation.

# Extended, enhanced and new breaks can save taxes for parents and students

The OBBBA makes permanent various TCJA provisions affecting families and education. It further enhances certain tax breaks and even creates a new way to save for your children's future. By getting to know the changes, you can be sure that you and your family are making the most of the deductions, credits and tax-advantaged savings opportunities available to you.

## Child, dependent and adoption credits

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

1. **CTC.** The OBBBA makes permanent the TCJA's higher Child Tax Credit, plus for 2025 increases it to $2,200. It also adjusts the CTC annually for inflation starting in 2026. You may be able to claim the CTC for each qualifying child under age 17 at the end of the tax year. The CTC phases out for higher-income taxpayers. (See Chart 2.) The OBBBA makes permanent the TCJA's higher phaseout income ranges — but it doesn't annually adjust them for inflation.
2. **COD.** The OBBBA makes the TCJA-created $500 Credit for Other Dependents permanent but doesn't annually adjust it for inflation. You may be able to claim the credit for each qualifying dependent other than a qualifying child (such as a dependent child over the age limit or a dependent elderly parent). But the COD is also subject to the income-based phaseout.

If you adopt in 2025, you may qualify for the adoption credit — or for an employer adoption assistance program income exclusion. Both are $17,280 for 2025, but the credit is also subject to an income-based phaseout. (See Chart 2.)

## Care-related breaks

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

**Child and dependent care tax credit.** For middle-income-and-higher taxpayers with children under age 13 or other qualifying dependents, for 2025 the credit generally equals 20% of the first $3,000 of qualified expenses for one child or dependent or 20% of up to $6,000 of such expenses for two or more. Beginning in 2026, under the OBBBA, certain middle-income taxpayers may be eligible for a credit equal to a percentage of qualified expenses between 20% and 35%.

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

## Kiddie tax

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

## 529 plans

If you're saving for education expenses, consider a Section 529 plan. You can choose a prepaid tuition plan to secure current tuition rates or a tax-advantaged savings plan to fund education expenses:

- Although contributions aren't deductible for federal purposes, any growth is tax-deferred. (Some states offer tax breaks for contributing.)
- Distributions used to pay the following expenses of the beneficiary are income-tax-free for federal purposes and potentially also for state purposes, making the tax deferral a permanent savings:
  - Qualified postsecondary school expenses, such as tuition, mandatory fees, books, supplies, computer equipment, software, internet service,

Chart 2
**2025 child and education breaks**

| Tax break | Modified adjusted gross income phaseouts | |
|---|---|---|
| | Single / Head of household[1] filer | Joint filer |
| CTC & COD | $200,000–$240,000 | $400,000–$440,000 |
| Adoption credit | $259,190–$299,190 | $259,190–$299,190 |
| ESA contribution | $ 95,000–$110,000 | $190,000–$220,000 |
| AOTC & LLC | $ 80,000–$ 90,000 | $160,000–$180,000 |
| Student loan interest deduction | $ 85,000–$100,000 | $170,000–$200,000 |

[1] These ranges also apply to married taxpayers filing separately, except that separate filers aren't eligible for the AOTC or LLC or the student loan interest deduction.

generally room and board, and, under the OBBBA, after July 4, 2025, certain credentialing expenses,

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

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

The biggest downside of 529 plans may be that your investment options — and when you can change them — are limited.

## ESAs

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

But the $2,000 contribution limit is low, and the amount a taxpayer is allowed to contribute is phased out based on income. (See Chart 2 on page 4.) Also, contributions can generally be made only for beneficiaries under age 18. When the beneficiary turns age 30, the ESA generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

WHAT'S NEW!

## A new tax-advantaged savings account for children

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

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

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

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

## Education credits

If you have children in college now or are currently in school yourself, you may be eligible for a credit:

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

**LLC.** If you're paying postsecondary education expenses beyond the first four years, you may benefit from the Lifetime Learning Credit (up to $2,000 *per tax return*).

***Warning:*** Income-based phaseouts apply to these credits. (See Chart 2.) If your income is too high for you to qualify, your child might be eligible.

## Student loan breaks

If you're paying off student loans, you may be able to deduct up to $2,500 of interest (per tax return). An income-based phaseout applies. (See Chart 2.)

If your employer pays some of your student loan debt, you may be eligible to exclude up to $5,250 from income. (Student loan interest payments for which the exclusion is allowable can't be deducted.) The OBBBA makes this break permanent, and the limit will be annually adjusted for inflation after 2026.

Forgiven debt is typically treated as taxable income, but tax-free treatment is available for student loan debt forgiven after Dec. 31, 2020, and before Jan. 1, 2026. Under the OBBBA, beginning in 2026, only student loan debt that is forgiven due to the death or total and permanent disability of the student will be excluded from income, but this exclusion is permanent. ***Warning:*** Some states may tax forgiven debt that's excluded from federal tax.

## ABLE accounts

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

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

# What every investor should know about taxes

The OBBBA doesn't include major changes affecting taxes on investments, other than making permanent the lower ordinary income tax rates that apply in certain situations. So, it's not surprising that many investors are focused more on market performance than on tax consequences. Your goals, time horizon and risk tolerance are also important. But so is the potential tax impact of buying, holding or selling different investments (along with any related fees and charges). Understanding these factors can help you make more informed decisions.

## Capital gains tax and timing

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

The long-term gains rate applies to investments held for more than 12 months. The applicable rate depends on your income level and the type of asset you've sold. (See Chart 3.)

Holding on to an investment until you've owned it more than one year may help substantially cut tax on any gain. Keeping it even longer can also make tax sense. But be sure to look at your specific situation. And be aware that the NIIT could apply to both short-term and long-term gains. (See Case Study 1 on page 7.)

Chart 3
**2025 capital gains tax rates**

| Type of gain | Rate[1] |
|---|---|
| Short-term (assets held 12 months or less) | Taxpayer's ordinary-income tax rate |
| Long-term (assets held more than 12 months) | 15% |
| **Some key exceptions** | |
| Long-term gain of certain higher-income taxpayers | 20%[2] |
| Most long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate | 0% |
| Long-term gain on collectibles, such as artwork and antiques | 28% |
| Long-term gain attributable to certain recapture of prior depreciation on real property | 25% |

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

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

## The 0% rate

The 0% rate generally applies to long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate. If you have adult children in one of these tax brackets, consider transferring appreciated or dividend-producing assets to them. They can sell the assets or reap the dividends and enjoy the 0% rate, which also applies to qualified dividends. This strategy can be even more powerful if you'd be subject to the 3.8% NIIT or the 20% long-term capital gains rate if you sold the assets.

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

***Warning:*** If the child will be under age 24 on Dec. 31, first make sure he or she won't be subject to the "kiddie" tax. (See page 4.) Also consider any gift tax consequences. (See page 14.)

## Being tax-smart with losses

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

The year's realized capital losses are netted against realized capital gains to determine capital gains tax liability. If net losses exceed net gains, you can deduct only $3,000 ($1,500 for married taxpayers filing separately) of losses per year against ordinary income (such as wages, self-employment and business income, interest, dividends, and taxable retirement plan distributions). If

year-to-date you have a net loss, it could provide an opportunity to divest yourself of appreciated investments in a tax-efficient way.

If you don't have enough gains to absorb losses, you could be left with losses in excess of the annual ordinary-income deduction limit. But you can carry forward excess losses until death, and building up losses for future use could be beneficial. This may be especially true if you own a closely held business that might generate substantial future gains. Building up losses could also be beneficial if you have a large investment portfolio or real estate holdings — or if tax rates increase.

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

## Mutual funds

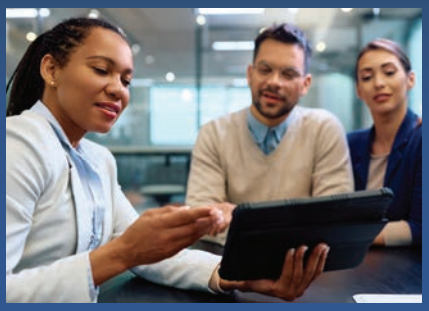
Mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you tax dollars because of the lower rates that apply to long-term gains.

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

Finally, think twice about buying equity mutual fund shares late in the year. These funds often make capital gains distributions toward year end. If you purchase shares before such a distribution, you could end up with capital gains reportable on your tax return for the year of the distribution, even if the distribution is reinvested in the fund.

Case Study 1

### Beware of the NIIT



Earlier this year, Jordan accepted a new job with a large salary increase. His wife, Julia, also received a nice raise, and their investment portfolio was doing well. So Jordan was worried that they could become subject to the 3.8% net investment income tax (NIIT). His tax advisor said he was right to be concerned.

She explained that taxpayers with modified adjusted gross income (MAGI) over the applicable threshold (see Chart 3 on page 6) may owe the NIIT on top of whatever other tax they owe on their investment income. Because the MAGI thresholds aren't annually indexed for inflation, the NIIT is affecting more and more taxpayers — especially double-income married couples like Jordan and Julia, because the joint filer threshold isn't that much more than the threshold for singles.

The NIIT equals 3.8% of the lesser of net investment income or the amount by which MAGI exceeds the applicable threshold. Net investment income can include capital gains, dividends, interest, rental income and other investment-related income (but not business income or self-rental income from an active trade or business).

Jordan's advisor pointed out that many of the strategies that can help save or defer income tax on investments in general also can help avoid or defer NIIT liability. And because the threshold for the NIIT is based on MAGI, strategies that reduce MAGI — such as making retirement plan contributions (see page 12) — can also help avoid or reduce NIIT liability.

## Income investments

Certain investments produce income in the form of dividends or interest. Here are some tax consequences to consider:

**Dividend-producing investments.** Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher ordinary-income tax rate.

**Interest-producing investments.** Interest income generally is taxed at ordinary-income rates. So stocks that pay qualified dividends may be more attractive tax-wise than other income investments, such as CDs and taxable bonds. But also consider nontax issues, such as investment risk, rate of return and diversification.

**Bonds.** These also produce interest income, but the tax treatment varies:

- Interest on U.S. government bonds is taxable on federal returns but exempt on state and local returns.
- Interest on state and local government bonds is excludable on federal returns. If the bonds were issued in your home state, interest also may be excludable on your state return.
- Tax-exempt interest from certain private-activity municipal bonds can trigger or increase the alternative minimum tax (AMT), but the AMT now occurs much more rarely.
- Corporate bond interest is taxable for federal and state purposes.
- Bonds (except U.S. savings bonds) with original issue discount build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.

Finally, keep in mind that interest and dividends can also be subject to the NIIT. (See Case Study 1.)

# Factoring the latest tax provisions into your business and tax strategies

The OBBBA creates more tax certainty for businesses by making many temporary tax provisions permanent. And it provides some new tax-saving opportunities. You'll want to factor OBBBA provisions into your tax planning while continuing to implement tried-and-true tax strategies where they make sense — all while keeping in mind your overall business strategy and goals.

## Business structure

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

The TCJA significantly changed the tax consequences of business structure. It created a flat corporate rate of 21% that is substantially lower than the top individual rate of 37%, providing sizable tax benefits to C corporations and mitigating the impact of double taxation. But the TCJA also introduced the powerful 199A QBI deduction for many owners of pass-through entities. (See below.) The OBBBA retains the TCJA rates and the 199A QBI deduction.

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

## 199A QBI deduction for pass-through businesses

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

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

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

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

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

Under the OBBBA, beginning in 2026, the income ranges over which the limits phase in will widen, potentially allowing larger deductions for some taxpayers. (The bottoms of these ranges will continue to be annually adjusted for inflation.) Also beginning in 2026, the OBBBA provides a minimum deduction of $400 for taxpayers who materially participate in an active trade or business if they have at least $1,000 of QBI from it. These amounts will be annually adjusted for inflation after 2026.

## Depreciation

For assets with a useful life of more than one year, you generally must depreciate the cost over a period of years. In most cases, the Modified Accelerated Cost Recovery System (MACRS) will be preferable to other methods because you'll get larger deductions in the early years of an asset's life. But if you make more than 40% of the year's asset purchases in the last quarter, you could be subject to the typically less favorable midquarter convention.

Chart 4
**Income tax differences based on business structure**

| Pass-through entity or sole proprietorship | C corporation |
|---|---|
| One level of taxation: The business's income passes through to the owner(s). | Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive. |
| Losses pass through to the owner(s). | Losses remain at the corporate level. |
| The top individual tax rate is 37%, but, for eligible taxpayers, up to 20% of qualified business income is deductible. | The flat corporate tax rate is 21%, and the top rate on qualified dividends is 20%. |

Other depreciation-related breaks and strategies may be available, such as the qualified improvement property (QIP) deduction. Qualified retail-improvement, restaurant and leasehold-improvement property are classified as QIP. QIP has a 15-year MACRS recovery period and qualifies for Sec. 179 expensing and bonus depreciation, which have been significantly enhanced by the OBBBA and can provide substantial current deductions for a wide variety of assets. (See "What's new!" at right.)

## Vehicle-related deductions

Business-related vehicle expenses can be deducted using the mileage-rate method (70 cents per business mile driven in 2025) or the actual-cost method (total out-of-pocket expenses for fuel, insurance and repairs, plus depreciation).

Purchases of new or used vehicles may be eligible for Sec. 179 expensing, and buying a large truck or SUV can maximize the deduction. The normal Sec. 179 expensing limit (see "What's new!" at right) generally applies to vehicles with a gross vehicle weight rating of more than 14,000 pounds. A $31,300 limit applies to vehicles (typically SUVs) rated at more than 6,000 pounds, but no more than 14,000 pounds.

But even if you prefer to buy a smaller vehicle, you can still potentially enjoy a valuable first-year deduction. Vehicles rated at 6,000 pounds or less are subject to the passenger vehicle limits, and for 2025 the first-year depreciation limit is $20,200 ($12,200 plus $8,000 bonus depreciation).

If you use a vehicle for business and personal purposes, the associated expenses, including depreciation, must be allocated between deductible business use and nondeductible personal use. The depreciation limit is reduced if the business use is less than 100%. ***Warning:*** If business use is 50% or less, you won't be able to use Sec. 179 expensing or the regular MACRS; you'll have to use the straight-line method.

## Meals, entertainment and transportation

Businesses used to commonly claim deductions for a wide variety of meal, entertainment and transportation expenses, as well as employee reimbursements of such expenses. But the TCJA changed some of the rules related to these expenses, and the OBBBA makes additional changes:

**Meals.** Business-related meal expenses, including those incurred while traveling, remain 50% deductible. Through 2025, the TCJA expanded the 50% disallowance to meals provided via an on-premises cafeteria or otherwise on the employer's premises for the convenience of the employer, and the deduction was scheduled to be eliminated after 2025. (Such meals used to be 100% deductible.)

The OBBBA generally retains this deduction's 2026 elimination, with some limited exceptions that will qualify for a 100% deduction. Meal expenses also generally can be 100% deducted if the meals are *sold* to employees.

**Entertainment.** The TCJA's elimination of the deduction for entertainment expenses remains in place under the OBBBA.

**Transportation.** Transportation expenses for business travel are still 100% deductible, provided they meet the applicable rules. The TCJA eliminated employer deductions for qualified employee transportation fringe benefits (for example, parking allowances, mass transit passes and van pooling). But those benefits are still tax-free to recipient employees. The OBBBA doesn't change these rules.

WHAT'S NEW!

### Expanded depreciation-related deductions will benefit many businesses

The OBBBA makes some significant enhancements to certain depreciation-related tax breaks:

**Bonus depreciation.** This additional first-year depreciation is available for qualified assets, which include tangible property with a recovery period of 20 years or less (such as office furniture and equipment), off-the-shelf computer software, QIP (see "Depreciation," on page 8), and water utility property. Contact your tax advisor to learn about other types of property that may qualify.

Under the TCJA, bonus depreciation dropped from 100% for 2022 to 80% for 2023 and 60% for 2024. It was scheduled to drop to 40% for 2025, 20% for 2026, and 0% for 2027 and future years. (For certain property with longer production periods, these reductions are delayed by one year.)

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

***Warning:*** Under the TCJA, in some cases a business may not be eligible for bonus depreciation. Two examples are 1) real estate businesses that have average annual gross receipts of more than $31 million for the three previous tax years and elect to deduct 100% of their business interest expense, and 2) dealerships with floor-plan financing that meet the same gross receipts threshold.

**Section 179 expensing.** This election allows you to currently deduct the cost of purchasing eligible new or used assets. Examples include equipment, furniture, off-the-shelf computer software, QIP and certain personal property used predominantly to furnish lodging. The following improvements to nonresidential real property are also eligible: roofs, HVAC equipment, fire protection and alarm systems, and security systems. You can claim the election only to offset net income, not to reduce it below zero to create an NOL. (See "Loss deductions" on page 10.)

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

**New deduction for qualified production property.** The deduction is 100% and generally applies to nonresidential real property used in manufacturing that's placed in service after July 4, 2025, and before 2031.

WHAT'S NEW!

## Tax law changes affecting employee benefits

The OBBBA helps reduce the cost of certain employee benefits by extending or enhancing related tax breaks:

**Student loan payments.** The OBBBA makes permanent the exclusion from gross income (for employees) and from wages for employment tax purposes (for employees and employers) of payments employers make toward employees' student loans. Currently, the maximum annual exclusion is $5,250, but the OBBBA adjusts the limit annually for inflation after 2026.

**Employer-provided child care credit.** Currently, an employer can claim a tax credit equal to 25% of its qualified expenses for providing child care for employees, plus 10% of qualified resource and referral expenditures, up to $150,000. Beginning in 2026, the OBBBA permanently raises the 25% credit to 40%, up to $500,000 per year. For eligible small businesses, these amounts are 50% and up to $600,000, respectively. The maximum dollar amount will be adjusted annually for inflation after 2026. (The additional 10% credit for resource and referral expenses will continue to be available.)

**Family and medical leave credit.** The TCJA created a tax credit for qualifying employers that provide paid family and medical leave to their employees. The credit is equal to a minimum of 12.5% of the employee's wages paid during that leave (up to 12 weeks per year) and can be as much as 25% of wages paid. This credit was scheduled to expire Dec. 31, 2025, but the OBBBA makes it permanent. The OBBBA also gives employers the option to claim the credit for a portion of premiums paid for family medical leave insurance rather than claiming the credit for actual wages paid to qualifying employees on leave.

Before 2018, employees could also exclude from taxable income qualified bicycle commuting reimbursements, and this break was scheduled to return in 2026. However, the OBBBA eliminates it.

### Employee benefits

Offering a variety of benefits not only can help you attract and retain the best employees, but also may save tax because you generally can deduct your contributions:

**Qualified deferred compensation plans.** These include pension, profit-sharing, SEP and 401(k) plans, as well as SIMPLEs. (For information on the benefits to employees, see page 12.) Eligible small employers may also claim a tax credit when setting up a retirement plan.

**Fringe benefits.** Certain fringe benefits aren't included in employee income, yet the employer can still deduct the portion, if any, that it pays and typically also avoid payroll taxes. Examples are employee discounts, group term life insurance (up to $50,000 per person) and health insurance.

***Warning:*** You might be penalized for not offering health insurance. The Affordable Care Act can in some cases impose a penalty on "large" employers if they don't offer full-time employees "minimum essential coverage" or if the coverage offered is "unaffordable" or doesn't provide "minimum value."

**HSAs, FSAs and HRAs.** If you provide employees with a qualified high-deductible health plan (HDHP), you can also offer them Health Savings Accounts. (See page 3.) Regardless of the type of health insurance you provide, you can offer Flexible Spending Accounts for health care. (See page 3.) You can also offer FSAs for child and dependent care. (See page 4.)

A Health Reimbursement Account reimburses an employee for medical expenses up to a maximum dollar amount. Unlike an HSA, no HDHP is required. Unlike an FSA (other than when an exception applies), any unused portion can be carried forward to the next year. But only the employer can contribute to an HRA.

(See "What's new!" above for some OBBBA changes affecting other employee benefits.)

### Interest expense deduction

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

Some other taxpayers are also exempt. For example, larger real property businesses can *elect* to fully deduct their interest. But then they're required to use the alternative depreciation system for real property used in the business and can't claim bonus depreciation.

### Loss deductions

A loss occurs when a business's expenses and other deductions for the year exceed its revenue:

**NOLs.** The amount of taxable income that can be offset with net operating loss deductions is generally 80%. NOLs generally can't be carried back to an earlier tax year — but they can be carried forward indefinitely.

**Pass-through entity "excess" business losses.** The TCJA applies a limit to deductions for current-year business losses incurred by noncorporate taxpayers: For 2025, such losses generally can't offset more than $313,000 ($626,000 for married couples filing jointly) of income from other sources, such as salary, self-employment income, interest, dividends and capital gains. Excess losses are carried forward to later tax years and can then be deducted under the NOL rules. In 2022, the Inflation Reduction Act extended the limit through 2028, and the OBBBA makes the limit permanent.

### Tax credits

Tax credits reduce tax liability dollar-for-dollar, making them particularly beneficial. Here are some potentially valuable tax credits:

**Research credit.** This credit gives businesses an incentive to increase their investments in research. Certain start-ups (in general, those with less than $5 million in gross receipts) can, alternatively, use the credit against their payroll tax. While the credit is complicated to compute, the tax savings can prove significant. Under the OBBBA, there's also an enhanced *deduction* for research and experimental expenses. (See "What's new!" on page 11.)

**New Markets credit.** This gives investors who make "qualified equity investments" in certain low-income communities a 39% credit over a seven-year period. This credit was scheduled to expire Dec. 31, 2025, but the OBBBA makes it permanent.

**Work Opportunity credit.** This credit is designed to encourage hiring from various disadvantaged groups, such as certain veterans, ex-felons, the long-term unemployed and Supplemental Nutrition Assistance Program benefits recipients. The maximum credit is generally $2,400 per hire but can be higher in some cases — up to $9,600 for certain veterans, for example. This credit wasn't extended by the OBBBA and is scheduled to expire Dec. 31, 2025. But it could be extended by other legislation. Check with your tax advisor for the latest information.

Additional rules and limits apply, and other credits may be available to you. Contact your tax advisor to learn more.

WHAT'S NEW!

### 1099 reporting simplified

Currently, businesses must issue a Form 1099-MISC to any payee (and to the IRS) when transactions reach $600 in a calendar year. And businesses that pay $600 or more for services rendered by an independent contractor must issue a Form 1099-NEC (Nonemployee Compensation).

Beginning in 2026, these thresholds rise from $600 to $2,000 and will be adjusted for inflation in subsequent years. This change simplifies compliance and reduces the risk of penalties for missed 1099 filings. However, businesses must continue to maintain accurate records of all payments.

## Business sale or acquisition

The tax consequences of a sale or acquisition can have a major impact on the transaction's success or failure. Consider installment sales, for example. A taxable sale might be structured as an installment sale if the buyer lacks sufficient cash or pays a contingent amount based on the business's performance.

An installment sale also may make sense if the seller wishes to spread the gain over a number of years. This could be especially beneficial if it would allow the seller to stay under the thresholds for triggering the 3.8% NIIT or the 20% long-term capital gains rate. (See Chart 3 on page 6.) But an installment sale can backfire on the seller. For example, depreciation recapture must be reported as gain in the year of sale, no matter how much (or how little) cash the seller receives. Also, if tax rates increase, the overall tax could wind up being more.

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

WHAT'S NEW!

### Immediate deduction for domestic R&E expenses revived

Beginning in 2022, the TCJA required businesses to amortize Section 174 research and experimental (R&E) costs over five years if incurred in the United States or 15 years if incurred outside the country.

The OBBBA permanently allows the deduction of domestic R&E expenses in the year incurred, starting with the 2025 tax year. A taxpayer that also claims the research credit (see "Research credit" on page 10) must reduce the deduction by the amount of the credit.

In addition, the OBBBA also allows "small businesses" (for 2025, those with average annual gross receipts of $31 million or less for the three previous tax years) to file amended returns to claim the deduction retroactively for 2022 through 2024. Regardless of size, businesses that incurred domestic R&E expenses in 2022 through 2024 can elect to accelerate the remaining deductions for those expenditures over a one- or two-year period, rather than amortizing them over the full five years.

## Deductions for the self-employed

Self-employed taxpayers generally must make estimated tax payments during the year because tax isn't being withheld from their self-employment income. Fortunately, along with the extra tax-paying responsibilities come some additional tax deductions.

First, while you have to pay both the employee and employer portions of employment taxes on your self-employment income, the employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible "above the line." So you don't have to itemize to claim the deduction.

In addition, you can deduct eligible business expenses and 100% of health insurance costs for yourself and, if applicable, your spouse and dependents, up to your net self-employment income. You also can take an above-the-line deduction for contributions to a retirement plan you set up (see page 12) and, if you're eligible, an HSA (see page 3).

You also may be able to deduct home office expenses from your self-employment income. Generally, you'll be eligible if your home office is your principal place of business (or used substantially and regularly to conduct business) and that's the only use of the space.

Finally, depending on your income level, you may qualify for the 199A QBI deduction. (See page 8.)

# Saving for retirement isn't enough — you also need to be tax savvy

Are you early or mid-career? Nearing retirement? Already enjoying your post-work years? Wherever you are on your life journey, how you leverage tax-advantaged retirement accounts can have a major impact on your financial security during retirement. To make the most of these accounts, contribute consistently, weigh the pros and cons of traditional vs. Roth options, and time your withdrawals strategically to minimize taxes and avoid penalties that can erode your nest egg.

## 401(k)s and other employer plans

Contributing to a traditional employer-sponsored defined contribution plan is usually a good first step:

- Contributions are typically pretax, reducing your taxable income.
- Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions, hopefully in retirement when your tax rate may be lower.
- Your employer may match some or all of your contributions.

Chart 5 shows the 2025 employee contribution limits. Because of tax-deferred compounding, increasing your contributions sooner rather than later can have a significant impact on the size of your nest egg at retirement. If your employer offers a match, contribute at least the amount necessary to get the maximum match so you don't miss out on that "free" money.

Employees age 50 or older can also make "catch-up" contributions. But be aware that some rules for these additional contributions are changing. (See "What's new!" on page 13.)

## More tax-deferred options

In certain situations, other tax-deferred saving options may be available:

**You're a business owner or self-employed.** You may be able to set up a profit-sharing plan, Simplified Employee Pension (SEP) or defined-benefit plan that allows you to make much larger contributions than you could make to an employer-sponsored plan as an employee. You might not have to make 2025 contributions, or even set up the plan, before year end. But many requirements may apply.

**Your employer doesn't offer a retirement plan.** Consider a traditional IRA. You can likely deduct your contributions, though your deduction may be limited if your spouse participates in an employer-sponsored plan. You can make 2025 contributions until the 2025 income-tax-return-filing deadline for individuals, *not* including extensions. (See Chart 5 for the annual contribution limits.)

## Roth alternatives

A potential downside of tax-deferred saving is that you'll have to pay taxes when you make withdrawals at retirement. Roth plans, however, allow tax-free distributions; the tradeoff is that your contributions don't reduce your current-year taxable income. Estate planning advantages are an added benefit: Unlike traditional plans, Roth plans don't require you to take distributions during your lifetime, so you can let the entire balance grow tax-free for the benefit of your heirs. Here are some Roth options:

**Roth IRAs.** The annual IRA contribution limit applies to Roth and traditional IRAs on a combined basis. (See Chart 5.) But an income-based phaseout may reduce or eliminate your ability to contribute to a Roth IRA.

**Roth conversions.** If you have a traditional IRA, a partial or full conversion to a Roth IRA can allow you to turn tax-*deferred* future growth into tax-*free* growth and take advantage of a Roth's estate planning benefits. The converted amount is taxable in the year of the conversion. Discuss with your tax advisor whether a conversion makes sense for you.

Chart 5
### Retirement plan contribution limits for 2025

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

[1] For taxpayers age 50 or older by the end of the tax year.
[2] Includes Roth versions where applicable.
[3] For taxpayers age 60, 61, 62 or 63 by the end of the tax year.
[4] The limit for Savings Incentive Match Plans for Employees can be 10% higher in certain circumstances. Check with your employer.
**Note:** Other factors may further limit your maximum contribution.

**"Back door" Roth IRA contributions.** If your income is too high to make Roth IRA contributions and you (and your spouse, if you're married) don't have funds in a traditional IRA, consider setting up a traditional account and making a nondeductible contribution to it. You can then immediately convert the contributed amount to a Roth account with minimal or no tax impact.

**Roth 401(k), Roth 403(b) and Roth 457 plans.** Employers may offer one of these in addition to the traditional, tax-deferred version. No income-based phaseout applies.

## Early withdrawals

Early withdrawals from retirement plans should be a last resort. With a few exceptions, distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

If you must make an early withdrawal and you have a Roth account, consider withdrawing from that. You can withdraw up to your contribution amount without incurring taxes or penalties.

Another option: If your employer-sponsored plan allows it, take a plan loan. You'll have to pay it back with interest and make regular principal payments, but you won't be subject to current taxes or penalties.

## Leaving a job

When you change jobs or retire, avoid taking a lump-sum distribution from your employer's retirement plan because it generally will be taxable, plus potentially subject to the 10% early-withdrawal penalty. To avoid current income tax and penalties, consider staying put (if your plan allows), rolling over to your new employer's plan, or rolling over to an IRA.

If you choose a rollover, request a direct rollover from your old plan to your new plan or IRA. Otherwise, you'll need to make an indirect rollover within 60 days to avoid tax and potential penalties. ***Warning:*** If you don't do a direct rollover, the check you receive from your old plan may be net of 20% federal income tax withholding. Your subsequent indirect rollover must be of the gross amount (making up for the withheld amount with other funds) or you'll be subject to income tax — and potentially the 10% penalty — on the difference.

WHAT'S NEW!

## Catch-up contributions are changing for some taxpayers

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

1. **Beginning in 2025, the act allows certain taxpayers to make larger contributions.** Taxpayers ages 60 to 63 can make catch-up contributions to most employer-sponsored plans up to 150% of the amount allowed for those age 50 and over. (See Chart 5 on page 12 for the 2025 amounts.)
2. **Beginning in 2026, the act will require the catch-up contributions of higher-income taxpayers to be treated as post-tax Roth contributions.** The requirement will apply to taxpayers who earned more than $145,000 (annually indexed for inflation) during the prior year. If you'll be affected by this limit and are age 50 or older, you may want to max out your catch-up contributions this year to take full advantage of your last chance to enjoy the upfront tax savings of pretax catch-up contributions.

## RMDs

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

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

Waiting as long as possible to take *nonrequired* distributions generally is advantageous because of tax-deferred compounding. But a distribution (or larger-than-required distribution) in a year your tax bracket is low may save tax in the long run. Be sure, however, to consider the lost future tax-deferred growth and, if applicable, whether the distribution could 1) cause Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect other tax breaks with income-based limits.

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

## QCDs

Taxpayers age 70½ or older are allowed to make direct qualified charitable distributions from their IRA to qualified charitable organizations up to $108,000 in 2025. If eligible, you can also make a one-time QCD of up to $54,000 (for 2025) through a charitable gift annuity or charitable remainder trust.

A charitable deduction can't be claimed for QCDs, but these amounts aren't included in taxable income and can be used to satisfy an IRA owner's RMD. A QCD might be especially tax-smart if you won't benefit from the charitable deduction. (See "Charitable deductions" on page 3.)

# Higher exemptions will continue, but planning is still critical

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

## Estate tax

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

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

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

## Gift tax

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

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

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

## GST tax

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

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

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

## State taxes

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

## Exemption portability

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

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

Chart 6
**Estate, gift and GST tax exemptions and rates**

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

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

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

## Tax-smart giving

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

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

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

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

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

Case Study 2

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

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

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

Therefore, the advisor suggests that Tim and Maureen hold on to highly appreciated assets that will benefit from the step-up in basis later, especially if their children are in one of the upper income tax brackets. But if the couple has some highly appreciated assets that they think the family should divest itself of now and their children are in *lower* tax brackets, gifting those assets to their kids might save tax for the family as a whole. Why? The children can sell them at a lower tax cost — perhaps even $0. (See "The 0% rate" on page 6.)

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

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

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

**Make gifts to charity.** Donations to qualified charities aren't subject to gift tax. They may also be eligible for an income tax deduction. (See page 3.)

**Consider "taxable" gifts.** Making some gifts beyond annual exclusion gifts and using some or all of your lifetime exemption can make sense if you have a large estate. These "taxable" gifts can protect transfers from gift and estate tax, even if the exemption drops in the future. They also remove the future appreciation from your estate. You do, however, need to keep in mind your beneficiaries' income tax. (See Case Study 2.)

## Trusts

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

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

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

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

Chart 7
## 2025 individual income tax rates

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

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

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

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

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

Chart 8
## 2025 corporate income tax rates

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

Chart 9
## 2025 estate and trust income tax rates

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

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

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